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Courtville Partners – Investment Outlook, July 2020

Summary of the key points in this quarter's Investment Outlook

- Markets have resembled rollercoasters over the last four months, testing investors' nerves to breaking point.
- We suspect the decade-long period of outperformance from the US stock market may coming to an end.
- We are also worried that the US dollar is entering a secular phase of weakness.
- We reiterate our advice to tilt equities exposure away from the US and Europe and towards Greater Asia, particularly Japan and China.
- In the longer term we see inflation as the biggest risk to investors' wealth.
- We have increased our weightings in cash and gold, both of which we prefer over bonds as diversifiers of portfolio risk.

We call them rollercoasters; but for Italians they are *montagne russe* – literally "Russian mountains" – a phrase that derives from the sledding hills carved out of ice in St Petersburg in the 16th century. With gradients as steep as 50 degrees, you would have needed steely nerves to ride your sled down them. In the same way, investors have required all their fortitude to stomach the markets' gyrations this year. Global equities fell 35% in just 28 days up until 23rd March (Lock-up Day here in the UK). In the process they established a new record for the quickest peak-to-trough bear market. But since then stock markets have zoomed up a staggering 42% and are now just 10% below their all-time peak on 12th February. Equities haven't experienced a more abrupt rise in our lifetimes – not on this scale, anyway.

Writing three months ago and only a few days after the point of maximum compression on the equities rollercoaster, we nailed our colours to the mast: "Do not run away from equities as an asset class. On the contrary, be brave and embrace equities for what they are, namely stakes in real, tangible, productive entities, many of which will still be able to generate returns for their owners above the cost of their capital. That said, tilt equity portfolios away from the West towards Greater Asia."

Although this has proved to be good advice over the last quarter, we claim no credit – for the simple reason (we cannot say it often enough) that we have little idea where stock markets are going over the short term. Let's be charitable and say that we have been right for the wrong reasons. It doesn't mean we haven't been surprised by both the speed and scale of market movements since March. The world's economy is facing the deepest recession in history; but stock markets are partying like it's 1999. Perhaps our surprise is naïve given that the driving force of the second quarter boom is easy enough to spot: the unprecedented fiscal and monetary responses from governments. In the US, for example, the Federal Government has unleashed measures worth $3.7trn. As a number it is incomprehensible, but weighs in at roughly 20 Marshall Plans or four Vietnam Wars. Is that big enough for you? As one commentator put it, governments have thrown all caution to the wind and have been printing money as if the world is coming to an end... But it isn't. So what will the consequences of all that money-printing be? We'll come back to this.

In the meantime, it seems appropriate to restate our profound belief that investors should ignore short-term movements in markets, however spectacular these may be and however hard it is to skip the firework show. Equities are for the long term. It is over periods of many years that

investors reap their rewards. To paraphrase Pascal's most famous dictum: the equity investor's problems all stem from the inability to sit quietly in a room alone.

For most of the last decade US equities have dominated the performance leaderboard, outperforming non-US equities by a whopping 7% p.a. compound. And US technology stocks have again led the way out of the March abyss: the NASDAQ has risen a cool 51% from the bottom. Much of that performance has come from the mega-cap stocks (Microsoft, Apple, Amazon et al.). If recession is likely to lay waste to corporate earnings, then it makes sense (sort of) for investors to concentrate on growth, especially if that growth comes with a heavy dose of technology. (We're all Zoombies now, aren't we?) But enough is enough. US stocks now trade on steepling multiples, at least relative to the rest of the world. We have come to the view that the US market's long-running global leadership may be in its twilight. We see several reasons for this.

- Combining mammoth fiscal manoeuvres with existing ultra-loose monetary policy may well lead to a more volatile macroeconomic environment. If this translates into more volatile corporate profits, then the premium enjoyed by US equities in return for their perceived earnings stability will be under threat.

- Corporate America is still highly indebted. Renewed volatility of earnings may test some corporate balance sheets to destruction, which would be bad news for US banks, among others.

- As we have already mentioned, the performance of US stock market aggregates relies more than ever on a relatively small number of monster-cap technology stocks, some of which are vulnerable to heavier regulation or even antitrust action.

- The US dollar may be set for a period of relative weakness. Rates across the yield curve are much lower than they were even in the second half of 2019. Meanwhile investors are starting to fret about the Federal Reserve's independence in a "whatever-it-takes" environment.

- Share buybacks (not just by the technology leviathans) have helped propel US equities to vertiginous levels. According to Absolute Strategy Research, US companies have bought back $5 trillion of their own shares over the last decade, which eclipses even the Federal Reserve's bond-buying programme ($4 trillion over the same period). If the roof is going to fall in on corporate earnings, balance sheets will need bolstering, which in turn makes buybacks much less likely from here.

- And then there is the looming presidential election. Victory for Trump may bring with it more trade strife, especially with China. A win for Biden could spell trouble for sectors such as technology and healthcare.

If US equities seem less attractive and government bonds everywhere offer derisory returns, where else should investors be looking? If sovereign bonds no longer do service as non-correlated diversifiers because of the risk to capital once yields rise, both cash and gold emerge as investments by default. This explains *inter alia* the high level of cash (19%) in our Model Portfolio. Some argue that Eurozone equities look more attractive in the wake of its "Hamiltonian" decision to allow the European Union to issue bonds in its own name and – crucially – to raise its own tax revenues with which to service the debt. We remain sceptical. Full fiscal and banking union, both of which

are needed to underpin the single currency, still seem an unlikely prospect. Instead, we continue to prefer equities in Greater Asia, especially China and Japan, where economies are emerging relatively unscathed from the pandemic – relative to the West, anyway. In a world starved of growth, Asia simply offers better prospects in this regard. Chinese sovereign bonds also look relatively attractive, as we argued in April.

So what happens to the gazillions that governments have pumped into their economies? We still see inflation as a major medium-term risk, though probably not until the recession now underway has played out. Never in human history has so much money been chasing so few goods and so few financial assets. Sceptics will argue that central banks printed money like crazy in the wake of the financial crisis of 2008; and inflation has yet to stir 12 years on. Fair enough. The difference now is that central banks are printing money to fund directly governments' Covid-induced spending splurges. In 2008 most of the newly printed money went into financial assets, whereas this time much of it is being injected straight into the real economy via furlough programmes, new bank lending schemes, VAT rebates, etc. In the absence of additional economic output, the velocity of money is bound to rise, driving prices higher. On the macroeconomic front there are warning signs aplenty, such as the weaker US dollar – which has roughly the same effect on the rest of the world as a tax cut. Energy prices remain low in absolute terms for now, but could easily rise once economies begin to recover.

Whether investors fear inflation or not, they would do well to keep a weather-eye on the prices of oil and – of course – gold. The latter has risen 25% in a year, outperforming every major currency in the process, and is now within a whisker of its all-time high (reached in September 2012). Is the gold price trying to tell us something? It feels like it.

And finally… What do Russians call rollercoasters? "American mountains," naturally. Everything is relative.

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Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	16	18.8
International Equities	42	41.8
Fixed Income	12	21.4
Alternatives	11	10.1
Commercial Property	0	0.5
Cash	19	7.4
Total	**100**	**100**

Courtville Partners Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC
UK Equities		**16**	**-6**	
UK	VUKE LN	8	-3	0.09
UK	VMID LN	8	-3	0.1
International Equities		**42**	**-4**	
US	VUSA LN	11	0	0.07
	XDPG LN	11	-2	0.09
Euro	VERX LN	2	-1	0.12
Japan	VJPN LN	5	-1	0.19
Asia	VAPX LN	6	1	0.22
China	IASH LN	4	1	0.4
Emerging Markets	VFEM LN	3	-2	0.25
Fixed Income		**12**	**3**	
Government Bonds				
Index Linked Gilts	INXG LN	4	0	0.25
China	CNYB NA	3	0	0.35
Corporate Bonds				
US	CORP LN	5	3	0.2
Alternatives		**11**	**1**	
Gold	PHAU LN	4	0	0.39
Infrastructure	INFR LN	4	0	0.65
Water	IH20 LN	3	1	0.65
Commercial Property		**0**	**-3**	
US	IUSP LN	0	-1	0.4
Europe	IPRP LN	0	-1	0.4
Asia	IFAS US	0	-1	0.59
Cash	GBP	**19**	**9**	0
Total		**100**		**0.18%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2020 YTD	-3.0%	-0.3%	-2.7%
Since inception(1/1/2015)	49.2%	45.8%	3.4%
CAGR	7.5%	7.1%	0.4%

The value of your investments can fall as well as rise, and you may not get back all the money you invested.