Amplia Monthly Investment Letter

A downbeat January

Global stock markets moved slightly lower in January, with S&P 500 and Euro Stoxx 50 closing 1.11% and respectively 2.00% lower than where they began the year.

The slide can be attributed to mainly two things: the rather unanticipated delays in vaccine deliveries and spreading of new COVID-19 variants that prompted many European countries to impose stricter lockdowns for longer.

Recovery delayed, not derailed

As usual, some market observants were keen to interpret the slide of the markets as a sign of deeper gyration under the surface. Frothy valuations and signs of a market bubble were cited following the duel of Robinhood retail traders versus hedge funds on a few single shares.

In our view, the market reaction however was this time rational because the sell-off was not massive and the markets reacted to the information. The coinciding shortage of vaccines combined with new virus strains turned Eurozone 4th quarter economic growth negative. If the lockdowns persist, the recovery in the running quarter is also at risk, and a technical double-recession looms. However, we think this is a mere delay that investors should discount as something temporary and focus on future cashflows instead of the present.

First, the 4th quarter earnings season has started off very well. Of the 500 firms of S&P 500, 186 have so far reported, with 82% of the companies beating the street expectations. Also, the magnitude of the earnings surprise has been considerable, with reported aggregate income coming in 19.29% over consensus estimates. There is admittedly strong regional fluctuation with regards to the level of earnings, with the Japanese Nikkei 225's companies posting even a stronger aggregate earnings surprise (24.68%) whereas the pan-European Stoxx 600 (-19.69%) reflects the lock-down blues of the old continent.

Second, the vaccination programs are progressing and any bottlenecks in deliveries should be solved soon. Most of the approved vaccines have proved to be effective against the new virus strains, which speaks for a reopening of (European) social gathering venues in the upcoming months. Globally, the 7-day moving average of daily new COVID-19 infections has dropped from its peak of 745'682 on 11th January to 522'508 at present, signalling that the worst may be behind us. Again, strong regional differences are evident here. Whilst Eurozone GDP is contracted by 5.1% p.a. in the final quarter of 2020, the real GDP of China and USA grew by 6.5% p.a. and 4% p.a., respectively. Even the logistics problems resulting from the current shortage of containers and the spike in freight prices are transitory phenomena and will vanish when the supply glut from China is cleared.

Third, the policymakers once again have re-iterated continuous support to the economy. Most notably, the ECB kept its policy unchanged in January after stepping up its Pandemic Emergency Purchase Programme (PEPP) in December by EUR 500bn to EUR 1'850bn and prolonging it until March 2022. The same message could be heard from New York on 29th January, when Fed's Powell noted the bank was nowhere near exiting its equally massive bond-buying program. The program runs at $120bn of purchases per month, until "substantial further progress" towards the central bank's employment and inflation goals are made. A few weeks earlier, the US congress finally passed the $900bn additional stimulus package.

Considering this relentless support and the good funding conditions, risky assets should have room to go higher, even if the recovery now were temporarily bogged down by virus fight setbacks in some parts of the world.

Our current asset allocation

We keep our overweight on risky assets, most notably listed equities. With regards to geographies, we favour stocks from North America and Emerging Asia, as Europe grapples with a new set of problems. The sectoral rotation from defensives to cyclicals may well resume again, if the virus variants are kept in check and the recovery continues. Still, rather than looking only for what is cheap, we maintain our preference on companies with dominant brands and market positions because these can generate good results in any operative environment.

Following the Democrats' victory of the US Senate as well, Biden administration is much better positioned to drive through its green deal agenda. We have reacted to this by overweighting growth and ESG stocks, especially those that focus on semiconductors, electric vehicles, and the various forms of green energy.

In terms of fixed income, the latest announcements from the leading central banks should keep the yield curves in check. For USD-based investors, both investment grade and high yield bond issuance has been abundant in January, offering good alternatives to choose from across the globe. For EUR-based bond investors, our preference would be to go for global bonds in a currency hedge form, as the EUR may continue its climb against the USD if the recovery continues. Going out in the yield curve to 5-10 years may be warranted for portfolio management and hedging purposes because longer maturities carry a higher yield, and the interest rate duration serves as a proxy hedge for falling equity markets.

As to other asset classes, as long as the central banks remain accommodative, gold, platinum, silver, various cryptocurrencies and many other stores of value can see their price rising. At the moment it feels like imagination is the only thing limiting the rise of various asset classes. The reason is easy to understand: ultimately, money flows from real economy to financial assets thanks to accumulated savings and debt. Some of the target investable assets however lack the traditional virtue of a good investment: quantifiable future cashflows that can be discounted to the present. Hence, we would not be surprised to see some of the new trendy assets lose their shine, similar to the tulip mania of the Netherlands in 1637. Meanwhile, we shall continue our work of trying to find good companies and diversify our risks.

On 2nd February 2021,

with kind regards

Juho Kivioja

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