PRICE**VALUE**PARTNERS

This too shall pass **9th August 2021**

"To all the silent good people watching our society tear itself in two, this essay is for you.

Those in charge have long since signalled that they have no intention of returning to a liberal democracy founded on the recognition of inalienable individual rights and freedoms. If data were the ingredient required to confront them, they would have folded long ago. They are impervious to data. This isn't about a virus. This is a psychological game and it's all about power and control."

- Julius Ruechel, *The Emperor has no clothes: finding the courage to break the spell*.

If you don't know who you are as an investor, the stock market is an expensive place to find out. The last 18 months will have been testing for huge numbers of individual as well as professional investors. How to make sense of where we are, and what lies ahead ?

Admittedly, nobody saw the Wuhan Virus "pandemic" coming. In his 20 risks to markets in 2020, for example, issued by the Deutsche Bank economist Torsten Slok, the idea of a global healthcare emergency did not even feature.

But while nobody foresaw the precise nature of the pin itself, there was plenty of evidence about the increasingly fragile nature of the balloon. The global financial system had become increasingly precarious since the Global Financial Crisis of 2008 ushered in a decade of extraordinary monetary accommodation, debt issuance, bailouts of zombie banks, taxpayer-funded support for "crapitalism" (crony capitalism) and a host of other financial shenanigans egged on by clueless central bankers and politicians. The world economy was already slowing markedly before something called Covid-19 entered stage left. Now it has been plunged into the freezer. Pay no attention to the dead hand of the Big State behind the curtain.

As that old Irish "joke" has it, for anyone looking for directions, you wouldn't willingly start from here. Nevertheless, here is where we are.

Everyone's risk appetite and investible time horizon may well be different, so the following is not meant as financial advice, so much as simply a summary of what we're positioned for, for our own investment clients.

We have long regarded bonds in any form as uninvestible, as return-free risk. The pandemic may yet put fixed income assets conclusively to the sword – in a frenzy of uncontrollable inflation. We have already seen interest rates slashed to the bone. Fiscal stimulus has been the next big bazooka to be unveiled. For those wondering about the macro outlook, the jury now seems to be in: as we have already seen courtesy of the "pandemic" response, first a global deflationary shock, then "the Mother of All Stimulus" (MOAS) to avoid riots in the streets. We may yet get those anyway. So since spring 2020 we have not sold our (relatively modest) equity holdings altogether, but rather we have rotated out of industrial cyclicals – and into the shares of sensibly priced precious metals mining companies and commodities companies more generally. Gold miners got whacked in the immediate Coronavirus panic, but their input costs (e.g. oil) also largely collapsed at the time, and their margins are now actually expanding. Gold bullion also looks like a genuine safe haven to us. You can print as much money as you like (25% of all the dollars *ever created* were printed in the last 12 months), but you still have to prospect for gold. At the time of writing, temporary weakness in the gold price can perhaps be attributed to distress selling by leveraged institutions desperately whacking the one ATM they can still access, to pay for margin calls incurred elsewhere. Or, perhaps, to gold being sidelined by a second or third wind of cryptocurrency enthusiasm.

We remain committed to 'value' stocks, which we define as highly cash-generative firms that are growing operational earnings with little or no leverage, but whose shares are trading at objectively attractive valuations relative to those operations.

Our other line of defence is systematic trend-following funds, one of the very few types of trading vehicle that is perfectly content to sell when the markets are falling. Most managers of UCITS funds lack that luxury. Trend-followers were probably a little late adjusting their books as Covid-19 wreaked its malign magic during 2020 and H1 2021, but most trend-followers may soon be net short the stock market. If you have fears about a fully-fledged market collapse, these funds should help. In any event, their historic correlation to either stocks or bonds is either zero or slightly negative: portfolio diversification helps.

Beyond that, it comes down simply to being patient. The human and economic cost of the "pandemic" is already grisly and likely to get worse. If you're not diversified now, when should you be ?

Charlie Munger, Warren Buffett's right hand man at Berkshire Hathaway, was interviewed by the BBC in the immediate aftermath of the (2008) Global Financial Crisis. The journalist involved asked Munger if he was fazed by the then 50% decline in the Berkshire Hathaway share price. Not at all, replied Munger, who added:

> If you're not willing to react with equanimity to a market price decline of 50% two or three times a century you're not fit to be a common shareholder and you deserve the mediocre result you're going to get compared to the people who do have the temperament, who can be more philosophical about these market fluctuations.

That is clearly a hard sentiment to convey to clients of any investment firm. Most fund managers, ourselves included, could not possibly get away with saying it. But Charlie Munger is right. If you're going to be blown off course by a savage – but temporary – collapse in asset

prices driven by fear and uncertainty, you may have to make do with the paltry returns you'll likely earn by sheltering in supposed 'safe' havens. (Bonds are not safe. Someone should tell IFAs.)

On which note, "investing" in bonds has now morphed, in our view, from being desperate to suicidal. If our read-through of the likely (and sustained) international policy response (even more of "the Mother of All Stimulus") is even half correct, bond "investors" stand a good chance of seeing their "investments" vaporised. As Warren Buffett himself has remarked, you pay a high price in markets for a cheery consensus. Owning government bonds issued by irredeemably indebted governments at their lowest yields in recorded history ahead of a tsunami of both monetary and fiscal incontinence seems to us to be acting like an insect in search of a windshield.

At the risk of concluding with a glib-sounding platitude, it's important at times like this to get a sense of perspective and to try to look through the current noise to what will almost certainly lie beyond it. Opportunity lies there. Without resorting to the honest brutalism of Charlie Munger, this too shall pass.

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