MARKET UPDATE

AUGUST 2020 MPU

The New Reality

There are so many headline grabbing statistics in these strangest of times that it is hard to know what to focus on. Let us start though with the dollar, which has just had its worst month in a decade and stimulated a hot debate on the reasons behind the fall and, perhaps more importantly, raised the question; does this signify the start of the demise of the dollar, the world's reserve currency? For most people, the answer is simple; no, it is not, but for others who have been foretelling of such a happening there is at last some (circumstantial) evidence to potentially back up the prophecy.

The real rates (yields) in the US (i.e. after inflation) are at record lows of circa -1%. Jerome Powell, Head of the Fed, commented at their previous meeting "We're not even thinking about, thinking about raising rates". This has led many investors to conclude that, for all intents and purposes, there will be no rate rises ever. This extreme rhetoric from the world's most influential central bank has helped power and support equities as well as precious metals. The gerrymandering of the markets boxes investors into a corner and leaves us all with some difficult choices.

Not only is this unprecedented real rate position unlikely to reverse any time soon, but it could become more radical with potentially even more 'guidance' issued in September's meeting. This is important because you cannot bet against the effects of something when it is almost certain to happen, that is not how markets are supposed to work, but that is the reality how they currently function.

With the expectation of more of the same medicine we can expect more of the same results, but at some point the combination of fiscal and monetary stimulus on an unprecedented scale is going to be inflationary and that is going to be the really tricky bit. All the assets, whose prices have risen majestically through the ongoing Covid -19 economic woes, could look eye wateringly expensive at the point where the economic effects of the virus are finally reversed. We strongly believe that day will come.

In conclusion, we went on record in our March webinar saying that we were "more bullish on equities than at any time in the previous decade". This situation and outlook has sadly become much more muted. The potential returns of sovereign bonds, which are used to offset the equity bullish trade, look derisory from here and have a higher level of downside risk than at most points in recent history. We would also highlight the often overlooked legislation which was rushed through by many countries to avoid the bankruptcies caused by the effects of Covid-19. There are a series of potential cliff edge dates coming up following the suspending of the obligation to file for insolvency. In Germany for example this date is 30 September 2020 and for some others it stretches into 2021. How this will play into defaults in the corporate bond space is yet unknown, but the risks are real. The paradoxical reality of an investors historically safest assets having such limited upside and very real downside re-emphasises the need for diversification of assets and investment styles. Investors should accept, as they have needed to in many points throughout history, that what has worked before and is still working now will not work forever. We will endeavourer not to succumb to the siren calls of recency bias. As an example, we bought treasuries as an asset for capital growth nearly three years ago when the 10 year was yielding circa 3%, at the time of writing it is yielding 0.55%, that ship has sailed unless you believe rates are going to -2.5%. We still believe they are going to zero, but that still doesn't leave too much more to go and alternatives need to be sought.

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