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Global equities – Outlook

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We prefer what we know and can control. Covid-19 was frightening as it took control of the world and created uncertainty. It caused the most pronounced and fastest decline in economic activity since World War II - a flash recession. With previous expectations of 3% global growth in 2020, we will probably end up closer to minus 4% – a whole 7 percentage points difference – and this, despite extreme stimulus packages. In the past, recessions and bear markets have travelled in tandem. Significant intervention, where the US Federal Reserve purchased bonds for the equivalent of USD140 million per minute, lead to strong asset markets. These interventions will continue depending on the dynamics in interest rates and government policy. Politicians and central banks will probably not accept that an increase in government spending is destroyed by markedly higher interest rates. Is explicit yield curve control the next tool to be used?

We are facing a tough winter before we can claim victory over the Covid-19 virus. We think this ugly collective experience - the worst

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Will central banks guarantee low interest rates to maximize the impact of government spending? This will be a key question for 2021.

pandemic since the Spanish flu 100 years ago and the consequences of the massive stimulus packages – will have long-term effects on the world economy and on consumer behaviour that ultimately will be priced in by equity investors.

We have a strong belief that success as an equity investor comes with long-term thinking and a deep understanding and appreciation of the concept of compounding. So, let us look into some of the themes shaping not just the investment thinking of 2021 but also the decade ahead.

The increasing importance of our home

Many of you will read this while being at home because of the pandemic. Your home has become your castle – and you need a castle these days in order to house a fully equipped office, a place to relax, a restaurant, a kindergarten and a fitness studio. Research highlights that 70% of people would prefer to work from home two days a week (despite all the additional requirements) and many of the key companies we speak to, especially those with a significant presence of knowledge workers (users of IT), are planning to make savings by reducing physical work space. The natural response and theme is therefore the aspiration towards 'home-expansion' and a better home.

Working from home and adhering to social restrictions has proved to be helpful in that we, as humans, are gaining control of the virus rather than the virus controlling us. The current pandemic has exposed us to a fear-based media offensive which risks settling in the collective consciousness. For most people, the home is associated with security – now more than ever. The increased importance of our home is a very important trend for stock markets – both in the short and long term.

The US economy is and will be the key driver for global stock markets for many years to come. The net wealth to GDP ratio in the US is now 6-fold – and has never been higher. Changes in net wealth influences GDP more than ever – and among stocks, bonds, and pensions, the dominant asset in a typical household is the home. Politicians get elected if they create jobs and better living conditions. So, in the 2020s house prices need to be stable and/or rising – especially in the US, where domestic consumption is 70% of GDP. A happy consumer is one who owns a house or apartment that rises in value over time. We are in the particular situation where a macroeconomic meltdown is caused by falling asset and home prices – not the other way around.

High indebtedness causes high interest rate sensitivity

We live in a world that is hypersensitive to changes in interest rates. Fed chair Powell tried to increase rates three years ago, though quickly changed track. Now we are even deeper into a world of low interest rates. Under the new administration, US economic policy will be run by finance minister Yellen, an experienced former Fed chair, and current Fed chair Powell. We would therefore expect more of the same – at least for the next four years. More of the same could be considering explicit yield curve control.

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There is desperation in the eyes of some people who pay for the privilege of parking money in the bank (especially here in Europe), while forgetting the pleasures of having near zero interest on their mortgage loan. This nurtures speculative behaviour – higher risk taking. Speculation and investing are two different disciplines, where the key difference is the time horizon.

Be careful out there at the virtual gambling tables that extend into parts of the stock market. Understand the difference between objects of speculation such as one of the 28 cryptocurrencies with more than a USD 1 billion valuation and fundamental value creators like companies, where there is a reasonable linkage between its enterprise value and future value creation.

Don't confuse price with value. And don't confuse low valuation with value, as value comes in many forms. We think it makes most sense to first understand the company behind the stock first. Understand the long-term potential of the underlying company, understand its so-called "right to win" and then consider the stock afterwards. This is especially the case in a world where capitalism is being reformed, and where Europe appears to be playing a leading role in what could be termed sustainable capitalism – the sustainable 2020's. Where governments play a bigger role, but also a world where the financial sector and companies actively take responsibility.

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Capitalism is being reformed to what could be termed sustainable capitalism. Here Europe appears to be leading the way.

Cheap money also fuels innovation and sustainability

There are other effects from low interest rates. Easy and cheap access to seed capital in the 2020s will continue to put pressure on the price of human labour and probably lead to continued low inflation. There are books worthy of reading that describe our world rapidly progressing into a state, where human labour becomes redundant as we underestimate the capabilities of self-programming machines and artificial intelligence (e.g. 'A World Without Work' by Daniel Susskind). Overall, we are much more optimistic on behalf of humans, but we share the view that there is an important and accelerating development in the field of robotics and automation. We are exposed to this automation theme in our portfolios. We equally see a continued need for politicians to bridge the education gap to avoid a further widening between the winners and losers of these innovations in automation.

In 1484, Columbus was unable to raise capital from the King of Portugal to finance ships to find a new trade route to East Asia. As a modern entrepreneur, he did not give up and finally obtained financing from the Spanish Queen Isabella. As history tells us, Spain thus conquered a new continent acquiring sugar, tobacco, gold and silver deposits. Financing subsequent expeditions was naturally easier thereby laying the foundation of imperialistic capitalism. Following the enormous financial success of the major digital platforms such as Amazon.com, Google and Facebook, there are many who - in quest for success like the financier of Columbus - make capital available for new products and services in the digital society. This creates a self-sustaining momentum. Data is the new valuable commodity that can be exploited. Artificial intelligence is then used to obtain more data points about what is going on in our society, creating patterns of data to develop better solutions and new products and services. Global patents are booming within this area.

This development goes together with a more sustainable agenda. Certain cities have made significant progress in terms of understanding environmental data and using technology to achieve better utilisation of scarce freshwater resources. The collection and analysis of better and larger amounts of data can help solve societal problems while at the same time create wealth and powerful new companies on the stock markets.

Smart connectivity and the emerging consumers are important growth themes

There are other growth themes. We have spent the last few years understanding smart connectivity and the 5G technology, where enormous amounts of data can be moved in an instant. New products and services will emerge, and we see a few, but clear winners.

China will continue to move forward, and growth will be driven by domestic consumption. China is advancing by ambitiously aiming to be CO_2 neutral by 2060, but also by demonstrating its hegemony in Hong Kong, for example. China has a tendency to reach its goals. With size comes the desire for more influence, and here technology is key as technology is an instrument of political and economic power. Today, China remains dependent on the western world for leading-edge technologies, and the greatest geopolitical risk, which could also affect stock markets, is the situation regarding Taiwan. This is a topic that we have analysed and covered in detail in previous articles.

Finally, we see India as the country with the greatest potential. India could benefit from geopolitical tail-winds and increased direct investment from European and US companies that now wants to establish themselves in India instead of China. Generally, we see exciting investment opportunities in Emerging Markets.

Technology both destroys and creates jobs. Technology creates entertainment, joy, but also anxiety and political power battles. The world is full of dilemmas that continues to be reflected in the global stock markets creating challenges and long-term opportunities.

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Speculation or sustainable investments in the 2020s

It is difficult to imagine a more supportive investment environment for equities. With interest rates at zero, speculation is frothy, and we advocate caution, especially in the most obvious instruments, including cryptocurrencies and selective stocks, where speculation could be driven too far. We are in an environment that invites speculation, which inevitably will cause higher market volatility. However, high valuations can often be justified by low interest rates and strong long-term fundamentals for the underlying company. Do not confuse a simple cheap P/E with fundamental value creation. Understanding long term fundamental value creation is the key task for the active manager. There are just a few companies that are able to truly deliver sustained 'value added earnings' growth in the long term. Thus, according to Bernstein, it is merely 1% of the companies in the US S&P 500 Index which have delivered more than 5% compounded annual earnings growth over rolling 10-year periods. Only five companies out of 500!

There are so many listed companies that are not worth investing in. It is the few that really make a difference. The decline in interest rates has proved a historic tail-wind for equity prices. The decline cannot continue and interest rate volatility is to be expected. Now is the time to be even more selective - more strategic and fundamental analysis is warranted to choose the right stocks and create good risk-adjusted returns. That is the message for the coming decade – a decade that eventually and hopefully could become known as a decade with focus on sustainability – known as the Sustainable 20's.

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We are facing the new sustainable '20s.

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