NEWSLETTER

APRIL | 2020

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FEATURE ARTICLE TITLE

INTEGER POSUERE ERAT A ANTE VENENATIS DAPIBUS POSUERE VELIT ALIQUET. MAECENAS SED DIAM EGET RISUS VARIUS BLANDIT SIT AMET NON MAGNA JUSTO ODIO, DAPIBUS AC FACILISIS.

of Hong Kong residents.' That summer the American liner, SS President Cleveland, arrived in San Francisco from Japan with 96 percent of its passengers and crew having fallen ill. They were suffering from Asian flu, which had begun in China, gone onto Hong Kong and then spread throughout Asia.

Even before the advent of mass air travel, it took just five months for the Asian influenza virus to traverse the globe. About 250 million people became sick and over one million died. The fatality rate was about 0.6%, resulting in 115,000 deaths in the United States alone. The country's population has roughly doubled since 1957, so even at the lower estimate of this year's coronavirus fatality rate, if left unchecked, it could lead to 230,000 deaths in the United States.

Just like the coronavirus, some of those infected with Asian flu experienced only minor symptoms, such as cough and mild fever, while others experienced life-threatening complications such as pneumonia. There was a silver lining for those exposed to the 1957 virus, as they retained immune protection against the 1968 Hong Kong influenza pandemic.

While Asian flu gripped the US in 1957-58, the country slipped into the worse recession since the Great Depression. The US economy contracted by 4% in fourth quarter of 1957, followed by a staggering -10% drop in the first quarter of 1958. Corporate profits fell by by

25%, which triggered a -17% fall in the S&P 500. It would be logical to attribute the cause of the recession to the Asian flu, since they occurred at the same time, but the financial reporting and commentary then and since make no reference to the pandemic.` Rather it was the steep rise in US interest rates which was blamed for the economic slowdown.

1957 was also the year that Standard & Poor's introduced its S&P 500 index, made up of 500 large cap stocks listed on the New York Stock Exchange. Despite an inauspicious start marked by Asian flu and recession, as well as suffering four negative years, the S&P 500 would go onto double in value in its first decade.

As scary as this present crisis appears, the financial crisis of 2008 had the potential to have been much worse. In late 2008 banks across Europe, the US and many other parts of the world from S.Korea to Russia, faced an existential crisis. Some had already collapsed, many others were on the verge of doing so. ATMs would go empty and savings disappear. Credit was frozen - no mortgages, credit cards nor business loans. A total economic collapse threatened, when governments stepped into rescue the banks - to the tune of almost $500 billion in the case of the US. For those outside of the financial industry, it is hard to comprehend the catastrophe that never was, but consider this: when in the early 1930s banks were allowed to collapse, the unemployment rate in the US soared to almost twenty-five per cent and soup kitchens and shantytowns sprang up across the country.

Shoring up the banks during the financial crisis cost the US equivalent of 3.5% of gross domestic product (GDP), but since that time its GDP has grown by 45%, so it turned out to be a worthwhile investment. Governments around the world are now bracing for another bold response to head off the devastating impact of the coronavirus. The support needed is on a scale comparable to the economic loss, in the US case, a $2 trillion commitment equating to roughly 10% of GDP.

If this huge sum is to be funded by debt, should we worry? The short answer is no, because the cost of borrowing is at a historic low - the yield on ten-year US treasuries, or the interest rate being demanded by investors to lend to the US government, is just 0.7%. The rate on ten year UK government debt is lower still at 0.4%, while that of Germany is minus -0.4%. The interest on $2 trillion at present rates will cost the US annual interest payments equivalent to just 0.1% of GDP. No crisis ever arrives at a good time, but there has never been a better time to raise the trillions needed to rescue an economy from the edge of a precipice.

From the 1970s oil shock, early 80s and 90s recessions, 1987 Black Monday, 1997 Asian financial crisis, 2000 dot.com bubble, 9/11 and the 2008 global financial crisis, hindsight permits us to see how the world economy overcame past crises to grow from 18 to 89 trillion in fifty years . Every crisis was different, but every crisis ended in recovery. Whilst in the midst of a crisis, we lack the reassurance of knowing how and when it will end. But history is on the side of those investors who believed times would get better and backed the recovery.

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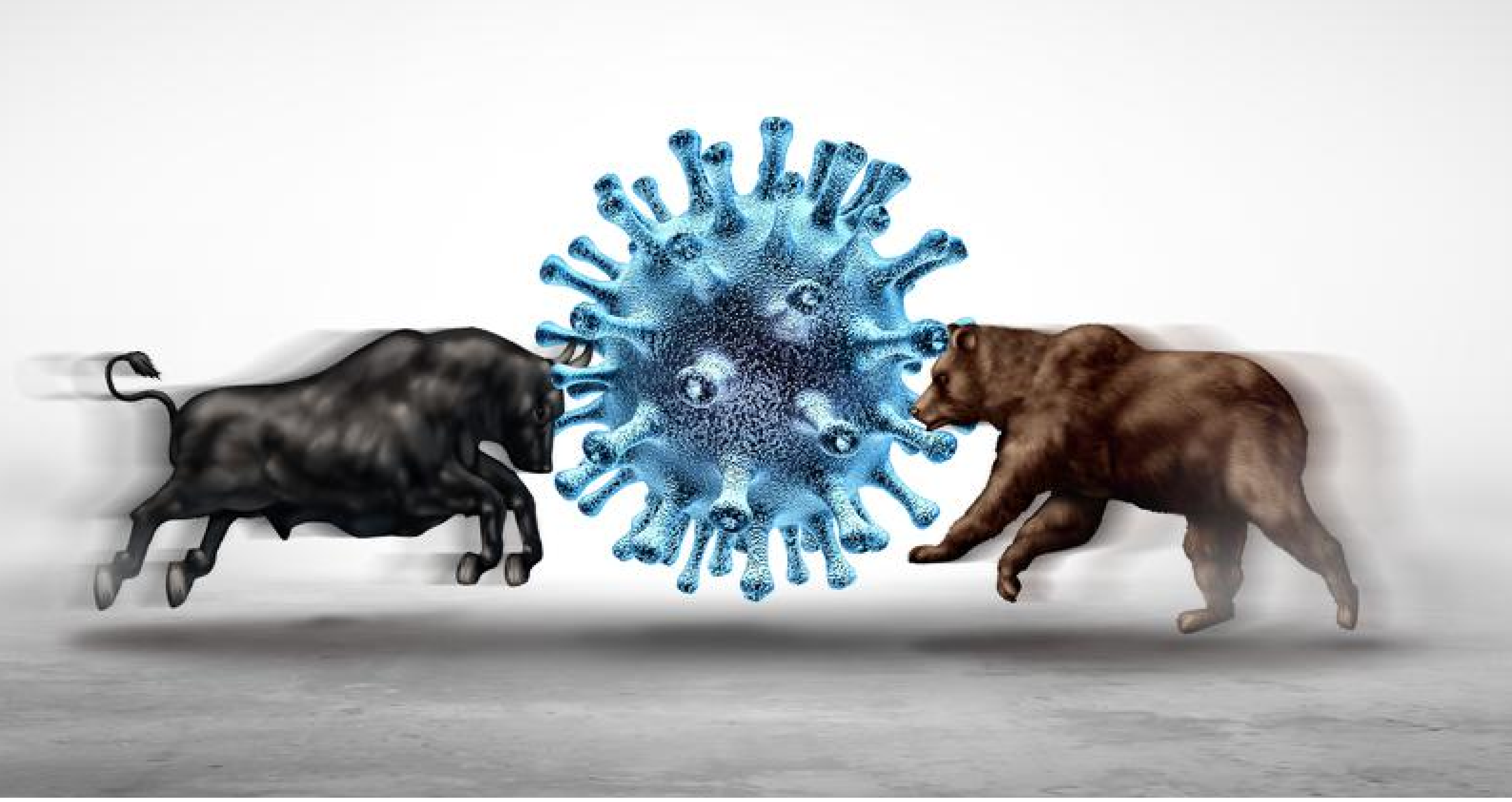

FEATURE ARTICLE TITLE

By Ridiculus Cras

INTEGER POSUERE ERAT A ANTE VENENATIS DAPIBUS POSUERE VELIT ALIQUET. MAECENAS SED DIAM EGET RISUS VARIUS BLANDIT SIT AMET NON MAGNA JUSTO ODIO, DAPIBUS AC FACILISIS.

In the early 1980s the US entered a deep recession, after inflation had risen to 15% and interest rates reached 20%. Unemployment unofficially hit 16%, while 10% of all US banks would go onto fail. The outlook for stock investors was so bad that Businessweek famously ran the headline 'The Death of Equities'. In 1982 one of history's greatest investors, Sir John Templeton, made a television appearance in which he made a bold contrarian prediction: the Dow Jones, then trading at around 800, would rise to 3,000 within the next ten years. The Dow breached 3,000 in 1991.

The coronavirus has brought on an onslaught of bad news, fear, and uncertainty. When something unexpected happens like this, markets fall in response to the supposed 'uncertainty'. But the reality is uncertainty was ever present - investors only had the illusion of certainty before because the risks were unknown, overlooked or just disregarded.

Now that the initial shock and panic caused by the pandemic is abating, the impression that stocks can do nothing but fall should likewise begin to abate. Investor sentiment will remain fragile however, veering between guarded optimism that an end is at least remotely in sight - and despair that such hope might prove false. This will cause markets to rally and then roll over to test former lows. This may happen repeatedly, until on the final occasion, the rise does not reverse. As with the bear market's beginning, almost nobody will recognise its end until after the fact. For those investors on the sidelines watching the rise in stock prices, the fear of being in the market will be superseded by fear of missing out.

By and large the problem for the markets now is one of numbers, the difficulty in finding a fix on the likely numbers of infections, mortality rate and consequent economic impact is responsible for the wild daily swings. Once scientists and economists can quantify the numbers with a degree of confidence, the financial markets will prove adept at pricing in the outlook two, three or four quarters ahead.

The turning-point in stocks fortunes will occur while news remains almost unrelievedly grim. Sir John Templeton famously argued the best time to buy is at this point of maximum pessimism, for he made his biggest gains during the twentieth century's bleakest moments.

Templeton first established his reputation buying up shares from panicking investors at the outbreak of the second world war. Over the next four years, his war-time portfolio would go on to quadruple in value. It was the beginning of his fortune and a spectacular investing career.

What is almost always left out from this oft repeated investment tale, is that in the first couple of years the outcome of Templeton's wager looked far from certain and investors with less fortitude would have bailed before it became a winning trade. Templeton had jumped in after France was invaded in 1940, as the Dow Jones got hammered - over an eight-day period it fell -23%. While US stocks rallied after that, the worst was yet to come, for in the summer of 1941 the Japanese attacked Pearl Harbour. The Dow sank again until by May 1942, it had given up all the gains of the previous eight years.

While fascism and totalitarianism enveloped Europe and was running rampant across the Pacific the US stock market unexpectedly turned upwards. There seems to have been no single event that triggered it. It was perhaps, the realisation among investors that once the US was fully mobilised for war, it would undoubtedly win. Amid fear, despair, and pessimism, a spectacular bull market had begun that would run for the next 24 years. The Second World War stock market bottom turned out to be one for the ages.

Templeton recognised that in the prices of stocks lay the single-most important determinant of success or failure. Counterintuitively buying stocks becomes more risky as markets rise and more rewarding when they fall. He was not afraid therefore to reduce his allocation to stocks to zero on occasion when stock prices were too high. He was also willing to invest everything in stocks when they traded at bargain prices. Insight over instinct led Templeton to buy stocks during the early 80s and 90s recessions, amidst what proved be the longest stock market bull run in history. Going against the crowd, he sold before the dot.com bubble burst and again before the financial crisis.

It is important to note that Templeton never tried to predict where the market was heading in the next few months. He was well aware that low valuations can go even lower (and expensive can become more so), so they should not be used as a market timing tool.

While bull markets feel good, it is in the inevitable bear markets that fortunes are lost and won.

Buy low and sell high sounds easy when markets are calm, but when we are being bombarded with bad news and a tidal wave of investors heading for the exits, we become too fearful, no matter how cheap stocks become. During the second world war, investors became so scared of stocks, even a 9.5% dividend yield could not entice them to buy. This behavioural shortcoming goes to the core of contrarian investing, doing what others can't, as Sir John Templeton proved time and again:

'TO BUY WHEN OTHERS ARE DESPONDENTLY SELLING AND TO SELL WHEN OTHERS ARE AVIDLY BUYING REQUIRES THE GREATEST FORTITUDE AND PAYS THE GREATEST ULTIMATE REWARDS.'

SIR JOHN TEMPLETON

ALL INVESTMENTS INVOLVE THE RISK THAT YOU MAY NOT GET BACK ALL THE MONEY YOU INVESTED.

THE VALUE OF AN INVESTMENT CAN CHANGE QUICKLY AND MAY GO DOWN AS WELL AS UP.

PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RETURNS.

INVESTORS SHOULD BUILD A DIVERSIFIED PORTFOLIO TO SPREAD RISK.

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