Elgin asset management

investment commentary monthly

Monthly Commentary 4th February 2019

January was a very strong month for financial markets as equities, bonds and commodities all ended the month with bumper gains. World equities as measured by MSCI World were up more than 7%, with the US and Emerging Markets doing especially well. The “laggards” were the UK and Japan that rose less than 4% each. Bonds also posted solid returns across the board with Emerging Market and High Yield doing especially well. Oil also rose strongly, partially recovering from the very large Q4 losses. Finally, in currencies, sterling was the standout performer, rising almost 3% versus both the dollar and the euro.

How quickly things change

Only a month ago, following a horrible down-year, predictions for the markets were downbeat. The drumbeat of usual worries was louder than ever. Barron’s Roundtable, the prestigious group of finance “wizards” met in early January to present the world with their crystal balls for the year, and it was almost unanimous that the first half would be very bad and the second half, not that bad. So far, they have been proven wrong, but there’s a way to go.

In fact, we have always stated that beyond fundamentals, investor sentiment plays a huge part in short-term market returns. And this dynamic seems to have followed the script in January. With so much negativity as we entered 2019, it seems that most investors had already positioned themselves by selling, with sellers drying up and buyers back in firm control.

This narrative of course is not as simple as that. There is still much to worry about, not least of which is the possibility of deteriorating, and even negative earnings growth in the US. Markets rarely like that. So we can expect more drama in the coming months. In the end, markets are there to frustrate the maximum number of investors. Unfortunately, we cannot control what markets do. Rather, we stick to what we can control, and that is buying quality, not speculating and sticking to our clients’ risk profiles.

More on market timing

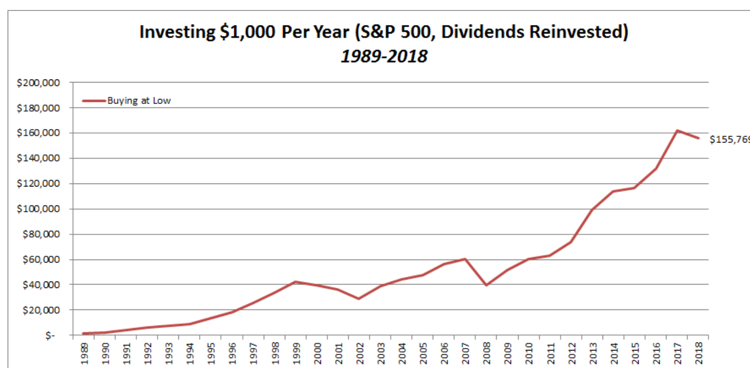
Last month we wrote about our aversion (and our inability) to time the markets. Had we indeed sold at the end of December, when admittedly most investors were expecting further falls in anticipation of better entry points, we would have missed the strong January rally.

Albert Bridge Capital, a London-based investment firm, wrote the following small piece on the futility of timing the markets:

Imagine you are 25 years old, and you are going to invest $1,000 per year into the S&P 500, and do so for the next 30 years of your life. Then imagine that you also were trying to pick the perfect day to invest that $1,000; and that you indeed picked that perfect day, each year, over the next thirty years to do so. The odds of you picking that perfect day each year for thirty consecutive years were (1/253)^30, or a one-in-1240 followed by another 69 zeros' chance.

But, let's imagine you were that good.

Now let's imagine you are 55 years old today, and started this practice back in 1989. And after investing your $1,000 annually, picking the low daily close each year for the next thirty years, you would – today – have $155,769.

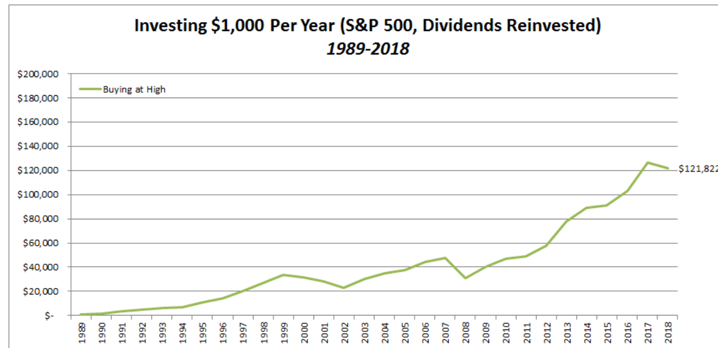


Investing at market lows each year

If this is you (it's not), well done!

Now, imagine the unluckiest market-timer in the history of capital markets. Not just unlucky, but actually extremely good at being extremely bad. Imagine this investor – instead of picking the absolute best day to invest his $1,000 each year – picks the absolute worst day.

Will he end up with $50K?   Maybe $75K? How much worse off do you think he is?
This guy, the worst market timer ever, investing $1,000 at the very worst possible time each year, still has $122K.



Investing at market highs each year

So the difference between the perfect idiot and the man with perfect foresight, is the idiot has nearly 80% of the nest egg as the impossibly accurate market-timer.

So, not only can you not pick the perfect day to invest, there isn't even a whole lot of upside from trying!

And this isn't just a recent phenomenon. In looking back at previous 30-yr periods the differences were not that much.

So don't get cute. Even if you think you are better than average, you just aren't going to get much out of it.   Stop trying to pick the perfect time to invest. Just invest, and get back to work.

On European equities

There has been a lot of Europe-bashing in the media lately; that the economy is weakening meaningfully, that the continent is dysfunctional, that it is too polarized to ever become efficient, that there is too much bureaucracy etc., etc. We do not disagree with most of these statements.
Nevertheless, we need to ask if the continent is indeed a basket case, or if there is value in investing in European equities today.

Stuart Mitchell, a fund manager at SW Mitchell Capital came up with the following bullet points recently:

• On a P/B (Price-to-Book) multiple Europe is trading at a 54% discount to the US. This is the biggest discount on record.
• Across a blend of valuation metrics, the current discount is 40% vs the 24% long-term average.
• On a consensus forward P/E of 11.7x (Price-to-Earnings), Europe is now at a 19% discount to its long-term average multiple.
• Using the cyclically adjusted, Shiller P/E ratio, Europe is valued at 16.5x, below its 19.4x average since 1990 and at an extreme discount relative to the US at 29x.
• Analysing 10-year returns since 1979 shows that European equities went on to generate a 6.9% median annualized return from current CAPE and P/B valuation levels.
• Strategically important sectors like autos are now trading at their lowest valuation on record: German auto OEMs and suppliers are on 0.28x EV/Sales.

Surely European equities merit some consideration. After all, despite so many handicaps, and much to some Brexiteers' chagrin, many countries in the EU are doing something right, with their per-capita GDP being higher than that of the UK. These are Germany, France, Holland, Belgium, Austria, Denmark, Sweden, Ireland, Finland and Luxembourg. Not to mention productivity…

The Elgin Analysts' Team

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