Monthly Commentary 3rd August 2018

July was good month for global equities, with the MSCI World Index up almost 3%. Emerging Market equities were also up, but less so, as trade-war fears and an elevated USD have contained the correlation with developed markets. Bonds did not move much and commodities were hit hard, with oil, precious metals and base metals all down sharply.

How long can equity markets ignore the negative headlines?

With a trade war becoming increasingly likely, it would be unwise to think that markets will remain as sanguine as they have been. True, the US market has been far ahead of other major markets this year, but has remained flat for the last six months, as stronger corporate earnings have countered the worsening trade outlook. Other markets have been hit harder, with Germany, Japan, and especially China all down this year. Can it be that the US believes it has less to lose than its trading partners, and has thus adopted a hard line? Or conversely, have investors over-reacted in punishing Germany and China even though their exports to the US account for less than 4% of their respective GDP?

Tough to tell. While we are under no illusions that an escalation of trade wars and tit-for-tat tariffs is very bad news for the markets, there is also a lot of negative sentiment that might already be reflected in prices. Europe is trading at a 10% discount to its average valuation and Emerging Markets are trading at a massive 25% discount to developed markets. In the US, earnings growth has easily kept up with equity prices. So not all is dour, and the markets seem to be climbing the wall of worry once again.

One sure sign of a lack of belief in the markets are the continuing and accelerating outflows out of US equity funds in favour of bonds. The graphic on the next page says it all. We maintain that as long as sentiment remains less than exuberant, the markets will not fall of their own weight.

On Wall Street geniuses and darts

Every year, the Sohn Investment Conference brings together "the world's savviest investors" (according to CNBC) to share fresh insights and moneymaking ideas to benefit the Sohn Conference Foundation's work to cure and treat pediatric cancer. Last April, each investment guru picked his or her top stock for the next year. There were 12 speakers, and thus 12 stocks picked.

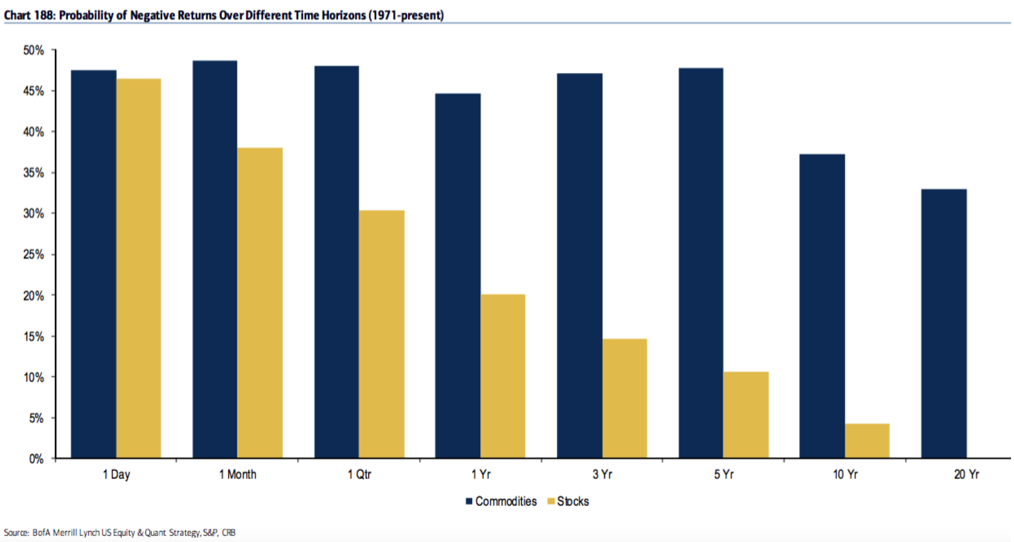
A group of journalists from the Wall St Journal decided to throw darts at 10 stocks, to compare the aggregate performance of the guru picks vs the darts' picks. They would monitor progress every three months.

The results of the first three months are out, and **in aggregate the darts have returned +7.23% vs a slightly negative return for the gurus' picks**. No comment necessary. The only conclusion that can be drawn is that stock prices are far too complex for even the smartest investors to predict. While we are not advocating the use of darts, we do suggest that one should temper their expectations when it comes to expert advice on equities. We shall revisit next April to see if the results are similar.

Probability of losses

Merrill Lynch updates the below very informative chart on a regular basis. It shows the probability of negative returns from commodities and US equities during various time horizons. It is quite easy to conclude that the longer one stays invested, the less chance there is of losses.

We have always advocated that **the minimum investment horizon for anyone should be at least 5 years**, where the probability of losses is merely 10%. Not bad odds. The below chart also shows that commodity investing is far more risky.



The Elgin Analysts' Team

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