

thenavigator

Winter 2016

HAPPY NEW YEAR (NOT!)

2015 was the hardest year for making money in 78 years – the worst since 1937! Not one major asset class had a good year with stocks being the best performers returning 2% including dividends, the 30year US treasury produced a -2% return whilst the 3 month Treasury bill returned 0.11%. Even in 2008 bonds were up 22%.

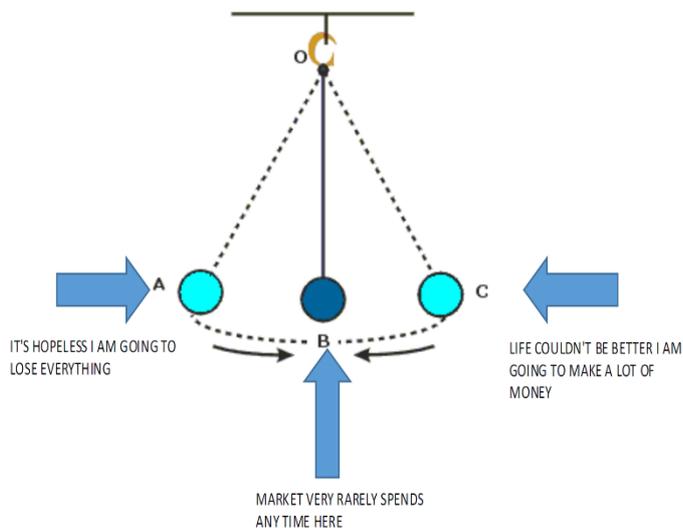
After such a troublesome and volatile year many were looking forward to relative calm and the usual positive seasonal effect of the Santa Claus rally followed by the January effect.

The reason is perhaps somewhat simpler. Most of these issues have been known for a considerable time but because now they all seem to be worried about at the same time therefore investors have moved from denial to capitulation.

Many have referred to stock markets as a discounting mechanism I would add that they discount geniuses into fools and vice versa.

What happened?

- Was it the recent discovery of terrorism?
- Did we suddenly wake up and realize North Korea was a problem?
- Were we shocked to discover that the Federal Reserve was going to raise interest rates (that one caught me by surprise)?
- Who knew that the Chinese economy couldn't grow by 10% a year forever!
- The sudden discovery that the price falls if you produce more of a commodity (oil) where demand is quite inelastic might have been it!



The day to day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously - Ben Graham

Source: swisspartners Advisors - Peter Ahluwalia

Monkey Magic

2016 signifies the year of the monkey in the Chinese zodiac. The monkey occupies the 9th position in the Chinese zodiac and has character traits of curiosity, mischievousness and cleverness. Monkeys are not quick to settle down, tend to get bored easily, however, when they find the perfect partner they tend to end this behaviour.

Continuing on the animal theme it seems that predictions of a global recession and a new bear market are rife within the media. When you are attacked by a bear it need not prove fatal – it all depends on what type of bear it is!



Source: www.rileyaviator.com

It may look cute and cuddly with fluffy ears, however, it has surprisingly sharp claws. An attack is unlikely to prove fatal, nevertheless, you will have to visit a hospital for rabies and other shots.

Lost the Plot

Looking at the Fed's dot plot (their expectations of US interest rate rises) it would seem to be out of touch with reality. Given recent turbulence in markets, worries over slowing growth and the strong USD, it seems highly unlikely that there will be 4 interest rate rises in the US this year. With the US election nearing by year end and the US economy still in stop-start mode our best guess is that the cut-off date for any rate increases will be the middle of the year and that there will probably be no more than 2 rate increases in 2016.

Too young to die!

Many have been freaked out that the price declines in markets are similar to those seen in the beginning of 2008 (but even worse).

Whilst history never repeats itself exactly, it does quite often rhyme, but this would be the first bust I have ever seen without a boom!

Comparing where we are now to those previous dark times, investors are not as leveraged neither are banks.

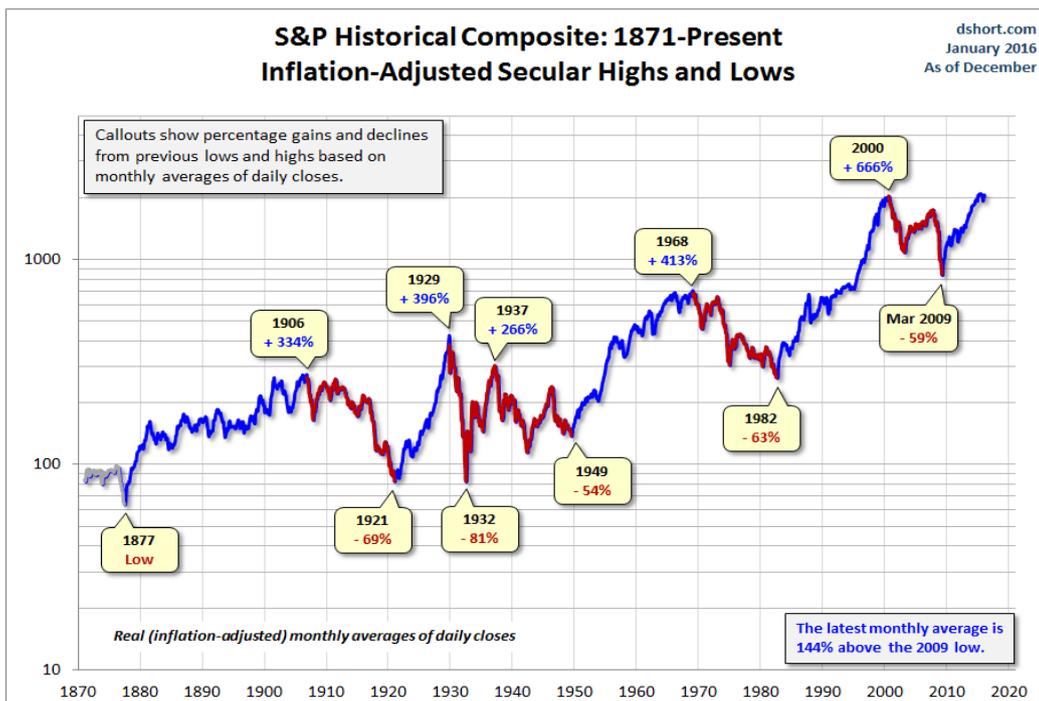
There has been no real boom in stock markets or the economy, businesses have been loath to expand their facilities, wages have been stagnant, the recovery in the US economy has been modest at best and no one believes Europe has turned the corner, despite confirming economic data.

The global economy is expected to grow by 3% this year and corporate profits in developed economies are likely to be in the mid to high single digit range, hardly scary stuff.

Valuations look compelling in Europe (20% below the average) and cheap in Hong Kong, Japan and China. In the US valuations have now become more modest.

Looking at the longer term picture of equity markets (blue lines represent secular – long term bull markets whilst red lines represent bear markets) it would seem as if we have not even reached the halfway stage in this secular bull market. The average gain for a secular bull market is 415% whilst the gains we have achieved so far since 2009 are only 144%.

Looking at recent market movements (S&P500 -6%, FTSE100 -5.3%, Dax -8.3% and Nikkei -7.0%, all YTD), I consider it highly unlikely that such uniform declines were the result of independent, objective analysis of the impact of events on each economy and company. It is more likely the result of investors 'shared psychology'.



Source: Dshort.com

For those investors with a longer term time horizon, who can stomach the volatility we are probably close to the best buying opportunity we have seen in 2 years.

Markets do not have to be complicated, sometimes simpler is better. Asking ourselves the simple question, “Are things getting better?” the answer is a resounding yes. Whilst it is human nature to always want more and the whole world is frustrated with the pace of economic growth we must remember that the recovery time period from large shocks such as 2008 is quite long.

We remain convinced that the global economic recovery will eventually reach escape velocity we will just have to be a bit more patient.

By 2020 the middle class in China (those earning between USD25,000 and USD45,000 per annum) is expected to increase by 50 million people!

How can it be wrong to buy quality companies at a discount to book value, where the dividend yield is excess of the respective bond yield and profits are growing steadily?

[Perhaps this is the best Christmas present of all](#)

Being upbeat in the current market environment is not a comfortable position to be in and let me paraphrase a song from the American band “Green Day”, which emulates my feelings at the moment “I walk a lonely road the only one that I have ever known, I don’t know where it goes. My shadow’s the only one that walks beside me on the boulevard of broken dreams”.

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