A View From Here - November 2020

Climbing The Walls

If somebody told you in early January that the virus we're starting to hear about would create the kind of havoc we have witnessed - particularly when it comes to your investments - how would you have reacted? Having been through mild reactions too MERs, Swine Flu, Ebola and one that affected us more directly, SARS, perhaps we would have known better. Yet if we look to where we are now, it seems amazing and almost impossible to believe, that markets are soaring around the world, and our accounts are now up on the year... and better than in the past three. How is that even possible given the circumstances we find ourselves in economically, politically, and societally? Maybe it can just be chalked up to the old saying, that 'markets climb a wall of worry.'

Prior to the lockdown markets were in a conundrum. Rooted in the strength of large tech corporations accounting for over 25% of the Dow Jones Industrial and S&P and over 40% of the Nasdaq, the indexes were increasing daily. Each morning I would awake to pre-market futures (an indicator of how markets are predicted to open based on existing newsfeed) and wonder how this could be sustainable. While this was occurring, the wider market (many of the companies we follow) continued to weaken. The healthiest stock market occurs with the widest possible participation of all publicly traded companies. The narrowing band of companies performing well reminds us of two other periods, namely 1999-2000 and the early 1970s. During those periods, if you weren't in cutting edge technology at lofty valuations, you were nowhere. It didn't take long into the Pandemic for technology companies to rise exponentially as investors looked to these online behemoths to be the only future of investing.

In the early 1970s, investors were all about the Nifty Fifty, a group of companies that many investors believed was all you really ever needed to own. In both cases, investors were pricing in valuations based on a future that may or may not occur. I have been taking a lot of calls about this 'certainty' particularly among younger investors, and while we don't know the future, we can learn from the past when similar circumstances prevailed. This left many companies outside of the 'accepted' field of growth, in the waste bin.

But a funny thing started to happen in the late summer. Namely, these forgotten businesses began to rise to levels not seen since they collapsed in 2018.

This has brought our performance up substantially and we are now flirting with new all-time highs for our accounts.

You Never Can Tell...

Early in lockdown, it became apparent that no one really knew how this was going to play out. But if I told you at the onset that the pandemic would infect over 50 million people, shut down the economy, furlough and lay off over a third of the worlds work force, bankrupt restaurants, retailers, gyms etc. and take the markets down over 35% in its first weeks, with the promise of a second wave hitting in the fall, which has proven to be more intense than most thought, would you think that the stock markets would reach new highs? If we add the anxiety of a great political divide, fake news, foreign intervention, elections, escalating cases and deaths, how could this transfer to higher markets with wide participation...remember that's the best kind?

But this is what has happened. Perhaps, when things get better out there, we'll see the exact opposite. One thing these strange times has demonstrated is that stock markets do indeed climb a wall of worry...and never has worry been so prevalent. As I've said in previous notes, the resilience of the stock market is an encouraging sign of the future. This is because the stock market is seen as a leading economic indicator, with constant revaluation of its constituents as information from their collective corporate developments getting priced in. It's too easy to think that the market strength is a fool's game or manipulated.

Recently, a friend warned me of upcoming political crises that few currently know about that could have the power to strike a major blow to the economic world as we know it. My reaction was that if it has anything to do with the economy, elections, and even Covid-19, the markets are well aware. It is simply too top mind for it not to be factored in. It is surprise that changes valuations and it is likely to come in the form of something that few, if any have thought of. Think back to the financial crisis of 2008 as a perfect example. The market has more information than we do on all things political, Covid-19 and/or current market views. It is the message that we are going to come out of this predicament in due course.

When the pandemic hit, markets retreated over 35% because it was forced to factor in a new reality. What is amazing to see is its subsequent strength. So far, third quarter earnings are coming in better than expected. The caveat is that a number of companies are still warning of possible disappointments down the road. All the while, high earnings multiples exceeding a median of 21 can be seen as unsettling.

I think investors need to stay calm, but also alert to developments that can change the current view, but I remain encouraged by the potential optimism this environment has shed on such a difficult time for the world.

Thanks for taking a look and, as always

All Good Things,

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