Market Update

"Girl Reading a Letter at an Open Window," Vermeer, the painter from another pandemic age!

By Bruce VonCannon

February 28, 2021

Winter Storms and Vaccinations

The Voice for Reason

Comments and Views for the Individual Investor

(February 28, 2021)- The painting on the cover of this month's "The Voice for Reason" comes from the Delft School of Dutch artists in the 17th Century. Artist Johannes Vermeer's 1659 painting depicts an intimate indoor scene of domestic life. It was also an age during which Europe had been ravaged by pandemics. Records show such outbreaks were occurring in 64 years of the 17th century. Vermeer, the master of light and colours, produced over 30 major pieces of art during his career often indoors as if a 17th century version of "lockdown art" and creating images within Dutch households, courtyards, and tranquil street scenes in the artist village hub of Delft.

Meanwhile, investors have welcomed with great hope the arrival of the Year of the Ox in the middle of this past month and seemingly there is no desire to see the outgoing Year of the Rat prolonged. After all a global pandemic over the past year, the likes of which not seen in over 100 years, has infected over 115 million and killed over 2.5 million to date and nearly shutdown industries like tourism, hospitality, and airline travel.[1] A winter storm crashing through the U.S. Central plains and southward to Texas lowered temperatures levels not seen in over 90 years. It resulted in widespread residential and commercial real estate damage estimated in excess of USD 200 billion and crippled the Texas state electric grid resulting in episodes of finger pointing between Washington and the state of Texas Republican governor Phil Abbott.

However, global breakthroughs in vaccination and change in leadership in the United States have offered investors increasingly a ray of hope. The new Biden administration in Washington faces staggering challenges on multiple fronts, but it is very clear that this administration is staking its reputation immediately on further containing the spread of COVID-19 and vaccinating a critical mass of the

[1]The Spanish influenza which started in a US army barracks in Kansas in 1918 quickly spread outside U.S. borders to World War I battlefields in Europe and then globally and killed an estimated 50 million, including over 675,000 in the United States alone.

American population by late summer. Beyond this single focus, the Biden Administration has shelved the isolationist foreign policy trend of the past four years by the previous administration.   They have immediately renewed America's commitment to supporting global initiatives that promote free and fair trade, emphasize environmental sustainability, and promote global cooperation to arrest diseases such as COVID-19.   It is a stark change in style from the previous administration and a return to a more traditional style of presidency. To date Biden's appointed cabinet ministers are a diverse collection of men and women from differing ethnic backgrounds and mostly persons of clear merit who have solid experience and are likely to remain in office longer than the average cabinet minister of the previous U.S. president. The Biden agenda has also fully embraced <u>science</u> when it comes to combating the Covid-19 pandemic. Whereas the horrific death toll in the U.S. has now surpassed 500,000 this past month, the new administration has embraced a strategy that will focus on distributing vaccines as aggressively as possible through as many types of distribution outlets as can be adequately organized. This, too, is a contrast to the past administration that had wanted to allow states within the continental U.S. to decide how to handle distribution. The new Biden goal is to have available 150 million vaccine dosages available by June of this year which is slightly less than half the size of the U.S. population. President Biden, in stark contrast to his predecessor, is often seen sporting a face mask as are his Vice President Harris and fellow cabinet members. Even with vaccines becoming more and more available, common sense preventive measures to contain the coronavirus and avoiding relapses of outbreak are being encouraged by Washington.

Are Markets at Bubble Point?

Much scrutiny has been given to the surging levels of the stock market in recent weeks. Average P/E ratio of the S & P 500 recently hit 38:1 which suggests "bubble territory" if compared to the historical average of 16:1. However, it is important to note that the impact of the pandemic across the U.S. has created corporate winners and losers. No doubt service industry sectors have suffered staggering losses and suffering across a wide swathe of the population continues. The stock market recovery that we witnessed in the second half of 2020 was not fully reflective of what has happened across the broader strata of U.S. society. Millions of jobs were lost in the service sector and may never return. However, the PPP program and Cares Act passed by U.S. Congress were critically helpful.

They provided job loss insurance and the Cares Act resulted in significant liquidity remaining within the U.S. economy. With so much liquidity remaining in the economy, the U.S. stock market rebounded and registered another year of positive performance in 2020.[2] On the winners side, estimates are that the digital age has been advanced by up to 6 years by the impact of the pandemic. Industries involved in warehousing, logistics, and food deliveries have shown significant increases in operating income.

The classic inverted yield curve, another measure by which historians have traditionally used to forecast a recession, has also not been in evidence. In fact, if anything, the US Dollar yield curve has steepened during the past two weeks. The US Fed under Chairman Jerome Powell, as well as US Treasury Secretary Janet Yellen (herself a past Fed Chairman), have given hints that they still see unemployment a bigger threat to the US economy than inflation. As such, while inflationary expectations are a bit higher and the US yield curve has steepened at the tail end, it remains to be seen if higher long-term borrowing rates will spoof the stock markets.

Certainly, traditional industries will show performance downturn when corporate earnings are announced later this quarter. However, companies in information technology and communication/online networking have remained buoyant. If one also takes a global perspective on recovery, one should also take note that certain parts of the world are re-emerging from the pandemic quicker than others. One example would be China. Despite a dramatic slowdown and impact on its economy in 1st quarter 2020 when Covid-19 was acknowledged as an outbreak in the city of Wuhan in Hebei Province, China's implementation of draconian measures helped it to contain 80% of the spread of the coronavirus to just one of their 23 provinces. The number of infections and deaths in China reported to date are about 20% of the U.S. total. As a result, China actually managed to achieve +2% positive GDP growth in 2020 compared to -7.5% in Europe and -5.0% in the United States. With such comparative success combating the disease, China's economy in 2021 will likely return to a more normal state of activity quicker than in the West. The same can be said of

[2] Despite falling by 32% in the first quarter of 2020, the S & P 500 registered a 16.3% return for the year.(source: CNBC)

Taiwan and South Korea who have also shown to date great adeptness in handling Covid-19 with infections and mortality rates far below the U.S. average.[3]

What are the key points to look for in 2021 when investing?

Market stability in the new year will continue to depend significantly upon perceptions of how upon coronavirus containment and successful rollout of vaccination are proceeding. The current higher than normal stock market P/E ratio level is unsustainable longer term. It will likely change based on corporate earnings results. The ratios adjust downward naturally when earnings are boosted or the price of a stock falls. So, watch for corporate earnings results later this quarter.

The U.S. dollar has weakened almost 10% against most major currencies in the past year. This normally presents investment opportunities outside of one's country. A current consensus of bank forecasts is that the U.S. dollar could depreciate a bit more in the coming year. This highlights the opportunities that may exist in both fixed income issues and equities in the emerging markets. For US based investors there are opportunities to locate such investments via ETF funds that have underlying global geographical sector or industry sector themes. American Depository Receipts (nicknamed in financial jargon, "ADRs") exist as an asset class on both NYSE and Nasdaq exchanges and are listings denominated in U.S. Dollars of overseas stocks on the U.S. stock exchanges.

Just remember if there is a correction in the stock market, the S & P 500 has experienced 27 bear markets since 1928 and 28 bull markets.[4] The average length of bear markets is approximately 9 months and the average length of bull markets is about 33 months. While stocks normally correct 36% during bear markets, they typically gain over 100% during bull markets. In 91 years of market history, stocks as an asset class normally advance annually over 70% of the time. Such historical facts support the view of staying invested!

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[3] To date Taiwan has suffered less than 1,000 infections and only 9 fatalities. South Korea has suffered 92,000 infections and 1,632 fatalities. Adjusted for their smaller populations compared to that the U.S., their infection rates are a fraction of the horrific U.S. Covid-19 statistics.

[4]Research provided by Hartford Funds and Ned Davis Research (Sept 2020)

The Longer Term View.....

Longer term I wish to highlight a recent report of LGT Bank which noted the rise of the demographic group, Generation Z, who now number approximately 2.5 billion of the world's 7.8 billion inhabitants and have replaced the Baby Boomer Generation as the largest global demographic group. Born between 1996 and 2016, this group will be the first digitally native generation. Their traits and characteristics differ dramatically from not only the Baby Boomers, but also Generation X and Y. The rise of Generation Z will likely lead to major changes in consumer habits in the coming decades as Gen Zers exhibit characteristics which are much different from previous generations. The Gen Zers are characterized by a preference for e-commerce, digital and smart card payment (rather than credit cards), attachment to pets, and frequent use of social media (e.g., Tic Tok). In fashion tastes, they like fast fashion with sustainability themes (not haut culture nor polo shirt yuppie!) And for making trips they are loyal to Uber and Air BnB which are hallmarks of what is being called the new "shared economy." With regard to investing tastes, Gen Zers care about environmental sustainability governance (ESG) and are likely to attach more importance to a corporation's carbon footprint than their parents. Currently, the two largest populations of Generation Z are in the United States and China. However, in the coming decade, watch India whose population will likely surpass China in the coming decade. At present 41% of Generation Z live in Asia Pacific and 90% live in the emerging markets. Their income levels are expected to increase by 5x in the coming decade. These demographic changes and new themes are worth taking note. They will be the precursor of major shifts in wealth and investment habits in the world as well.

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,* was recently released in hardback and e-book copy by Palgrave MacMillan.