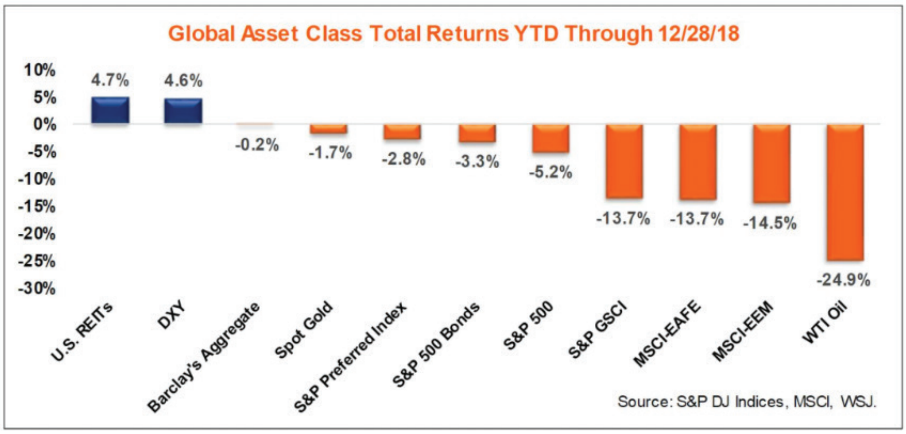
thenavigator

Winter 2019

Merely a glitch?



A glitch is a word that has been used by the US president to describe the recent vicious sell-off in markets. For those who have lost money, there might be some other choice of words. As seen in the chart above, there really was nowhere to run to last year and nowhere to hide, with the exception of REITs and USD cash.

Horror stories

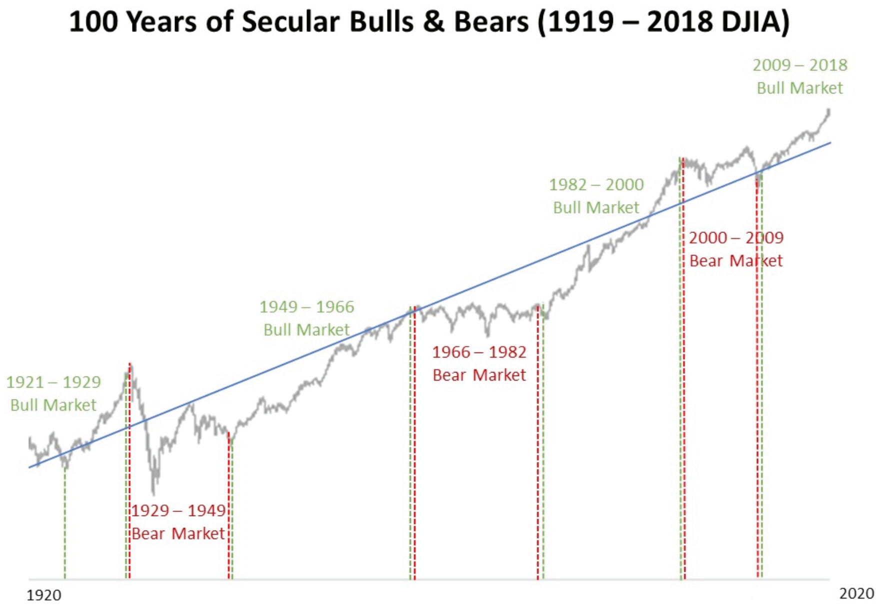
- Equity funds worldwide saw outflows of $39billion in the week to Dec. 12, the largest ever weekly outflows from stock funds[1]
- With stocks tanking, pessimism among mom-and-pop investors hits highest in more than five years[2]
- U.S. stock market exodus is second-biggest on record, BofA says 3[3]
- U.S. stocks posting their worst December since the Great Depression[4]
- The FTSE All-World index, which tracks thousands of stocks across a range of markets, plummeted 12% this year. It's the index's worst performance since the global financial crisis and a sharp reversal from a gain[5]
- For the year, the S&P 500 fell 6.2%, the Dow dropped 5.6% and the Nasdaq Composite shed 3.9%, marking the worst annual performance for all three since 2008[6]

The reading is grim, and whilst we do not mean to scare you, it is important to be aware of the pervasive pessimism that is present in markets at the moment.

Although the human instinct is to become scared and sell at times like these to preserve wealth, we strongly urge you to pause and not make any hasty decisions but instead focus on the original time frame and investment strategy you have envisioned. Over time, we are convinced that last year’s event should just represent a minor blip on the charts.

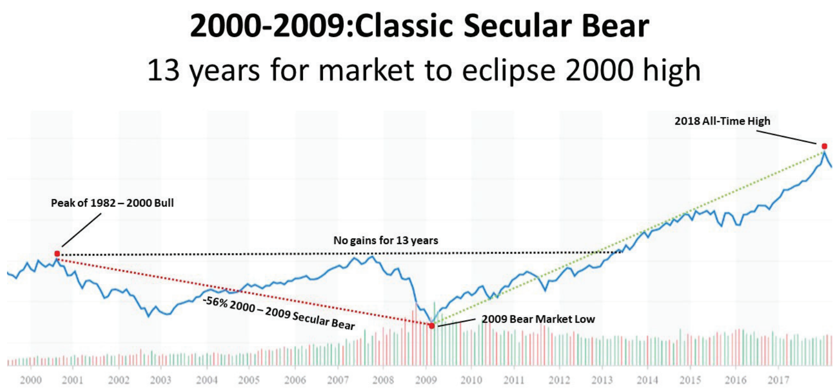
Just remember that sometimes the “Only Thing We Have to Fear Is Fear Itself” (Franklin D. Roosevelt).

Think bigger



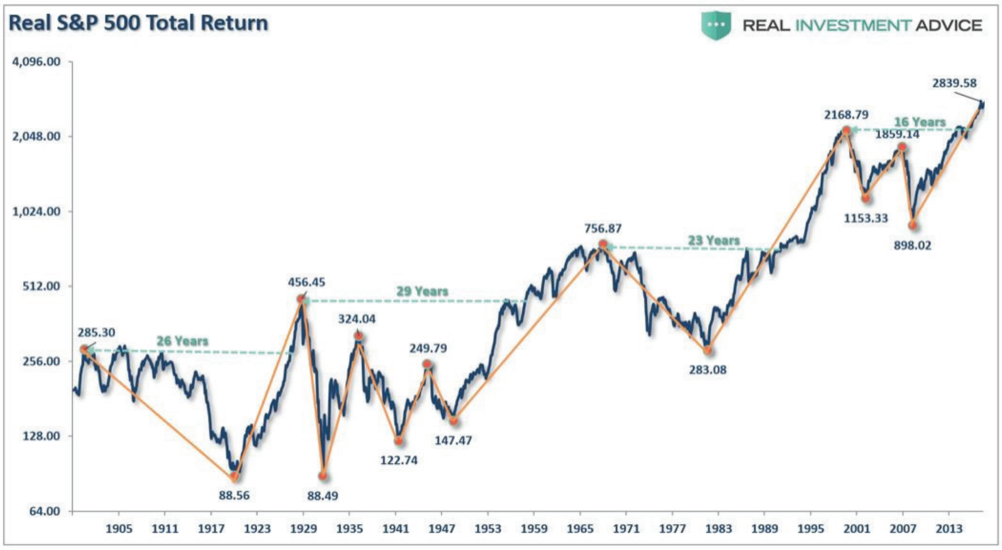
Source: Bulls N Bears, Secular Bull and Bear Markets, https://bullsnbears.com/secular-bull-bear-markets/

We completely disagree with the consensus analysis that we are in a cyclical bull market (5-7 years in duration). We rather make the case, as we have done many times before in our Navigator, that this bull market is secular (15 years plus) and will probably end up as one of the longest in history. It took markets 13 years to make gains from the end of the technology bubble in 2000.



Source: Bulls N Bears, Secular Bull and Bear Markets, https://bullsnbears.com/secular-bull-bear-markets/

Looking at the bigger picture, we really have not come very far, either in terms of duration or gains, compared to the last secular bull market which lasted from 1982 to 2000.



Source: The Real Investment Advice

Of course, there will be downward moves as we saw in this period, but the key takeaway is that the overwhelming trajectory of markets over the longer term is upwards.

There are distinct, powerful trends that lend weight to our argument:

1. The growing middle class in Asia/EM with a high propensity to consume – 60% of luxury goods growth to come from China in 2019.
2. After almost 100 years of relative stagnation in innovations in transport, we now have autonomous driving, Hyperloop (train travel at 700mph on demand) and urban air mobility arriving in the not too distant future. The world is about to become significantly smaller, and our productivity is going to increase by leaps and bounds.
3. Artificial Intelligence, progress in nanotechnology and the resumption of space exploration are all wildcards which we expect to help boost economic growth.
4. On the side of demographic developments, just the sheer number of millennials entering the workforce with their spending power will have a positive impact on growth.

In fact, from a personal perspective, I have not been as excited about the longer-term global prospects since the nineties. The future looks bright indeed for the next generation.

Headwinds likely to turn into tailwinds

Yes, this is the exact opposite of the headline we used in the last Navigator!

It now seems clear that one of the major headwinds - rising of US interest rates last year- is now somewhat in the rearview mirror, and we may actually be at the peak of the current US interest rate cycle. The FOMC`s supportive comments regarding adjusting the pace of quantitative tightening should also be encouraging.[7]

Markets look oversold by many measures with the European equity risk premium at 2011 levels. It can hardly be claimed that Europe is in worse shape now than during the height of the Eurozone crisis. In fact, we just celebrated the 20th anniversary of the euro, and membership of the Eurozone is still expanding despite the doomsayers.

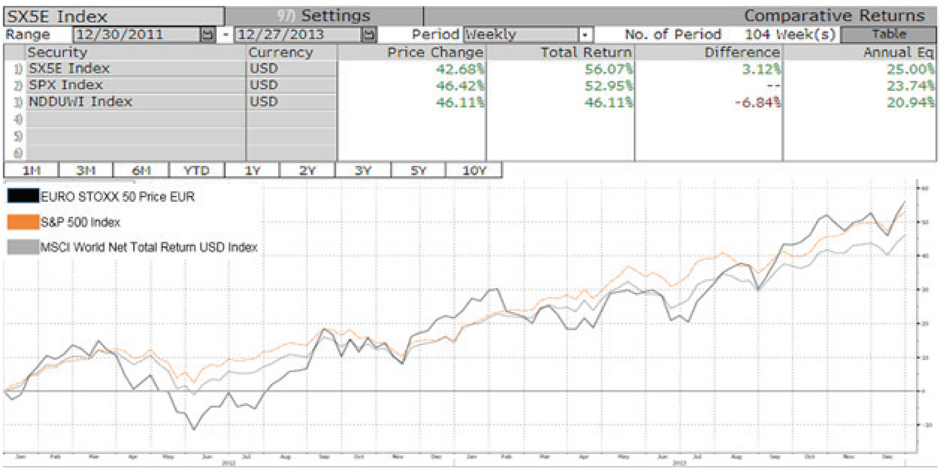
Valuations on equities look much more reasonable with the P/E for S&P500 at 18x level at the beginning of 2019, which is 16% lower than the January 2018 peak of P/E at 21.5x. Europe looks cheaper still with equities trading at below 16x 2019 earnings and the dividend yield at the highest level versus bond yields since records began.

We are fully aware that the US economy will slow this year to a pace of around 2-2.5% but this is hardly the recession that everyone has been concerned about. Europe's economy is also likely to post positive GDP growth north of 1% with good upside potential as many one-off factors ("gilets jaunes" (yellow vest protesters), German car regulations) fade into the background and make comparisons easier.

We believe that the biggest game changer this year will be the quick resolution to the tariff disputes both with China and with Europe as the malaise has now finally caught up with the USA in terms of lower company earnings and economic growth. We believe, there has been a period of enlightenment (or you could call it self-realisation) in the White House that the economic slow-down and unpleasant market movements are not only due to the FOMC but also due to the entire tariff situation, which, when all is said and done, has no winners.

As the year progresses – perhaps towards the tail end - we fully expect markets to start pricing in stronger economic growth and earnings recovery, thus helping to produce decent gains in 2020.

In our opinion, the current situation feels very similar to 2011- just look at what happened in the two subsequent years.



Source: Bloomberg, Euro Stoxx 50, S&P500, MSCI world index returns for 2012 to 2013.

As we come to the conclusion of this newsletter with the sun glinting off the freshly snow-dusted Alps and markets having the strongest ever January on record, we really cannot help but feel positive for the future outlook.

The Navigator
has been written by:

Peter Ahluwalia, Partner
Chief Investment Officer

References

1. https://www.bloomberg.com/news/articles/2018-12-14/u-s-stock-market-exodus-is-second-biggest-on-record-bofa-says
2. https://www.cnbc.com/2018/12/13/pessimism-among-mom-and-pop-investors-hits-highest-in-more-than-five-years.html?__source=iosappshare%7Ccom.apple.UIKit.activity.Mail
3. See note 1, above.
4. https://edition.cnn.com/2018/12/18/investing/stocks-worst-december-since-great-depression/index.html
5. https://edition.cnn.com/2018/12/31/investing/global-stock-markets-2018/index.html
6. https://www.cnbc.com/2018/12/31/stock-market-wall-street-stocks-eye-us-china-trade-talks.html
7. https://www.cnbc.com/2018/12/19/fed-chief-powell-says-he-doesnt-see-the-fed-changing-its-strategy-for-shrinking-the-balance-sheet.html