Elgin asset management

investment commentary monthly

Monthly Commentary 5th October 2020

September saw falls in equity markets with the MSCI World Index falling almost 3%. The US market fared a bit worse than that and Europe a bit better. Bonds were largely flat in the US and stronger elsewhere, while commodities slid, with a huge fall in Silver (-16%) but also greater than 4% falls in gold and oil. The USD reversed its losing streak and rose almost 2%, as measure by the USD Index.

US Elections and the markets

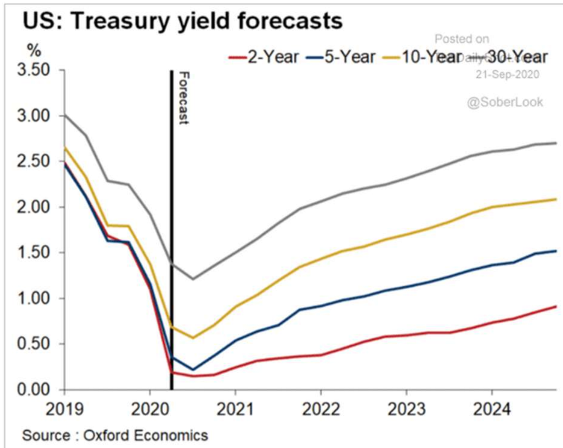
Quite a few clients have voiced concern about the impact of the elections on the markets. We have seen dozens of articles on this matter and it is not conclusive if the markets will do better with Biden or Trump. What is more likely is that they will do worse if the outcome is indecisive and the losing candidate contests the result. We do not have much to go by, but if we look at the contested Bush/Gore election, the uncertainty period lasted for 5 weeks and in that period US equities were down by about 5%, international equities fell by 3.2% and gold and US Treasuries were up by 1.6% and 2.3% respectively. Considering the volatility that has prevailed for much of this year, these are not huge numbers.

Could Trump have an advantage if he contests the election? Perhaps, as the Supreme Court, the ultimate arbiter, will have 6 conservative vs only 3 liberal judges. Hopefully judges will act independently and decide the case on the evidence and not on political conviction.

On Bonds

Portfolio managers often use the 60-40 (equity-bond) allocation as the benchmark for structuring portfolios. Bonds are supposed to be safer and provide stable income, while equities are riskier and provide growth. This model is increasingly questioned as bond yields have been falling for many years. All of the world’s outstanding bonds account for $128 trillion in value, at least 50% more than all of the world’s equities. And to think that these bonds, including government, corporate, agency, municipal, etc are now yielding an average of only 1%, it is shockingly insufficient to meet investors’ liabilities and expectations. In fact there are many trillions worth of bonds that have negative yields. That is, investors pay the issuers to hold their bonds!

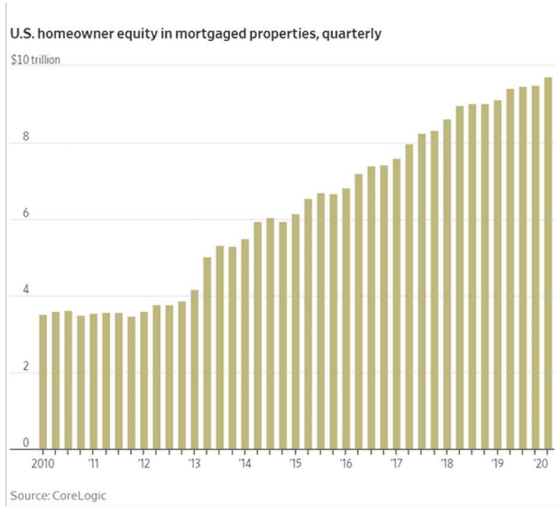
If, as expected, yields rise even a little, the meager yield would be lost due to capital losses. Below are the expectations for bond yields in the US government bond market:



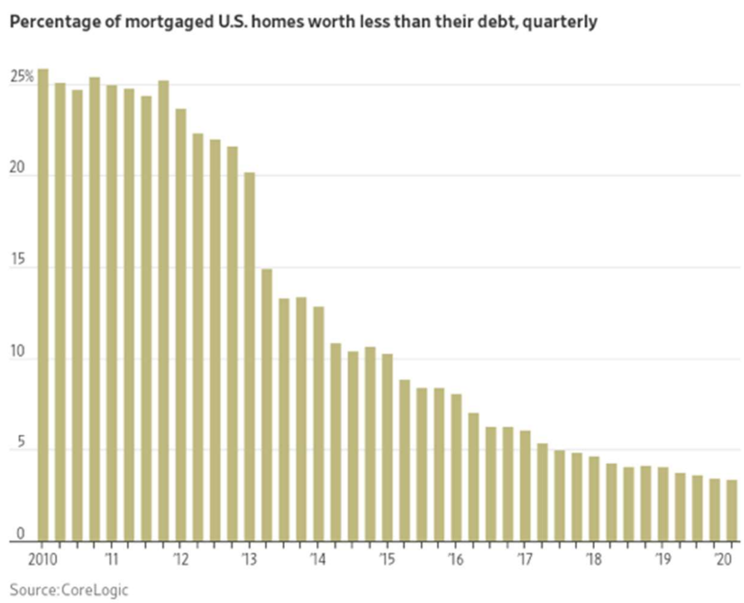
This is not encouraging. Fund managers have been underweight global bonds in their portfolios for most of the past 20 years, and they have largely underestimated the fall in yields, which produced decent capital gains. Could it be that yields are so low that we are running out of capital gains? If that is the case, investors will have to take on more risk in search for yield.

US Housing

Despite the multiple hardships created by the Covid-inflicted recession, it seems that one bright spot in the US has been housing. Americans have accumulated a net of almost $10 trillion in home equity for houses that still have a mortgage. This is almost three times as much as in 2010. The charts are from Core Logic:



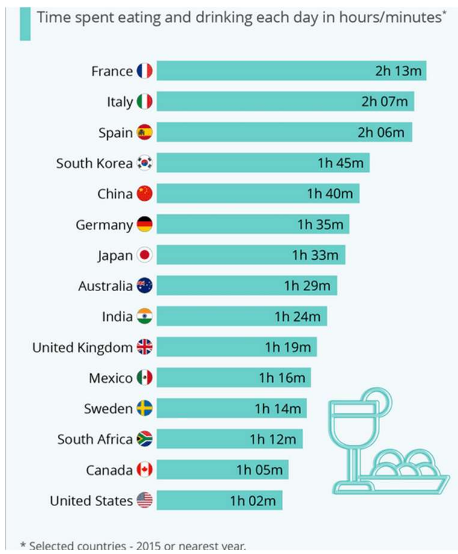
At the same time, their mortgage debt has also fallen dramatically, and they are thus more able to service it. The total number of homes with negative equity has fallen dramatically to less than 5% of the total.



Add to that the massive jump in household savings and the US consumer is, in the aggregate, in good shape. This bodes well for the markets.

Eat to live or live to eat?

The chart below was not at all surprising to us, as the French, Italians and Spaniards spend much more time than North Americans indulging in food and drink.



We wonder if it is reflective on their quality of life?

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