Market Update

"The Girl with the Pearl Earring" (Vermeer, 1665), a painting for the pandemic epoch!

Navigating the market during the age of disruption!

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The Voice for Reason

Comments and Views for the Individual Investor

(May 31, 2020)- The painting on the cover of this month's "Voice for Reason," "The Girl with the Pearl Earring," by Dutch 17th century painter Johannes Vermeer is most appropriate to our current day and age. In the words of CNN journalist and art critique, Breeze Barrington, Vermeer's paintings reflect an age in 17th Century Europe that was stricken frequently by a series of plagues and pandemics. Plagues struck Vermeer's hometown in Holland in 1635-36 killing thousands and then again in the 1650s and 1660s. It forced a sort of "social distancing" which has suddenly become commonplace in our current lifestyles. As Barrington notes, many of Vermeer's paintings were produced in isolation often done in indoor settings. The observer is confronted with a simplicity of scene that contains a complexity of detail reflected in use of light, shadow, color, and featuring simple and seemingly mundane objects in the painting which belie a mastery of thought and reflection.

It is now a half year since the outbreak of the Covid-19 pandemic which was first reported in Wuhan, China. Following the stellar year most investors experienced in 2019, this year investors have been subject to a series of negative events that have created significant systemic risk in the markets and caused noted NY Times op-ed journalist, Tom Friedman, to refer to the current situation in America as being tantamount to experiencing the 1929 stock market crash, the 2001 9/11 attacks, and a reoccurrence of the 1918-19 Spanish flu pandemic[1] all at once.

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[1]It is widely believed that the Spanish Flu pandemic began in a US military barracks in Fort Riley, Kansas in 1917, a camp located beside a pig farm from which the virus originated. The virus spread quickly to World War I battlefields in Western Europe later that year infecting many military personnel from several countries and eventually spreading around the world in two major waves in 1918 and 1919. Over 500 million people were reportedly infected and the death toll has been estimated to have reached 50 million people including over 650,000 fatalities in the United States alone.

The three major causes of the volatility in financial markets to date have included the growing frostiness in the Sino-U.S. relationship which started as a series of trade spats early in the Trump Administration tenure that disrupted global supply chains and has increasingly morphed into a larger ideological power play game. Phase I of a new trade deal, struck in mid-January by Chinese and U.S. trade negotiators, has now again become tainted by petty episodes of harsh rhetoric being expressed by both sides.

Beyond the tension between these two economic superpowers, the outbreak of Covid-19 has been a health crisis for every country across the globe and pushed adherents of an orderly globalised world to the limits. The outcome of a barrage of "America First" rhetoric coming out of the White House and a twisted desire by President Trump to find a scapegoat in the form of the World Health Organisation (WHO) in Geneva has thwarted a carefully coordinated global response to Covid-19. Trump has announced the U.S. will leave the WHO over their mishandling of the Covid-19 pandemic and (in his eyes) their closeness to China. While the virus originated and left a trail of death in China, its devastation has been even more deadly as the virus spread westward and reached the U.K., Italy, Spain, and the United States. The rates of infection and mortality figures in these four countries have been appalling and, as campaigning for the upcoming November presidential election in the U.S. heats up, will figure as a big negative haunting President Trump's chances of being re-elected.

A third blow to the global economy in the first half of 2020 has been the extreme volatility in global energy prices which has been caused by a dispute on production quotas by two large energy providers, Russia and Saudi Arabia. On March 8th the benchmark Brent oil price dropped by 24% in a single day to US$ 34/barrel, the largest single day drop in 29 years. In fact, the price kept dropping and fell below $ 0 (yes, zero!) per barrel reaching the seemingly impossible price of just below $ -20 per barrel before stabilising. The global economic slowdown in travel and shipment of goods has meant that an oil tank that was empty had actually become worth more than an oil tank that was full. It was the Saudi-Russian spat that proved to be the <u>tipping point</u> which sent global equity markets tumbling in early March by an average of 32%.

Looking forward into the 2nd half of 2020, with such a minefield of factors that could potentially negatively affect investors, we urge clients to remain diversified in investment choices. Staying disciplined within the asset allocation that suits your risk profile is important. Holding a bit more extra cash in your portfolio than usual would also not be imprudent. There will be some opportunities to build investment positions once the outlook for the market improves.
While short term interest rates remain unattractive, adding on positions in fixed income market should be done cautiously. In the high quality investment grade niche of the market, yields are at historical lows. The bellwether US 10 year Treasury note is trading at a 65 basis points yield——— lower than dividend payouts offered by many high quality stocks. Forays into the equity markets, likewise, should be done with caution. Following the sharp drop in global equity markets in early March, aggressive action by the US Fed to shore up liquidity and prompt action by the US Congress approving the Paycheck Protection Program (PPP) have been wise and timely responses. As a result, equity indices have crept back up slowly re-tracing losses and almost reaching parity with the high index levels that were achieved in late February. However, this re-surgence of the market has essentially been liquidity driven and based on wishful outcomes. At some point, corporate earnings will need to support these renewed stock market valuations. For the time being, investors should stay away from troubled sectors such as airlines and hotel groups and energy. Hi-Tech and healthcare/biotech still look like sectors that can provide good returns to investors. Moving forward into the post Covid-19 age, our lifestyles will revolve more around technology (not less), and preventive medical care solutions will become family priorities.

A selection of alternative investments in one's portfolio should also be considered as they often can provide "market neutral" solutions for investors. Within this section of an investor's asset allocation, one can consider precious metals and specialty funds that have low correlation with the behavior of the stock market.

The second half of 2020 will be impacted by the near shutdown of the US economy that occurred for most of 2nd quarter. During certain weeks throughout the 2nd quarter up to 97% of businesses in the United States were shut down, and this has had a severe impact on the earnings of corporate

America. Such absent earnings cannot be replaced merely by applying monetary easing or fiscal stimulus policies. P/E ratios constitute a fundamental type of equity analysis, and the "E" will be a lower figure in the coming weeks as corporate quarterly earnings are announced.

Also, the November election will increasingly be a factor affecting financial markets in the 2nd half. Current polling shows the Democratic Party candidate Joseph Biden clearly leading President Trump in most polls by an 8-10% point margin, well beyond the normal 5% margin or error usually associated with polling. The Trump White House is perceived increasingly by voters as having failed badly in its response to the Covid-19 pandemic with the U.S. death toll now in excess of 100,000 and the ensuing economic hardships forced upon each state to contain the spread of the virus. The number of Americans filing for unemployment has now exceeded 30 million, and over 42% of Americans have less than $400 in their bank account. Meanwhile, the stunning racially motivated murder of an Afro-American in the mid-west city of Minneapolis on May 25th while being detained by four policemen has resulted in a boiling over of social and racial tensions in the United States and the outbreak of street protests in over 150 American cities. The Trump White House has handled this crisis in a very divisive manner resulting in President Trump being harshly criticized by both his former Secretary of Defense and Chief of Staff and a string of former senior military officials, state governors, city mayors, and urban police chiefs. Despite Trump's fiercely loyal political base comprising about 1 in 4 American voters, his approval rating has rarely drifted above 40%. He is the only American president since polling began whose approval rating has never exceeded 50% during his entire tenure in office, and he has also consistently had the worst disapproval rating of any American president in modern history.[2]

If the election were held today, the new president would be Joseph Biden and likely both houses of U.S. Congress (the House of Representatives and the Senate) would become controlled by the Democratic Party. Such change in leadership would likely result in a slowdown and re-think in the vestiges of Trump's "America First" policies. Such policies and presidential executive

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[2]Gallup Polling Group recently reported a consensus of polling data from 12 major polling groups which showed Trump's job disapproval rating among voters to be poorest of any president in the modern era with an average disapproval of 53%.

actions have systematically over the past three years shown a reckless disregard toward controlling the growth of US government deficit[3], disengagement from the world stage in the form of openly criticizing U.S. allies in the NATO alliance and world bodies like WTO and WHO, as well as "brinkmanship" regarding the Sino-U.S. trade relationship. A change in leadership in Washington (which today one could cautiously say seems likely!) could represent an opportunity to catch and reverse a disrupted world order with traditional alliances and cooperation in free-fall and spinning out of control. With leadership change in the White House and in the U.S. Senate after the November election appearing more and more likely, starting to prepare for it today in one's investment decisions is wise.

About the author:
Bruce VonCannon is a native of North Carolina USA and currently a Managing Director with Vanheel Management Ltd., a Hong Kong SFC and U.S. licensed independent asset management firm founded in 2002. His career spanning 27 years in international banking and wealth management has included assignments in New York, Taiwan, Hong Kong, Singapore and Geneva. He is an author and frequent speaker at financial seminars, universities, and business forums. His latest book, "Status Anxiety: Hong Kong's Crisis of Identity" is scheduled for release in hardback and e-book copy this summer by Palgrave MacMillan.

[3]According to the U.S. Bureau of Statistics the U.S. debt to GDP ratio has worsened under the Trump Administration expanding from about parity in 2014 to 105% in 2020.