VERMEER

NEWSLETTER

July 2021

THOUGHTS ON 2021

And the beat goes on…

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- Markets continue their upward trend
- Re-opening benefits deferred
- Higher inflation is here now
- US retail investors banging their drums
- The emergence of SPACs
- US remains the key market

After focusing solely on inflation in the last quarterly review, we will return to our more normal format of discussing our current thoughts on the general economic situation and views on individual countries and markets. The general backdrop is unchanged with most asset classes continuing to make progress and dancing to the same tune that this piece is titled. None of our concerns on inflation, high valuations relative to history or the long-term impact of the pandemic have dissipated, but the low cost of debt, abundance of liquidity and paucity of yield mean the natural direction of markets remains up. Until the decision to reduce liquidity is taken and implemented and we start to understand the full implications of this unprecedented process then we see little to disturb this upward trend.

Unfortunately, we still must begin our piece with the ramifications of the Covid virus. It is both frustrating and disappointing that this is still the major driver of both economic and political discourse at the current time. The identification, development and roll out of vaccines has been a spectacular success and has given governments globally a set of options for the first time. However, the short-medium- and long-term effects of the pandemic will continue to dominate political and economic policy. The recent emergence of the delta variant means that although anticipated re-openings will still occur, they are likely to be on a more limited basis and the short-term costs and restrictive practises we have all experienced will continue in reduced form for the foreseeable future. As such the economic benefits of these re-openings will be more muted both at a macro level, and in terms of the improvements in corporate profitability.

Since we penned our piece on inflation in April, not much has changed. Markets initially became very concerned with the prospects of accelerating inflation and then as economic data mitigated slightly, the market adopted a more relaxed approach. Inflation numbers themselves have in fact moved up. Look around you for hard evidence of this, virtually everything costs a little more. At present the market is comfortable with the notion this is transitory and not permanent. We suspect and fear many governments, and more worryingly central monetary authorities, are hoping consumers in particular end up regarding a series of so-called transitory periods of inflation as acceptable. People often forget when inflation is coming down, prices are still going up albeit more slowly. The erosion to the real wealth and spending power that occurred during the period of high inflation is never recovered, unless there is a period of deflation, which is currently regarded as a mortal sin. Markets are obviously supposed to take a more sophisticated view than this, although recent evidence would suggest otherwise.

We like to keep our readers up to date on our views and thoughts of the way markets are currently operating. Many of you will have read about the emergence of a new type of investment vehicle known as a SPAC. Like many acronyms SPAC is just another useful way for the market to reintroduce a well-known concept which, despite an often-patchy track record, is presented with the tag “it's different this time”. The concept of the SPAC is as old as the hills, and many readers would recognise it as the same as the cash shell which has been present in markets for at least the last two centuries. There is nothing fundamentally wrong with the structure except where it is abused, normally through the promoter awarding themselves excessive amounts of free equity. This has been a purely US phenomenon and it has unfortunately allowed several companies to float on the US market without (in our view) the appropriate level of due diligence and at excessive valuations. Unfortunately, this has put pressure on other stock markets and governments to relax their listing requirements, including the UK. We view it as disappointing the UK has decided to succumb to some of these pressures. In our opinion it is another market which will substantially disappear as general liquidity levels reduce.

One of the reasons SPACs have enjoyed such spectacular share price returns, is they have become very popular with the US retail investor. Indeed, it has been one of the main features of the continued bull run in the US equity market, that the retail investor has moved very much to the fore front in determining share price movements. We have further evidence of this in an area that has become known as the Reddit or Robin Hood trade, where large numbers of retail investors have clubbed together to buy stocks where there is known to be a large short position and thereby accelerate price rises. Whilst we will not comment on the investment merits of such activity, it

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should be made clear the reason that retail investors often have such large amounts of capital to invest in these trades, is due to generous government support programmes during Covid and the fact many trading platforms are willing to extend large amounts of leverage to their clients, enabling them to massively scale up their positions. There is already evidence this trend is reversing, and we would expect a commensurate reduction in activity. It is however ultimately good news if there is more diversification in markets, particularly with participants who are prepared to take different views so we would hope any correction does not deter these investors permanently.

As regular readers of our investment pieces know we have previously expressed concerns on Bitcoin and cryptocurrencies in general. Being one of the few commentators to publicly express concerns, our comments have tended to gather repeated press coverage. We would reiterate views that none of the currently popular cryptocurrencies meet the basic requirements to be considered as true currencies. We do however believe the underlying blockchain technology which supports all the cryptocurrencies is a very interesting development, that will have applications across a wide number of markets - not just cryptocurrencies. In the meantime Bitcoin will continue to be a very volatile instrument. There are many inconsistencies and anomalies in the way it is traded and delivered to the market which will eventually normalise. It is unlikely to totally collapse in the current environment of excess liquidity, but any type of general market correction will severely test large number of inexperienced investors who had committed considerable amounts of capital.

Looking forward our thoughts on markets globally have not really altered during 2021. The first quarter did witness some nervousness around inflation and the future path of interest rates, and this led to a sharp rotation into the more value ends of most asset markets. As usual this soon reversed and, by the end of the first half, the same set of stocks which have driven the market for the last decade reasserted their dominance. We retain our belief it is increasingly important to hold a balanced set of assets within portfolios which reflects concerns on short term inflation but recognises that the vast amounts of liquidity around the globe will continue to support most markets.

We find the current position in the US an intriguing one. The difference between the current President and his predecessor could not be starker. Joe Biden has been even more low key than expected and he has quietly designed and laid out a relatively radical set of proposals around government spending and environmental issues in particular. His challenge is now to deliver these plans both in terms of political approval and translating macro policies into specific programmes and projects. The one area that both concerns and disappoints us is his relatively tough stance on global trade and relations, which is likely to leave to the continuation of more isolationist policies around the world, which will hinder the pace of post Covid global economic recovery. Overall, the US economy remains in rude health and assuming the vaccination programme continues successfully, and the country remains largely open, the only constraint on further economic growth will be the availability of labour. Like many developed countries the US must balance the split view on immigration, the low employment participation rates of parts of the population, with the desire to bring more manufacturing capacity and jobs back to the US. Corporate profitability will continue to improve as more parts of the economy fully reopen, but progress will appear more pedestrian since the subdued comparatives that the initial phases of the pandemic produced will start to dissipate. This will be a feature that is witnessed around the world.

The UK economy remains a bit of a muddle. Growth forecasts continue to change materially, and the government appears completely focused on addressing the Covid situation at the expense of making decisions on some of the more serious long-term issues eg social care, increased taxes, and the funding of public spending. The strength of the pound would suggest global investors are not concerned presently about the relative position of the UK economy, but again this might change as the world moves into the post-pandemic period and the ensuing reduction in global liquidity levels. We would reiterate the fact that the UK stock market is not totally dependent on the performance of the UK economy. The UK market has once again underperformed its global peers during the first half of 2021 and as such remains a relatively cheap market. The private equity sector has woken up to this fact and there have been many bids for UK companies from various private pots of capital. They are attracted by the low levels of valuations and the fact that that UK is the easiest market to transact both legally and politically. These factors, coupled with the fact that the cost of debt remains very low and that most private equity players have raised substantial amounts of equity, means we should expect many more household names to disappear from the quoted market in the coming months. Although this may be unappealing from a jingoistic viewpoint, it is just the natural evolution of markets. We find it ironic that many of the more vocal critics are institutions that are funding many of the private equity players making the bids.

The market which has disappointed us the most has been Japan. At the corporate and individual stock level nothing has really gone wrong, but a weakening currency and the continuing apathy of international investors means the Japanese stock market has once again lagged global pairs during 2021. Indeed, it would appear that international investors have withdrawn money from the market. We find this surprising given: the low level of valuations of many companies in Japan; continuing tangible evidence of better

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corporate governance; improving returns to shareholders; and the emergence of more corporate activity resulting in more restructuring, private equity bids and increased dividends. We continue to believe that the inherent value and quality within the Japanese market will be recognised.

On the other hand, one market which has been surprisingly healthy has been India. We are very attracted to the long-term prospects of India, but we have been pleasantly surprised by the robust response of the Indian stock market to the escalation of the Covid virus.

Finally, a request. Hopefully many of you will have listened to the new podcast service we launched at the start of this year – and which you can listen to via our website. We have attempted to discuss and explain what we regard as the key investment issues of the moment in a simple and light-hearted manner. Feedback from our client base and other interested parties has been encouraging and in future we intend to broaden our list of contributors, to include some of the external fund managers we respect and other relevant individuals. We would be very interested in any of your thoughts and comments and particularly suggestions as to how we may improve the service.

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