Elgin asset management

investment commentary monthly

Monthly Commentary 6th May 2020

April was one of the strongest months ever for equity markets as the extreme declines of March reversed to give the markets a much-needed boost. World equities as measured by MSCI World, were up about 10%, with the US market leading with a 12%+ gain, while the UK's FTSE 100 was the laggard with "only" a 4% gain. Bonds also rose across the board, with corporate bonds – both investment grade and high yield – especially strong. Oil (WTI crude) bucked the trend and fell 8%, while gold rose more than 6%. The US dollar was largely flat.

How do we invest now?

There is no doubt that we are entering a highly uncertain period. The extreme level of recent economic statistics show numbers that are so off the charts that they are impossible to interpret.

Going back to basics, the main driver of the equity markets is corporate earnings growth. While everyone agrees that earnings will fall, there is a huge discrepancy among analysts and strategists as to the degree of the falls. As Ted Chang, a portfolio manager at Thornburg Investment Management, put it: "*We're flying in the dark here. All anyone can say with certainty is that estimates have to come down, and no one can say they need to come down by X, Y or Z amount.*" This creates a huge dilemma for investors who hesitate to jump back into the market when so much remains unclear, but they also fear missing out if stocks keep climbing from their recent lows.

So while the near term direction for earnings is negative, why have the markets bounced back so strongly from the March lows? Are they seeing some silver linings that most economists do not see? We do not think so. The only explanation is that both governments and central banks – led by the US – have been adding unprecedented levels of stimulus. Will this be enough to stabilise, and then fuel an earnings revival? Only time will tell.

Terry Smith, the manager of Fundsmith – a very successful global equity fund, also asked the same question about how to invest, and below are excerpts from a recent article of his in the Financial Times:

"We now have a fully-fledged economic crisis caused by the reaction to the Covid-19 pandemic. What should you do about it in terms of investment?

I would strongly advise avoiding the approach of many investment advisers or analysts. They spend their time speculating about what will happen. When will the lockdowns end? What will happen in the travel and hospitality industry? When will there be a vaccine? Who will be the winners – makers of disinfectant and masks? Drug companies? E-commerce plays? Home food delivery?

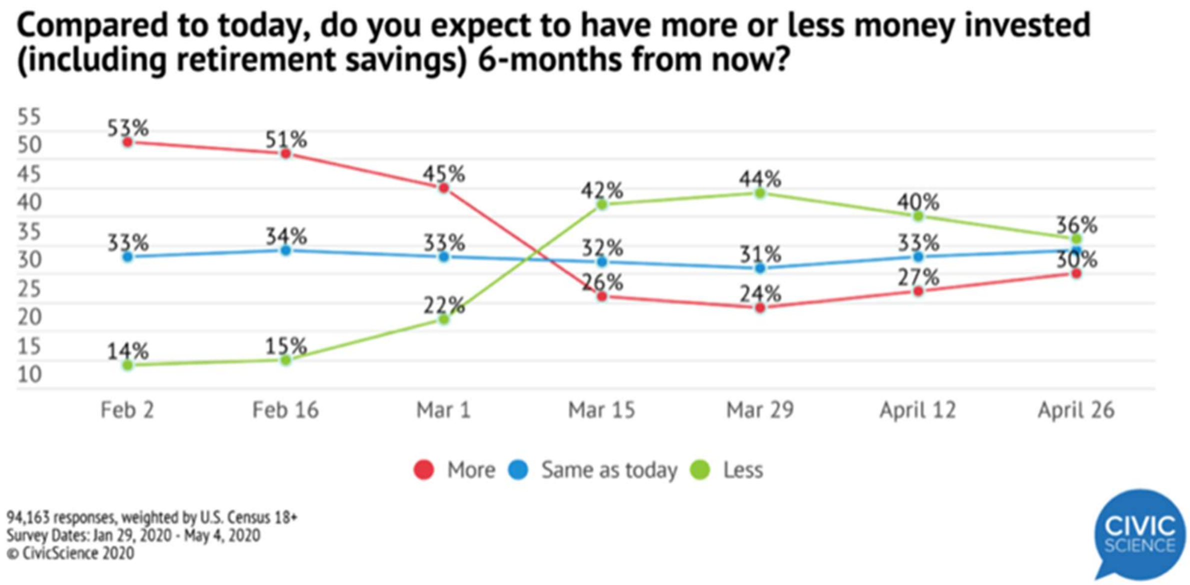
In my view, all of this speculation is useless. No one knows."

Terry sticks to his principles of investing in high-quality companies with solid balance sheets. They have served him well in the last 10 years and he expects that they will continue to do so in the next 10. We tend to agree.

Investor Psychology

We had mentioned in last month's commentary that a handful of our clients opted to sell all their holdings in March as they saw markets plunging and thought the world was ending. While we tried to prevent them from doing so – based on the many prior examples of markets eventually bouncing back – they insisted in getting out. As a result they missed all the subsequent rebound, which cost them dearly.

There will always be many investors who panic and sell, and it all has to do with psychology and the fear of losing all their savings. The graphic on the next page from Civic Science reflects how investors feel when the going gets tough. Individual investors were polled about their finances and in one question they were asked whether *they planned to have less or more money invested in the next 6 months*. Not surprisingly, when markets were doing well (in February), more than 50% said "more" and only 13% said "less". By the end of March when markets had fallen about 30%, the numbers were much different, with 44% saying they would invest less and only 24% would increase their investments. And that is why it is the few that benefit truly from the markets…



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