

Market Update



“The Glass of Wine” (Vermeer, 1658), an image from another pandemic age!

What is moving the markets?

By Bruce VonCannon

July 31, 2020

The Voice for Reason

Comments and Views for the Individual Investor

(July 31, 2020)- The painting on the cover of this month's "Voice for Reason," is another selection by Dutch 17th Century Baroque painter, Johannes Vermeer, called "The Glass of Wine." It features a Dutch gentleman toasting a youthful Dutch lady in an affluent indoor setting. If painted in the modern day, it might be suggested that they are "social distancing" since they are not milling about in a bar setting nor mingling in the presence of a large group of people. Vermeer lived during an age in Europe that was ravaged at least twice in his lifetime by plagues and pandemics in the 1630s and then again mid-century. It forced many activities indoors (like today) and one of the unique features of Vermeer's paintings is that they are mostly all indoor settings and most often feature sole characters performing simple mundane activities which he embellishes through his mastery of light, shadow and colors.

As the author recently flipped through a few chapters of Paul Kennedy's epic 1987 book, "The Rise and Fall of the Great Powers," the impression gathered was the current pandemic we are experiencing in 2020 in all its cruelty and inconvenience is not dissimilar to past episodes of world history and perhaps we should have seen it coming. Kennedy's review of history in the 14th Century includes reference to the Black Death 1347-51 which reduced late Medieval Europe's population by half. It took Europe almost to the year 1500 to recover from the plague and regain the same population it had enjoyed in the early 1300s.

In addition to the spread of the disease itself, Kennedy highlights the increased economic disparity that often results from pandemics. Popular uprisings and even wars itself are more likely to occur. For example, France had nine episodes of internal fighting during this period and the Hundred Years War occurred (1337-1453). Cultural and religious tensions became more prevalent, and a split in the Catholic Church occurred, commonly called the Western Schism (1378-1410). It resulted in two rival Popes both competing to become the

highest authority within the Catholic Church. The city of Avignon in France became the seat of the Pope opposing Vatican legitimacy during this period.

Kennedy's major assertion in his study of the rise and fall of great powers is that while we may commonly think great powers decline when defeated in military conflict, he notes, "...how a Great Power's position steadily alters in peacetime is as important.....as how it fights in wartime." The central thesis to Kennedy's masterpiece is clear. The threat of decaying from within is possibly a far greater risk to a Great Power's pre-imminent status than merely military conquest or might.

We have now passed the first half of 2020 and the year-to-date performance of financial markets has been eye catching in the least.¹ Volatility as measured by the CBOE's VIX index has been at least three times more volatile than a typical year.² Three major factors continue to be at play impacting the markets: i) the spread of the global COVID-19 pandemic and governments' reactions (for

Stock market's wild 2020 ride



¹Stock market graph year to date provided by Fact Sheet/ CNBC.

² The CBOE Volatility Index is nicknamed the "Fear Index" as it measures the market's 30 day forward looking volatility taken from inputs of the S & P 500 index options. Historically it hovers just below or just above the 20 level. In March of this year it breached the 70 level. The highest it has ever hit was 89 in October 2008.

better or worse) to it around the world, especially the struggle underway in the major economies in Western Europe, the U.K., and the United States, ii) the continued sharp edge trade frictions developing between the United States and China, and iii) the current unfolding US Presidential and General Election scheduled for this November 3rd which will likely result (if current polling data stays accurate) in the departure of President Trump from the White House and, more importantly, a possible change in leadership in the upper house of U.S. Congress, the U.S. Senate.

Global equity markets fell by an average 34% in the month of March as the COVID-19 pandemic spread from its origins in central China to Europe and North America. While the drop in the markets was stunning, its recovery in subsequent months has been beyond expectation and now seems to be defying fundamentals. The areas of the market that have performed exceedingly well have been the Nasdaq (up +17% YTD), Gold (up +30% YTD), and for geographical bias, the Chinese stock market (up +6% YTD). Other areas have been mediocre to just plain awful ranging from the Dow (break-even YTD) and Japan (down -4%) to the UK (down -19% YTD) and Spain (down -22%).³

Market Barometer

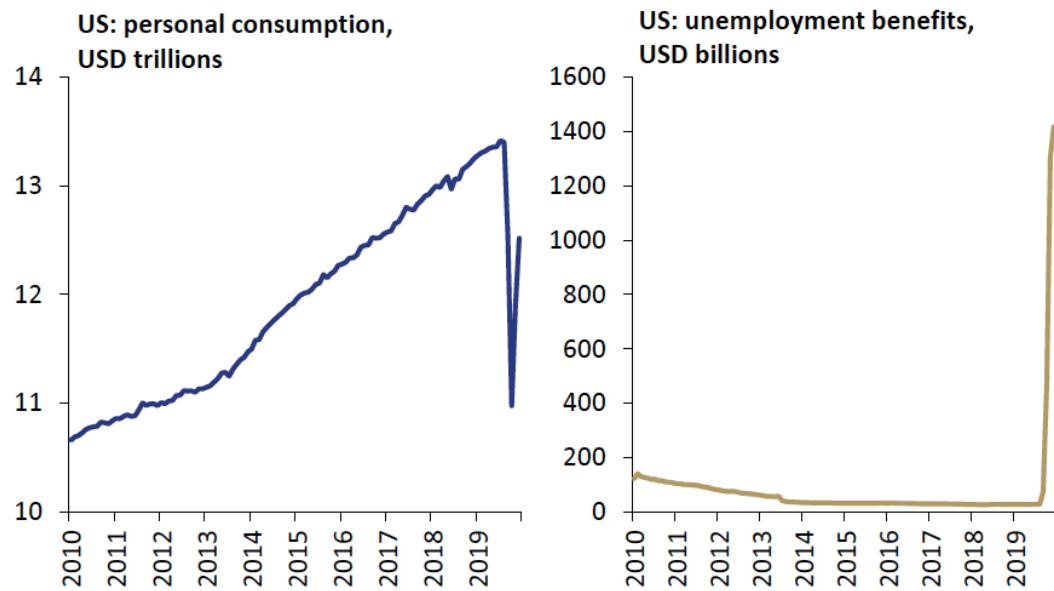
Equity Market	Last	1-Day (%)	1-Day (Chg)	WTD	MTD	QTD	YTD	12-Month
USA	3239.41	0.74	23.78	0.74	4.49	4.49	0.27	7.06
Nasdaq	10536.27	1.67	173.09	1.67	4.75	4.75	17.43	26.48
Mexico	37742.14	1.03	384.68	1.03	0.07	0.07	-13.32	-7.21
Brazil	104477.10	2.00	2095.50	2.05	9.91	9.91	-9.66	1.61
Europe	3302.84	-0.24	-8.05	-0.24	2.13	2.13	-11.81	-6.29
UK	6104.88	-0.31	-18.94	-0.31	-1.05	-1.05	-19.06	-19.13
France	4939.62	-0.34	-16.81	-0.34	0.07	0.07	-17.37	-11.95
Germany	12838.66	0.00	0.60	0.00	4.29	4.29	-3.10	3.37
Spain	7170.60	-1.70	-124.10	-1.70	-0.84	-0.84	-24.91	-22.27
Switzerland	10272.34	0.57	58.13	0.57	2.26	2.26	-3.25	3.05
Japan	22715.85	-0.16	-35.76	0.17	2.26	2.26	-3.66	5.23
Hong Kong	24603.26	-0.41	-102.07	0.43	1.57	1.57	-11.98	-12.63
China	3205.23	0.27	8.46	1.06	8.24	8.24	5.91	9.71

Commodities	Last	1-Day (%)	1-Day (Chg)	WTD	MTD	QTD	YTD	12-Month
Volatility	24.74	-4.26	-1.10	-4.26	-18.70	-18.70	79.54	103.45
Gold	1942.24	0.51	8.06	3.82	10.87	10.87	30.14	39.16
Oil	41.60	1.23	0.63	0.80	5.80	5.80	-27.96	-24.00
Thomson Reuters/Core Commodity	143.82	0.54	0.78	0.54	4.24	4.24	-22.59	-18.82
Bloomberg Commodity Index	68.50	0.79	0.54	1.31	6.26	6.26	-14.64	-12.32
USD/JPY	105.3700	-0.04	-0.04	0.76	2.46	2.46	3.10	3.27
EUR/USD	1.1752	-0.09	-0.0010	0.88	4.66	4.66	4.86	5.50
GBP/USD	1.2882	0.01	0.0001	0.77	3.97	3.97	-2.75	5.52

³ "Market Barometer" year to date performance facts provided by Bank Sarasin.

The levers at play in the United States abetting these YTD results have been the rescue package by the U.S. Congress and the Federal Reserve to provide pay check protection and liquidity to the markets⁴ which has enabled many

US emergency unemployment benefits support consumption



Source: US Bureau of Economic Analysis, LGT, August 2020, both charts

Americans families to endure the lockdown activities and despite swollen unemployment numbers (exceeding 20 million people) across the United States as COVID-19 infection rates have soared and the death count has surpassed 150,000. Another key period will be underway soon in the United States when unemployment insurance expires end of July. Another rescue package will be essential in August in order for the United States to endure the current health and economic crisis it is experiencing. Republican and Democratic members of the U.S. House and Senate must reach an accord on the size of rescue package.

Trade frictions have become even more extreme in recent weeks. The Trump White House, trailing badly in the pre-election polls, has decided to make an anti-Chinese front one of the centerpieces of their Presidential election campaign. The rhetoric, as exemplified by Secretary of State Pompeo's speech at the Nixon Library, bordered on the extreme with a right wing, anti-

⁴ US consumption and unemployment benefits data courtesy of US Bureau of Econ. Analysis and LGT Bank.

communist narrative not seen by a major U.S. leader since the 1950s. Such position, it might be emphasised, has been taken without much consultation with America's traditional allies. Much will need to be done to mend fences with China and America's tradition allies after the November election if Trump and Pompeo are no longer in power. In this game of tit-for-tat, China has responded to the closure of a PRC consulate (in Houston) last month by closing the US consulate (in Chengdu). The U.S. has rescinded Hong Kong's free trade status, an action which actually hurts the U.S. more than Hong Kong or China since the U.S. had a USD 26 billion trade surplus with Hong Kong—— the largest of any country or region in the world. China has stood its ground and seems to be content to wait out the outcome of the U.S. presidential election. With about 90 days remaining before the election, Trump's chances of being re-elected look increasingly slim.

Investors are advised to exercise extreme vigilance over the coming weeks and avoid becoming too exuberant about equity markets as they have reached all time high levels but without the impetus of supporting company revenues and cash flow fundamentals. The 2nd quarter U.S. economic indicators, greatly impacted by the effects of COVID-19, were the worst since historical data has been tabulated. Corporate Year-on-Year profitability has fallen sharply. The broader current P/E ratios of the S & P 500 are not justified by any signs of widespread profitability except for a handful of niche player tech and IOT stocks that have done exceedingly well during the lockdown environment. Selective positions in tech and healthcare may have merit. However, beware of the broader market.

FX markets have shown more and more US dollar weakness lately as evidenced by the US dollar index (DXY) which has fallen from the 98-99 range to just below 93 level.⁵ This is widely due to concern over how successfully the U.S. can pull itself out of the pandemic. The U.S. economy had already been showing signs of slowing prior to the pandemic. With the U.S. Dollar Fed Funds rate at an historical low, investors have frankly been rewarded more for holding Gold than holding U.S. Dollar cash. Gold has broken through the 1,900/oz level and seems to possibly be targeting a breakthrough of the 2,000/oz level. Holding a portion of one's portfolio in gold or silver has merits with

⁵ The US dollar index (DXY) reflects the dollar's value relative to the other major global currencies.

these fundamental trends firmly underway and unlikely to abate before the November election in the United States.

The fixed income and credit markets are quite vulnerable in the global economy at the moment given excessive issuance of debt over the past decade. Valuations of funds in this area have been down by double digits year to date. Companies with high leverage will find it more difficult to service debt when profitability figures are starkly lower. If large numbers of people remain unemployed it will have impact on bank mortgage lending and car loan and student debt. Taking on positions in this large asset class should be done cautiously.



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 second half of this year in hardback and e-book copy by Palgrave MacMillan.