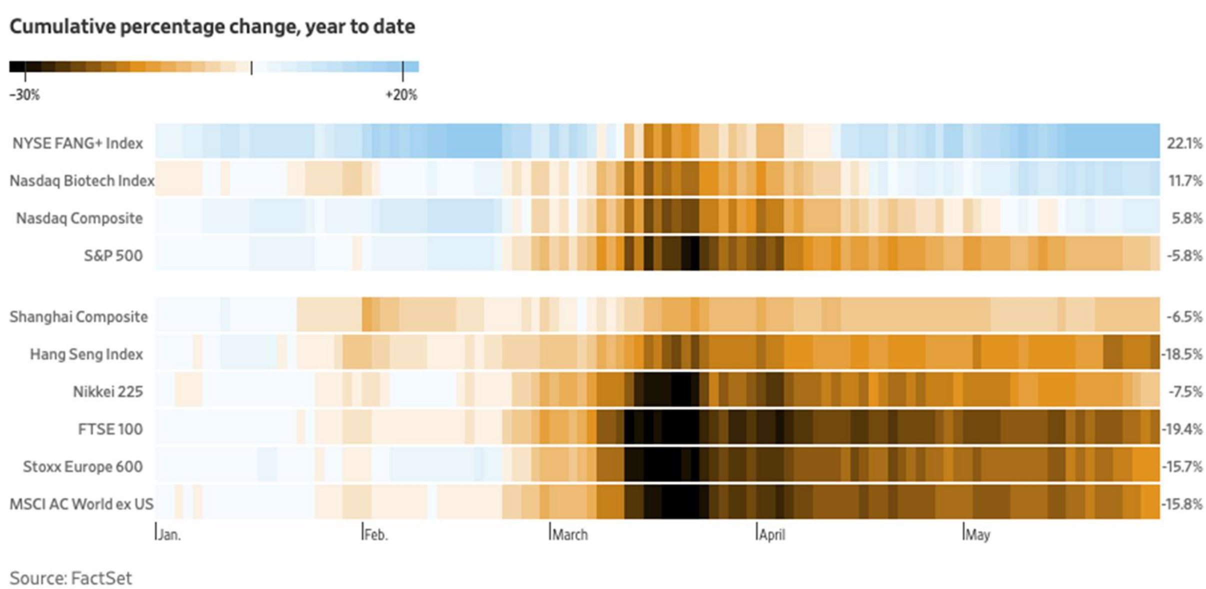
Monthly Commentary 4th June 2020

May was another good month for equity markets as they rose about 4% globally. First place among major markets went to Japan, where the Nikkei 225 rose more than 8%, followed by Germany, whose DAX index was up almost 7%. Bonds overall had another good month and commodities were up by double digits following a surge in crude oil prices, albeit from a very low level. Pound sterling weakened, especially against the Euro. Apparently, Brexit negotiations have stalled.

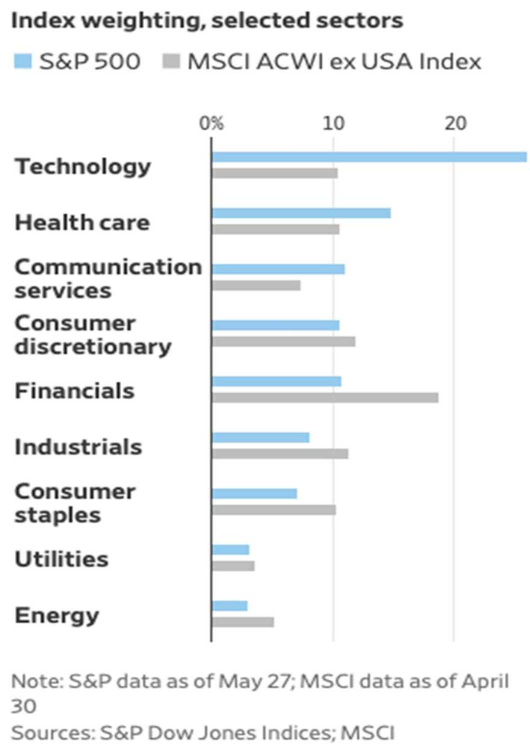
Conflicting forces

Why is there such a disconnect between equity markets and the "real" economy? To us, it seems that massive monetary and fiscal stimulus has continued to outweigh economic data. Nevertheless, this euphoric rally has been more concentrated in the US, and within the US to certain sectors. So, it is not as broad as one might think. The graphic below from Factset shows that all has not been rosy in global markets.



Only the "new economy" stocks, which include technology and biotech have in the aggregate, risen in 2020. US markets are still down so far this year, with the Dow down about 10% while the MSCI World Index ex-USA is down 15.8%.

It is the makeup of the US markets, with a much larger tech and healthcare component than foreign markets, which explains the divergence. If anything, the pandemic has accelerated the lead of the "digital economy" companies. The chart shows US and global sector weightings.



Remarkably, only four stocks – Apple, Microsoft, Amazon and Google, are worth more than the entire UK or Eurozone markets!

But not all indicators are rosy as one could argue that government and corporate bond prices in the US are "fake", as they have been "fixed" by the Federal Reserve's massive bond-buying programs. This could explain why equity prices might be behaving irrationally. As Merrill Lynch points out, more than 70% of the world's largest 3000 stocks are still in a bear market (more than 20% below their peak).

Also, if one was to look at gold and the level of the 10-year Treasury yield, they reflect plenty of investor caution with gold hitting $1,750 an ounce and the 10-year yield having a lot of trouble holding above the incredibly low 0.7% level.

Merrill also points out that if what we are undergoing is a "bear market rally", past rallies like this have historically risen on the average another 5% from today's (June 1st) level before reversing and resuming their downtrend. Fasten seatbelts.

Still, there are some indicators that we follow that justify the elevated market levels. One is that investor sentiment is still very negative, as measured by various sentiment indicators. This is a contrarian signal as markets keep climbing the walls of worry. Another interesting statistic is that US household net worth is at an all-time high! This is because of the combination of rebounding equities, stable/higher home prices and a surge in household savings, which have reached an unprecedented $1 trillion, or about 35% of US household disposable income (vs the average of about 5-6%). This can only be good for consumer sentiment, and being the main driver of the US economy, it makes investors hopeful.

All these mixed signals lead us to proclaim with confidence that we really do not know where the markets are headed. It is perhaps a good time to remind clients of the "quilt" of investment returns over the last 20 years (updated until late May).

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Commodities 31.8%	US Treasuries 6.7%	Commodities 25.9%	MSCI EM 56.3%	REITS 32.0%	MSCI EM 34.5%	REITS 37.5%	MSCI EM 39.8%	US Treasuries 14.0%	MSCI EM 79.0%	Gold 29.2%
US Treasuries 13.4%	Global IG 4.6%	Gold 25.6%	MSCI EAFE 39.2%	MSCI EM 26.0%	Commodities 21.4%	MSCI EM 32.6%	Gold 31.9%	Gold 4.3%	Global HY 62.0%	MSCI EM 19.2%
REITS 8.5%	Cash 4.4%	Global IG 14.9%	REITS 33.5%	MSCI EAFE 20.7%	Gold 17.8%	MSCI EAFE 26.9%	Commodities 16.2%	Cash 2.1%	MSCI EAFE 32.5%	Commodities 16.8%
Cash 6.2%	Global HY 3.1%	US Treasuries 11.6%	Global HY 30.7%	Global HY 12.4%	MSCI EAFE 14.0%	Gold 23.2%	MSCI EAFE 11.6%	Global IG -8.3%	REITS 31.7%	REITS 15.9%
Global IG 3.1%	Gold -0.7%	Cash 1.8%	S&P 500 28.7%	S&P 500 10.9%	REITS 10.7%	S&P 500 15.8%	US Treasuries 9.1%	Global HY -27.9%	S&P 500 26.5%	S&P 500 15.1%
Gold -5.4%	MSCI EM -2.4%	Global HY -1.1%	Commodities 23.9%	Global IG 9.4%	S&P 500 4.9%	Global HY 13.5%	Global IG 7.3%	Commodities -35.6%	Gold 25.0%	Global HY 13.9%
Global HY -5.8%	REITS -7.8%	REITS -2.4%	Gold 19.9%	Commodities 9.1%	Cash 3.1%	Global IG 7.2%	S&P 500 5.5%	S&P 500 -37.0%	Global IG 19.2%	MSCI EAFE 8.2%
S&P 500 -9.1%	S&P 500 -11.9%	MSCI EM -6.0%	Global IG 14.5%	Gold 4.6%	US Treasuries 2.8%	Cash 4.9%	Cash 5.0%	MSCI EAFE -43.1%	Commodities 18.9%	Global IG 6.0%
MSCI EAFE -14.0%	Commodities -19.5%	MSCI EAFE -15.7%	US Treasuries 2.3%	US Treasuries 3.5%	Global HY 1.5%	US Treasuries 3.1%	Global HY 3.0%	REITS -50.2%	Cash 0.2%	US Treasuries 5.9%
MSCI EM -30.6%	MSCI EAFE -21.2%	S&P 500 -22.1%	Cash 1.1%	Cash 1.3%	Global IG -3.0%	Commodities 2.1%	REITS -10.0%	MSCI EM -53.2%	US Treasuries -3.7%	Cash 0.1%

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020*
US Treasuries 9.8%	REITS 23.8%	S&P 500 32.4%	S&P 500 13.7%	S&P 500 1.4%	Global HY 14.8%	MSCI EM 37.8%	Cash 1.8%	S&P 500 31.5%	Gold 15.2%
Gold 8.9%	Global HY 19.3%	MSCI EAFE 23.3%	REITS 11.7%	US Treasuries 0.8%	S&P 500 12.0%	MSCI EAFE 25.9%	US Treasuries 0.8%	REITS 27.4%	US Treasuries 8.9%
Global IG 4.5%	MSCI EM 18.6%	Global HY 8.0%	US Treasuries 6.0%	Cash 0.1%	Commodities 11.8%	S&P 500 22.0%	Gold -1.9%	MSCI EAFE 22.8%	Cash 0.5%
Global HY 2.6%	MSCI EAFE 17.9%	REITS 0.7%	Global IG 3.2%	MSCI EAFE -0.8%	MSCI EM 11.2%	Gold 12.9%	Global HY -3.3%	Commodities 20.1%	Global IG -0.9%
S&P 500 2.1%	S&P 500 16.0%	Global IG 0.1%	Gold 0.1%	REITS -3.4%	Gold 8.6%	REITS 11.5%	Global IG -3.4%	MSCI EM 18.6%	S&P 500 -8.0%
Cash 0.1%	Global IG 11.1%	Cash 0.1%	Cash 0.0%	Global IG -3.8%	Global IG 4.3%	Global HY 10.2%	REITS -3.9%	Gold 17.9%	Global HY -8.2%
REITS -9.4%	Gold 8.3%	MSCI EM -2.3%	Global HY -0.1%	Global HY -4.2%	REITS 1.3%	Global IG 9.3%	S&P 500 -4.3%	Global HY 13.7%	MSCI EM -16.4%
MSCI EAFE -11.7%	US Treasuries 2.2%	US Treasuries -3.3%	MSCI EM -1.8%	Gold -10.4%	US Treasuries 1.1%	Commodities 7.6%	Commodities -12.9%	Global IG 11.4%	MSCI EAFE -17.8%
Commodities -13.3%	Cash 0.1%	Commodities -9.5%	MSCI EAFE -4.5%	MSCI EM -14.9%	MSCI EAFE 1.0%	US Treasuries 2.4%	MSCI EAFE -13.2%	US Treasuries 7.0%	REITS -20.8%
MSCI EM -18.2%	Commodities -1.1%	Gold -27.3%	Commodities -17.0%	Commodities -24.7%	Cash 0.3%	Cash 0.8%	MSCI EM -14.3%	Cash 2.2%	Commodities -34.8%

Source: BofA Global Investment Strategy, Bloomberg. * YTD

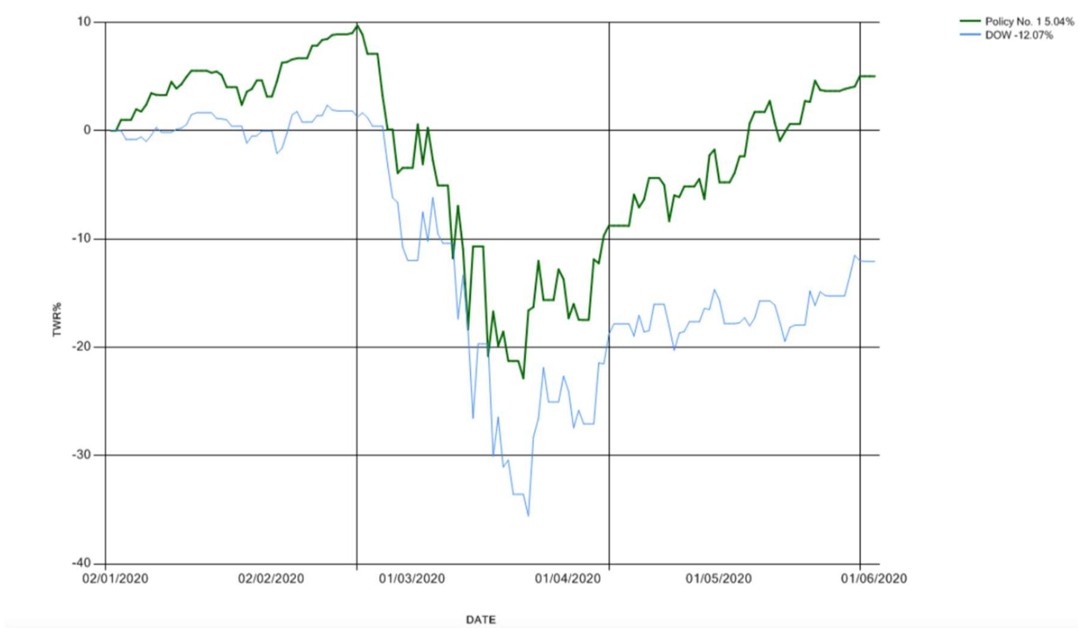
Perhaps the print is too small to identify each sector/region/asset class and see how each performed every year. The all-over-the-place nature of returns is a reminder that no one can predict the future winners and that making concentrated bets is not the best investment strategy.

Gucci says Fashion Week is out

Gucci recently announced that they will pare back and even cancel their presence in Fashion Weeks. Smart move by Gucci as it will save a lot of money as their strategists devise new methods to attract buyers. But not good for others. Fashion weeks in New York, Paris, London and Milan brought huge amounts of money to those cities. New York Fashion Week alone was estimated to have brought along with it more than $600 million a year to the city's hotels, florists, event planners and restaurants. No more. Is this one of the ways that the world is changing due to Covid 19? We disclose here that in our European Best Ideas portfolio we own Kering, the owner of Gucci and other luxury brands.

Elgin Best Ideas

Talking of our Best Ideas portfolio, we were happy to see that after a wave of bankruptcies (with many more expected in the near future), companies with strong balance sheets are continuing to prosper and outperform. Below is the Year-to-date performance of Elgin's US Best Ideas portfolio versus the Dow Jones:



As you can see, the portfolio is up 5% YTD vs a 10% drop in the Dow. One thing that companies in this portfolio have in common, is strong balance sheets. If you want more information on our Best Ideas portfolios, please contact us or talk to your advisor.