

A question of trust

15th February 2021

“MacReady: How you doin', old boy ?

Blair: I don't know who to trust.

MacReady: I know what you mean, Blair. Trust's a tough thing to come by these days. Tell you what - why don't you just trust in the Lord ?”

- From John Carpenter's *The Thing* (1982), screenplay by Bill Lancaster.

Asset allocation is pretty easy as at Q1 2021. In other words, avoid bonds like the plague, and buy cheap stocks. (Yes, they do exist – you just have to be looking for them, as opposed to riding the indices and benchmarks like one of the Gadarene swine.)

If the enormity of the bond market horror show is difficult to convey in words, it will be even more difficult for pension fund managers investing conventionally (i.e. owning boat-loads of bonds) to explain to their investors, using words, when the ship finally founders with all hands on deck. Perhaps they will be able to explain away their performance through the medium of interpretative dance. We don't invest thematically, but if we did, buying into listed legal firms ahead of a tsunami of claims by disgruntled pension fund investors seems like a decent bet for the next half-decade, at least.

Bond markets, how do we hate thee ? Let us count the ways..

In his January 2021 piece *The nine most terrifying words in the English language*, Kopernik Global Investors' portfolio manager Mark McKinney makes a pretty brutal case for the prosecution. It includes the following stats:

- 35% of all US dollars in existence have been printed in the last 10 months
- The US has increased its debt load by 170% in 12 years and expanded its money supply by 4 times over the same period
- 30% (\$18.5 trillion) of global bonds now have negative yields

It gets worse when you look at the tech sector rather than just the broad market. Last week's commentary featured the following doozy:



But if we just stick to the broad market, the weather doesn't get substantively better. The veteran investor Howard Marks:

One of the smartest things I have learnt was back in the early 70s and wise investors said to me that there are three stages to the bull market, the first stage when only a very few foresighted people began to believe there could be improvement. The second stage when everybody knows things are getting better. And the third stage when people believe things can only get better forever. It is important to know which stage we are in and the wise man acts in the first stage and gets great bargains because there is no optimism in prices and the fool overpays in the third stage because there is no pessimism and excessive optimism. So where are we? We are certainly not in the first stage, we are probably not in the second stage. We have to worry about being in the third stage and that is why I think it is important to be cautious.

As asset managers and fiduciary investors managing irreplaceable capital, our primary responsibility is to be cautious. So we eschew bonds, and we concentrate our equity firepower instead on listed businesses with some clearly definable characteristics, such as:

- Principled, shareholder-friendly management, who happen to be value-accretive asset allocators
- Having little or no debt
- Currently generating objectively robust cash flow, but trading on relatively modest earnings multiples
- Operating in the 'real assets' and commodities markets is currently no bad thing, given our fears about inflation.

The question of trust is a core one today. Politicians, by and large throughout the West, most notably in the Anglosphere, have made an absolute pig's ear of dealing with the coronavirus. We would rather trust Sweeney Todd to give us a quick short back and sides than allow modern politicians within a million miles of the economy, but we all have to play the hand we're dealt. As George Bernard Shaw once commented,

You have to choose between trusting to the natural stability of gold and the natural stability of the honesty and intelligence of the members of the government. And, with due respect to these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold.

So we don't trust politicians. We don't trust overvalued 'meme' stocks. We value committed free market capitalist entrepreneurs, we trust in price discovery as far as central banks will allow it, and we trust gold.

Tim Price is co-manager of the [VT Price Value Portfolio](#) and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries [here](#). You can listen to our regular 'State of the Markets' podcasts, with Paul Rodriguez of ThinkTrading.com, [here](#). Email us: info@pricevaluepartners.com.

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