thenavigator

Summer 2020

FEAR NOT DEATH FOR THE HOUR OF YOUR DOOM IS SET AND NONE MAY ESCAPE IT – VOLSUNGA SAGA, C.5

V

The letter V is an interesting character in both the present day and mythology. Being something of a dreamer (which newsletter writer isn't?), I find ancient mythology fascinating with its tales of heroism, brave deeds and stout hearts. In Viking times the letter V had great significance as the first letter in Valhalla, the resting place for Vikings who had died nobly in battle, led by Valkyries (female warriors) awaiting the final battle known as Ragnarok. In modern day terms, Valhalla could be paraphrased by the word "bliss".
But make no mistake – though it may feel like it now while we are in the eye of the storm, this is NOT our Ragnarok.

View – coming from a half English and half Indian background and living in the German speaking part of Switzerland does make me something of an outsider (in fact that is pretty much the case everywhere I go). However, it does give me a perspective that is somewhat different, that diverges from the consensus and takes a different outlook. In these uncertain and unprecedented times defined by the virus, the key to financial markets may well be having the ability to take a few steps back and view things from a different angle.

Vacations involving travel to different countries are something that many of us can only dream of at the moment. Having had the privilege to travel to five different countries (all with low rates of Covid-19) and rack up 3,000 km in my vehicle, I can confirm that you see a lot when you travel this way. For example, I was served my meals in Austria by waiting staff wearing full plastic protective shields and it struck me that the hotel was fully booked, while the restaurant was busy every single night. Shops (though less so grocery stores) were also very busy with a mixture of domestic and foreign footfall.
I saw exactly the same scenario in Germany, Slovenia, Italy and Croatia. This was pent-up consumer demand in action, making up for the months lost during lockdown. It is human nature to want to make up for lost time and to make sure your experiences are more vivid when the opportunity arises.
You also notice a lot by observing traffic. Everywhere I went there was not just a huge amount of heavy goods traffic but also a ridiculous amount of normal car traffic. Filling up at any petrol station in any country involved a waiting time – not because of any restrictions but because of demand. In fact, the conclusion could be drawn that as a result of this crisis people will value their personal space more. After all, in this environment who in their right mind would want to travel on crowded public transport if you can go by car?

You also glean a lot from engaging with people from different backgrounds – such as the US gentleman with whom I struck up a conversation in the car park of the Austrian hotel, who told me that he had been posted to Germany for over ten years working for the US military and that any troop reductions would take a minimum of nine months without any paperwork complications, though the process could drag on for 18 months.
And then there was the Slovenian fishing guide whose main business was in auto parts, where he is now starting to see some signs of life.

From a health perspective, the one common thread was the requirement to wear a mask in enclosed spaces. Perhaps this can explain the gradual return to normality in all the countries I visited.

Vast is an apt word to describe the monetary and fiscal stimulus in the system at the moment, which dwarfs the amount injected during the great financial crisis. In fact we expect these amounts to increase, with an eventual deal on the European recovery fund (EUR 750bn) and another round of fiscal stimulus from the US to tide people over.[1] Any central bank or government that tries to withdraw this stimulus early will be punished viciously by the markets.

V-shaped is perhaps the best way to describe the economic and market recovery which we expect to continue confounding most investors. Why? Well, besides the aforementioned reasons the bottom of the V was so low that it could have hardly been anything else. If we think of the global economy as a set of cogs in a large machine, the first experiment was to grind everything to a halt. The cogs are now turning again – albeit more slowly than anyone wants – and are creaking, but if the machine is shut down again the cogs may never restart. Furthermore, we do not believe that mass lockdowns will be accepted or tolerated by populations – just look at the recent riots in Serbia.[2]
We have to acknowledge that the V will be jagged at times when there are hotspots or flare-ups in Covid-19 cases. And we should not ignore positive binary outcomes such as vaccines or treatments. Financial markets, like human beings, have very short memories and are able to adapt quickly.

Valley is probably the best way to describe the situation we are in at the moment. Having got to the bottom of the valley we are climbing our way out again (the other side of the V) – the infamous wall of worry that financial markets always climb. Will there be a second wave? Please don't tell me this would come as a surprise! But if we look at this issue from a different angle it is worth considering whether a second wave could spur consumer spending as people rushed to the shops for fear of renewed closures.
We expect economic data and company earnings to show continued sequential improvement. Injecting a dose of realism into the mix, we acknowledge that economic and earnings data will not hit pre-Covid highs anytime soon. But this doesn't matter and our rather bullish scenario remains intact as markets will focus on the change in direction, which will continue to move the right way for an extended period of time.

To put it in simple terms, things will get sequentially better for an extended period of time while financial conditions will remain ultra-loose for years to come.

Value/valuation – we know it's not popular to talk about value at the moment but it is our inherent belief that the price you pay for an asset is important, whether it is in terms of growth rates or in purely monetary terms. There has been a lot of talk about the overall valuation of markets and especially the S&P500, which is still cheaper on a current PE basis than it was in 2018, 2017, 2009, 2003 and a significant number of other years.[3] Operational leverage is a concept that the vast majority of market participants are overlooking. Companies have cut costs drastically, laid off staff or have got governments to foot a good part of their employments costs. When the recovery comes – which it will – profits are going to be supercharged.

Volatility is likely to remain elevated for a little longer while the market continues to suffer from its paranoid schizophrenia of flipping between stay-at-home stocks and economically sensitive ones. However, I do wonder whether anyone will go home ever again once the all-clear is given.

Vision – our base case scenario is for markets to recover pretty much in the same order in which they entered this crisis (depending upon effective healthcare measures). Asia/China should recover first, then Europe (this is not dependent on the recovery fund, which would merely be the icing on the cake), followed by the US, where the recovery has been postponed somewhat but not cancelled. Countries which hit the virus hard and early have bounced back quickly. Domestic spending in New Zealand is now almost equal to pre-Covid levels[4], and the unemployment rate in Europe is lower than in the US.[5]

Vindication is what we hope to achieve by year-end and beyond. While we recognise that our view differs somewhat from the consensus – some may even say it's on the lunatic fringe – this always seems to be the way, and the same was true in, for example, 2009 or 2003, which were major market inflection points. In the meantime I have been for my third lockdown haircut and the barber is wearing a mask once again, though he forgot to cover his nose. My haircut has definitely improved.

THINGS ARE GETTING BETTER.
SEE YOU IN VALHALLA (BLISS)!

The Navigator
has been written by:
Peter Ahluwalia, Partner
Chief Investment Officer

[1] https://www.cnbc.com/2020/06/19/eu-leaders-negotiate-750-billion-euros-in-covid-19-stimulus.html
[2] https://www.dw.com/en/serbia-protesters-try-to-storm-parliament-amid-fresh-unrest/a-54135350
[3] https://www.multpl.com/s-p-500-pe-ratio/table/by-year
[4] https://treasury.govt.nz/publications/weu/weekly-economic-update-29-may-2020-html
[5] https://edition.cnn.com/2020/06/03/business/europe-unemployment-coronavirus/index.html

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