Amplia Monthly Investment Letter

Sweet late summer for equities

Equity investors can enjoy an early harvest this year, at least if measuring the growth of investments planted in the spring months following the COVID-19 outbreak. The US equity market shone in the limelight, with Dow Jones and S&P 500 rallying 7.6% and 7.0%, recording their best August month since 1984 and 1986, respectively.

As so many times this year, the technology sector was the driving factor behind the gains: NASDAQ jumped 9.6%, also marking its best month since 2000. Meanwhile in Europe the ride was positive although the tune was more muted: Euro STOXX 50 gained 3.1% and the Swiss SMI index 1.3% only. Although the performance differences can partly be explained by differences in the constituents of the indices, in our view the falling USD was the main contributor this time. For example, the euro gained 1,34% versus the greenback. Not only makes the USD weakness American equities cheaper in local currency terms for foreign investors, it also boosts the operating margins of those US companies that derive a share of their earnings abroad – something which basically applies to all large companies listed in New York.

Historic changes in US monetary policy

The US central bank Federal Reserve convened to its annual Jackson Hole conference last Thursday, 27th August, to discuss the course of its monetary policy. This year's event provided for plenty of topics of debate. The Fed's chairman, Jerome Powell, effectively revised the central bank's monetary policy framework entirely. Mr. Powell set a new milestone in central banking by re-defining Fed's dual task as a more "broad-based and inclusive goal" for maximum employment and the flexible use of "average inflation targeting," allowing monetary policy to "aim to achieve inflation moderately above 2 percent for some time" after periods when inflation has been below that level.

In plain English, this reformulation means that the Fed will allow inflation to overshoot the historically sacred two per cent mark for "some time" which can be – according to our understanding – years, or indefinitely long periods of time until inflation expectations have safely returned close to two per cent. It effectively denounces much of the work of Mr. Powell's predecessors, from Mr. Bernanke to Mrs. Yellen, as having been too aggressive, with too much focus on curbing inflation and too little flexibility to let the economy run on all engines for longer.

Combined with the current, historically low Fed funds target rates and the continuous balance sheet expansion to secure the former, the fact that inflation is allowed to run free should boost inflation expectations. Although consumer and producer inflation will likely remain muted due to the numerous uncertainty factors (COVID-19) that exist for now, asset price inflation should gain in strength following this announcement.

Because the Fed commits not to intervene in the short run, the only real hurdle that prevents asset prices from shooting higher from here is investor psychology. We would expect the valuation multiple expansion to continue: with more and more money flowing into the markets for risky assets, there will be more money chasing the same euro of earnings. In the big picture, this flood of cheap money should continue to overshadow other traditionally important economic leading indicators.

Arguably, the inflation pressures will eventually balloon, cheap money create disclocations of capital and social inequality deteriorate. However, at the moment we are far from seeing the peak of the money flow into the markets. Therefore, we remain comfortable with our overweight on equities, despite the usual political risks looming behind the corner: US election and US – China sabre rattling.

Our markets positioning

The patchy road to recovery for most of emerging markets has become a fact as well, as evidenced by improving PMIs and other positive signs from industry, in particular. Yet there are considerable differences, with India on one hand witnessing low activity and record numbers of new corona infections and China's economy meanwhile seeming to gain steam. Hence, we advocate keeping emerging markets in a neutral weight and being geographically selective when choosing equity investments.

As to equity sectors, our call to focus on secular trends (IT, communication services, health care and selective consumer discretionary) continued to bear fruit over the summer. We remain comfortable with these sectors whilst keeping a moderate underweight on the lagging ones, especially energy, utilities and – to an extent – telecoms.

On bond markets, especially Nordic bonds saw considerable inflows in July and August. This is welcome news to the sector that has so far this year been driven more by flows than underlying credit metrics. Also in a pan-European context, high yield spreads contracted to the lowest level since 5th March, albeit still noting agonisingly higher than in the beginning of the year. In North America, the pattern is exactly the same. We remain neutral on fixed income as a whole.

Gold trades at close to USD 1940 per ounce. Despite its steady climb since March, we would expect the rise of gold to continue because of low alternative costs (interest rates) and increased money supply. The price rise should however be more modest than with equities because of possibility to activate idle gold mines to boost supply amid rising prices.

With regards to FX, the USD keeps losing ground against the currencies of its main trading partners, as mentioned above. We would expect the upcoming US election to bring the USD downtrend at least to a temporary halt. Also generally, with a lot of institutional investors having bought considerable protection against equity market surprises at a high cost, diversifying one's currency exposure towards safe-haven currencies of JPY, CHF and USD remains a cheap portfolio hedging tool.

In Zurich on 4th September 2020,

with kind regards

Juho Kivioja

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