ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

> ***No matter what time it is, wake me, even if it's in the middle of a Cabinet meeting.***
> *Ronald Reagan*

Friday, 19 June 2020

In this week's Investment Insight

One the one hand...
Last week, on Thursday in particular, stock markets across the globe sold off strongly. The Russell 2000 fell by more than 7%. While there has been a reasonable recovery since then, the correction provided a stark reminder that markets have bounced substantially from the lows of mid-March, many would argue too much so given the economic risks that abound. There is so much that's inherently unpredictable about the outlook that one can convincingly argue both sides of the bull/bear case…so that's exactly what we do in this week's Inside Track.

Unprecedented presses
We have often discussed the implications of virtually unbridled money printing; indeed it features as one of the risks aluded to in The Inside Track debate this week. Could fiat currencies in general, not just the US dollar, be imperilled by the seemingly incessant and unprecedented activity at the money printing presses over the past dozen or so years? If so, gold might offer the only safe haven. In Pic of the Week we examine the interesting and indisputable correlation between gold prices and money supply.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: One day, maybe...

Are stock markets too cheap, too expensive, or fairly valued? All questions of valuation boil down to an assessment of expected return and risk. Uncertainties abound, but there are convincing arguments for both the bull and the bear cases.

There are several reasons to support a positive outlook for investment returns:

- The stock market doesn’t mirror the physical economy very precisely. Those sectors of the economy that are most directly impacted by the coronavirus are not the most material to the stock market. Hence, even if the broad economy suffers, it doesn’t necessarily drag the stock market down proportionately.

- The recession was triggered by an exogenous shock, rather than a systemic decline. The availability of a vaccine, into which vast efforts are going, should eliminate that shock. If earnings can recover by 2021/22 to levels they were at in 2019, then given the long-term nature of the cash flows implicitly embedded into share prices, equities should not be marked down significantly due to this exogenous and finite factor.

- Central banks the world over have reacted quickly and aggressively, flooding the financial system with liquidity. However, governments have supplemented this with extensive fiscal supports that should provide a more direct and effective stimulus to “main street” as well as increasing the velocity of money.

- Interest rates are at or below zero which provides a strong disincentive to saving and, by the same measure, a strong incentive to investing, thereby supporting equity markets.

And on the other hand…there is no shortage of the thing that investors hate the most – uncertainty:

- There are nascent signs of “second wave” outbreaks – Beijing and Florida being just two examples – the practical impact of which is not yet known. While preparedness is much greater than it was for the first wave, it nonetheless has the capacity to mess with supply chains as restrictions on movement are imposed.

- Thus far, despite the vast efforts, there hasn’t been a convincing vaccine breakthrough, and perhaps there won’t be.

- The political environment in the US is wracked with an abundance of variable outcomes. Congress will have to pass further coronavirus reliefs, the budget deficit will balloon further and all of this against a backdrop of the latter stages of a very divisive and divided election campaign.

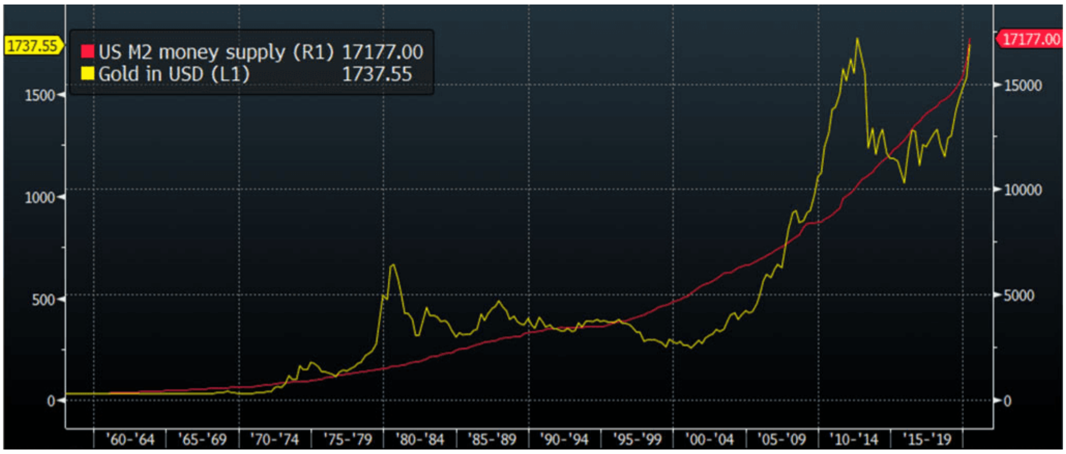
- Someday, somebody has to pay for the endless money printing…or maybe not? Depending on whether you subscribe to the “modern monetary theory” or your more of the neoclassical bent, there could be a large bill to pay at the end of all of this. Higher taxes, inflation, higher interest rates could all feature.

- In a worst case scenario (we hope!) economic Armageddon could ensue as a consequence of the extensive fiscal and monetary policies being used to beat the coronavirus shock to the economic system. Loss of confidence in and consequent debasement of the US dollar could deal a painful and lasting blow to the world’s largest economy.

So what does one do in the face of such contrasting possibilities? Untempered subscription to either camp is fraught with peril; the sensible answer is to adopt a balanced approach commensurate with your risk tolerance, return objective and time horizon…and then relax.

Pic of the Week: Unprecedented presses

In an era where all countries are printing money at will to accommodate deficit spending, what happens to the only hard currency out there, gold? The chart below shows the price of gold in dollars (yellow) against US M2 money supply in USD trillions (red) from 1960 to the present. It would seem the more they print, the more gold goes up, largely because you can’t print gold. Even a glance at the chart will serve to remind you that for long periods of time gold is a costly luxury - yielding nothing and ofen falling in value. Every now and again, however, about once per generation, it's the safest place to be.



Newswire

...on Monday
Easing a standoff on travel restrictions, US & China agree to allow four weekly flights between the countries.

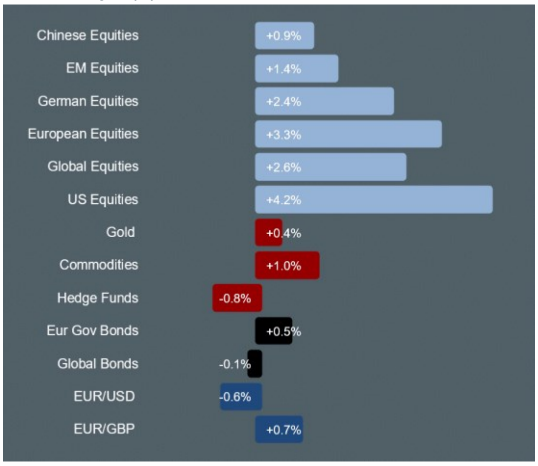
...on Tuesday
European shares record their best day in a month.

...on Wednesday
Amazon launches a website for shoppers in Saudi Arabia.

...on Thursday
The NTMA completes the auction of €750 million of six-month Treasury Bills at a yield of -0.49%.

Market View

Last 7 days (€)



Year to date (€)

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