Amplia Monthly Investment Letter

Stock performance differences widen

July marked a continuous recovery for US equities, with most of the American main indices clocking considerable returns: S&P500 5.64%, NASDAQ 6.85% and Dow Jones 0.74%. On the other side of the Atlantic, the tune was more muted. Euro Stoxx 50 posted a total return of -1.85%, with DAX being flat (+0.02%) and SMI also finishing the month mildly negative (-0.37%).

This performance dispersion may sound a bit counterintuitive, given the troubles the US is facing in the COVID-19 fight and the historical EUR 750bn COVID-19 recovery deal that paves the way towards a European fiscal union.

Looking closer to the performance however, part of this can be attributed to the different sectoral breakdown of the indices: the two worst-performing sectors of S&P 500 in July, energy (-5.13%) and financials (+3.77%) command a much higher weight in Euro Stoxx 50 than in S&P 500. Also, the fiscal progress in Europe catapulted the euro higher, with EUR/USD gaining 4,84% in July alone. The dollar weakness in turn will improve the operating margins of American companies in the months ahead and this in its turn the equity prices.

Treading the path of gradual recovery

Meanwhile, the macro economic development has been somewhat more positive on the whole than what the market consensus had expected. Caixin July China manufacturing PMI came in at 52.8 yesterday which marked the highest reading since February 2011. The same pattern was evident in Europe where Eurozone composite PMI also recorded the highest level since June 2018. The recovery in export orders, combined with stabilising labour markets imply that the economic activity has bottomed in most developed economies.

Poor consumer confidence numbers – which will likely remain weak as part of the lock-down safety measures are re-introduced – mean in turn that the recovery will remain slow and steady, not V-shaped. Nevertheless, the governments are incentivised to keep up the existing stimulus measures, as evidenced by the bipartisan support in the US for the "stimulus checks 2.0". Neither the governments nor the central banks have run out of ammunition in their zealous provision for fiscal and monetary support. Ironically, debt issuance and fiscal deficits that normally would be deemed reckless by markets barely draw anybody's interest now. Southern European EMU states, usually the most suspicious issuers in the developed world, got a massive boost of confidence from the latest EU fiscal agreement. Not only is their bond issuance guaranteed by EU-wide means, they will also receive a considerable direct support from the richer member states that will be funded by direct taxation in all states.

Fiat money continues to become more notional

Generally, the new normal in the developed world sovereign bond markets is TINA (there is no alternative). The last bastions of countries with at least some nominal interest rates attached to their public debt, Canada, Australia, New Zealand, the US and the UK, all have seen their 10-year government yields falling clearly below one percent, in many cases close to zero. In the absence of inflation pressures and practically zero borrowing costs, bond issuance is set to continue. Because the short-term rates are still lower than the long-dated ones, these bonds will attract buyer interest. On top of central banks that practice their quantitative easing, pension funds must adhere to their rules of having a considerable proportion of assets in high-rated bonds in their home currency. Also, other institutional investors and certain hedge funds still use government debt to seek some portfolio diversification and avoid negative deposit rate charges.

In such a dire environment for the yield-hungry investor, it is no surprise that equity, selective real estate and gold prices are creeping higher. We would recommend gold as one portfolio hedge for such investors who do not share our view about the continuing economic recovery and who would want to sell out of risky assets.

Our markets positioning

With regards to emerging markets, the recovery has also begun (especially in South East Asia) but remains uneven. EM equity valuations look attractive, and the USD weakness should help these economies. Nevertheless, we maintain a neutral stance on EM equities because second COVID-19 wave shocks could hit individual regions hard and the fiscal room for manoeuvre may be limited, unlike in the developed world.

Based on our expectation of a gradual recovery, we continue to favour equity sectors that are less vulnerable to unexpected shocks and rather rely on secular trends. These include IT, communication services, health care and consumer discretionary (especially the luxury producers). We would underweight companies with leveraged balance sheets or locally generated turnover, irrespective of the sector.

The development in credit markets has continued to be positive, despite the spreads falling at a much slower pace in July than in previous months, both in the Eurozone and the US. The performance has remained twofold, with investment-grade and most liquid issues already having corrected upwards, whereas sizeable parts of the high yield market continue to trade at subdued levels. We are neutral on fixed income as a whole, with a small overweight for high yield and small underweight on emerging market debt.

As to foreign exchange, the European fiscal pact broke many dams, sending the euro considerably higher vs. the US dollar. EUR and GBP may well keep climbing higher unless a new risk asset sell-off derails this trend. The big political events of the autumn (US presidential election, culmination of UK-EU trade talks) should ensure that currency volatility stays higher than in the past few years. CHF remains a good hedging tool for short-term purposes, as the interest rate disadvantage of the franc has practically evaporated, as explained above.

In Zurich on 5th August 2020,

with kind regards

Juho Kivioja