MONTHLY MARKET BLUEPRINT

To inflate, or not to inflate

September 2020

MAZARS

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FOREWORD

To inflate, or not to inflate

In a decision for the history books, the US Federal Reserve, the world's de facto central bank, abandoned a hard 2% inflation target in favour of a more flexible regime, attempting to prevent deflation resulting from secular stagnation exacerbated by the persistent COVID-recession. Inflation has finally been chosen as the weapon of choice against mounting debt levels.

Over the short and medium term this is good news for investors and risk assets as markets, still disconnected from the real economy, were eager to see more monetary stimulus. The Fed is widely expected to follow with more expansive policies in September, most of which, however, might already be priced in.

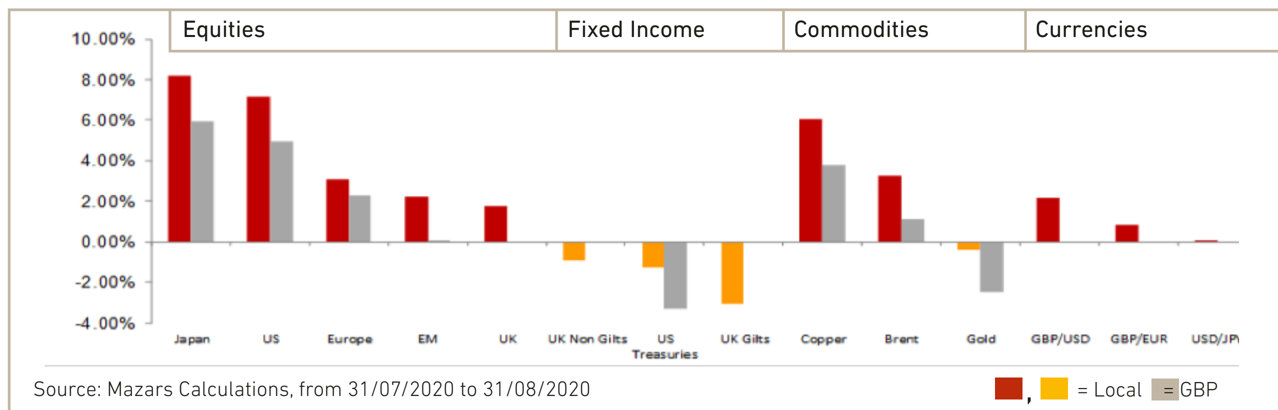
The question is of course whether the Fed will actually succeed. 'Tolerating' inflation is by no means the same as 'stoking' it. If it does succeed, it's good news for owners of real assets, like precious metals and real estate (more residential than commercial). It's bad news for bonds, however, as we have already seen real IG corporate yields turn negative, where government yields have been for some time. Bonds are an excellent diversifier but in terms of generating any returns they are bound to give headaches to asset allocators for some time. As for stocks? The jury is still out. On the one hand, extended QE and the history of inflation favour stocks. And of course, much like the rest of the economy they will benefit from depreciating their debt. But inflation might bad news for their clients who might be more reticent than authorities think to buy, after more than a decade of crises and a 20-year stagnation in wages. Also to raise new debt companies will have to offer better terms, i.e. higher yields. Those who issued a moderate amount of debt since 2008 will be ok. Those who binged should be afraid for their longevity.

But the biggest risk isn't the possibility off success, but the consequences of failure. Long term 'slow money' investors are bound to remain skeptical, as high debt, sluggish growth, low capital expenditure, a depreciating currency, yield curve tampering and inflation-feeding measures strongly echo the painful story of Japan. On the road to Japanisation, attempts to stoke inflation are an inescapable stop. Will the result be the same?

While the mechanics between Japan, a surprisingly 'closed' economic ecosystem, and the US, the world's most open consumer economy and owner of the global reserve currency, are as prodigiously different as are their chances of success, investors can't help but wonder if these moves are band-aids, signs that the global economic order is in grave need of an overhaul. Until such time as this question is answered, we expect investors to be careful, suspicious of recoveries, and overall growth lethargic and uneven. In other words a repetition of the last decade when fiscal initiatives gave way to constant monetary stimulus as means to keep the world chugging along. And the question is not simply whether stocks and bonds can keep growing ignoring real economy pains, but rather can quantitative easing, which worked under an ailing economic system, continue to boost risk assets under a possibly failing one.

George Lagarias
Mazars UK Chief Economist

MARKET PERFORMANCE – IN A NUTSHELL



Source: Mazars Calculations, from 31/07/2020 to 31/08/2020

The month in review: Equities Rebound from July Losses on Stronger Economic Data

Global stocks recovered in August, rising 6.7% in local terms, led by a buoyant Japanese market that returned 8.2% in Yen terms. The latest Citigroup Economic Surprise Index posted a strong reading of 193.4, as economic data tended to perform better than expected. The most significant economic update in August was the US Federal Reserve's shift towards an average (more symmetric) inflation target. In practice, this means the Fed will likely allow inflation to run 'moderately' above the 2% inflation target. To achieve this interest rates are likely to stay lower for longer, which caused yield curves to steepen and the US Dollar to weaken. The Fed also announced that the labour market will play a less important role in determining when to raise rates. Despite evidence in the UK Services PMI that 'Eat Out to Help Out' and the rising demand for 'staycations' helped support hospitality and leisure industries, job losses accelerated in August as firms look towards the closure of the government's job retention scheme. Global Manufacturing PMIs rose to their highest level since 2018, however this recovery is modest in comparison to the fall in output caused by the COVID-19 crisis.

As with July there continues to be dispersion in stock market returns. The FTSE 100 returned +1.8% for the month, whilst US returns were +5.0% in Sterling terms. US performance was driven by strong performance in large caps, particularly its five largest companies. Apple surpassed the combined market value of UK large caps at the start of September. Globally, Consumer Discretionary and IT were the best performing sectors, whilst more defensive sectors lagged, with Utilities negative for the month. Emerging Markets underperformed developed markets in August, returning just 0.1% in Sterling terms. This comes as Latin America continues to struggle with COVID-19, the region now accounting for almost half of all global deaths daily. Yields rose in August, though from low starting levels, with the UK 10-year and US 10-year yields rising by 20.7 and 17.7 basis points respectively. Sterling rose against major currencies and was up +2.2% against the US Dollar. Sterling strength in August saw equity markets rise less in Sterling terms than local currency. Gold fell -2.5% in August from its record highs set in July, although it remains up +27.4 year-to-date as investors look to diversify portfolios in an era of negative real yields in safe-haven government bonds.

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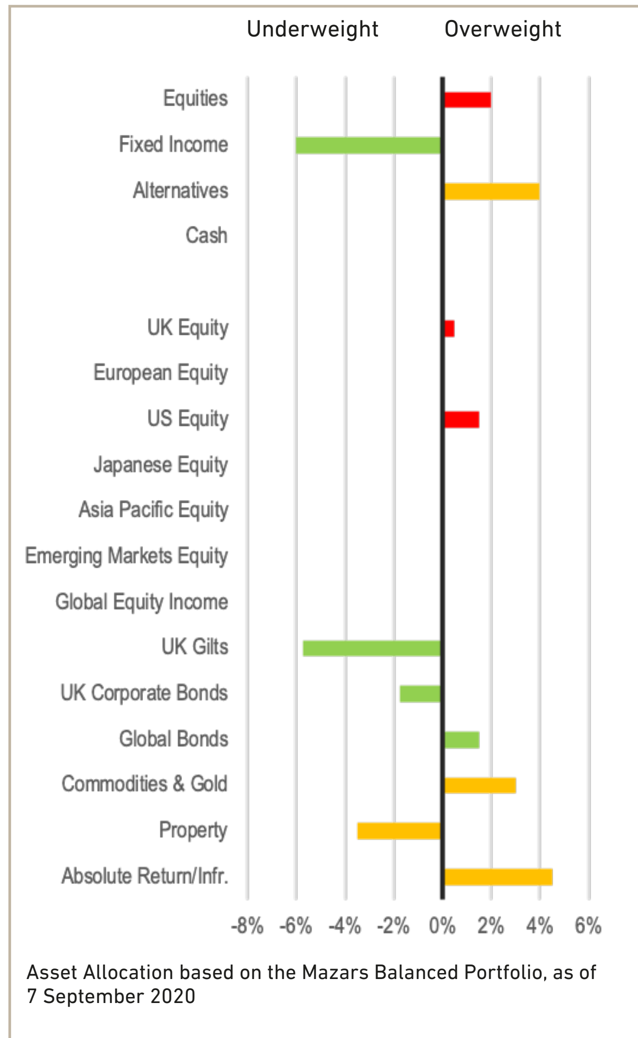
ASSET ALLOCATION



Asset Allocation based on the Mazars Balanced Portfolio, as of 7 September 2020

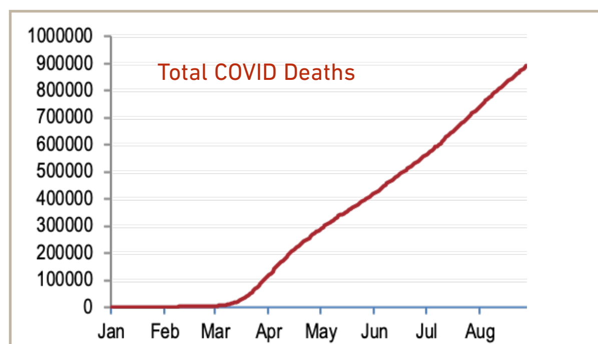
Outlook and portfolios

- The 11-year global economic and financial expansion cycle has come to an end, the result of a rare "Black Swan" event, a global pandemic. Economic data sharply deteriorated throughout March, April and May as a result of an unprecedented global lockdown. June onwards saw a meaningful rebound in economic activity as global economies reopened, albeit against a backdrop of deteriorating virus data. The data is still volatile. In some cases they suggest that the recovery is petering out, while in some others they indicate a more promising rebound.
- Governments and central banks have responded with unprecedented fiscal and monetary stimulus, the result of which was a stabilisation of equity and bond markets. The Federal Reserve has added $3tn of liquidity into the system since last September, almost three times greater than the first QE tranche in 2008, and abandoned its long standing aim to cap inflation at 2%, instead now targeting a rate of 2% on average over time.
- Global stock markets have rebounded, but with a great dispersion in returns, as investors seem to be more focused on US Dollar investments. With corporate earnings down 13% in Q1 and 34% in Q2, however, and a predicted 12 month drop of 25%, valuations are already stretched.
- The economy saw both demand an supply shocks which have damaged supply chains. Meanwhile, unemployment figures are still subject to upside revisions. Business and consumer confidence indices are still well below their long term averages.
- In the face of these developments, our investment committee decided to keep positioning unchanged and trust in the long-term properties of asset allocation. We remain roughly neutral on equities and underweight bonds, although we agreed to review the impact of more QE and low long-term yields for our Strategic Asset Allocation.

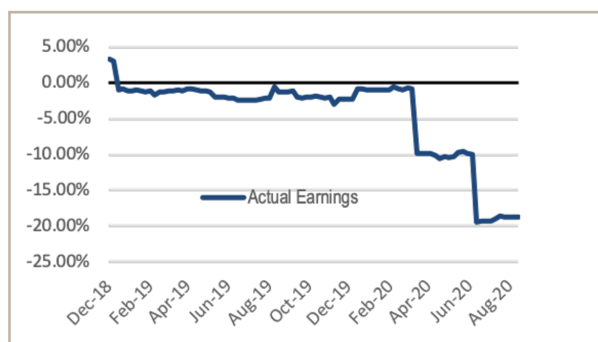
Charts Source: Mazars calculations

RISKS AHEAD

- Global economic growth faltered at the swiftest pace since WWII. Over the short-term, COVID-19 has had a significant impact on both economic fundamentals and market sentiment, while adding to de-globalisation pressures. At the time of writing, new cases have been going up globally, and the world is in the middle of a second wave, however policy reaction has been much more benign –no universal lockdowns. The system looks better prepared and hope that a vaccine is closer has reduced concerns for investors.
- In fact, despite the new coronavirus being the primary driver of economic performance, markets' focus has been fixed on quantitative easing, with investors convinced, for now, that central bank risk suppression is potent enough to weather the economic storm.
- Global bond yields might be low, and are likely to remain so for some time especially as the Fed has now effectively removed its 2% inflation target. But now companies find themselves with weaker balance sheets. Possible inability to raise new debt or refinance old debts, especially in the face of a sudden stoppage of operational cash flows, could have devastating consequences, especially for smaller-caps and companies teetering at the edge of the investment grade spectrum.
- In the US apart from the recession, investors are now worried about the impact of a change in the presidency next year, the possibility of more divided government, as well as illiquidity in the short-term debt market.
- In the UK we are seeing a record-drop in aggregate output, compounded by pressures of a potential hard Brexit at year's end.
- In China investors will be looking closely to assess the pace of the recovery, to make sure that growth doesn't falter again.
- In Europe some of the risks were mitigated, as countries have coalesced to mutualise some debt raised to fight the virus.
- We feel that short-term systemic risks are dominating and that longer term risks are building up. Even more liquidity may be needed. We need to wait for further clarity, as the world is currently in flux, before assessing the damage and further consequences of this new crisis.



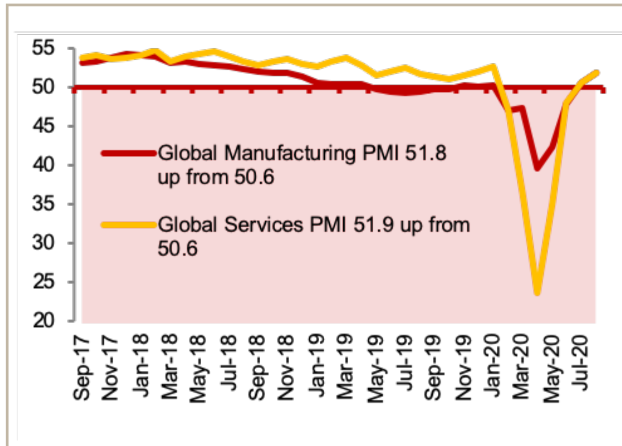
Total COVID Deaths.



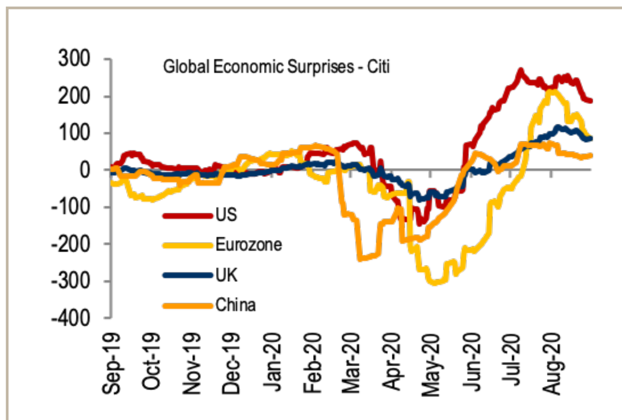
Global earnings are still very weak.

Charts Source: Mazars calculations

GLOBAL



Economic activity has rebounded somewhat, but it doesn't seem to be picking up significant momentum



The global economic momentum seems to be petering out

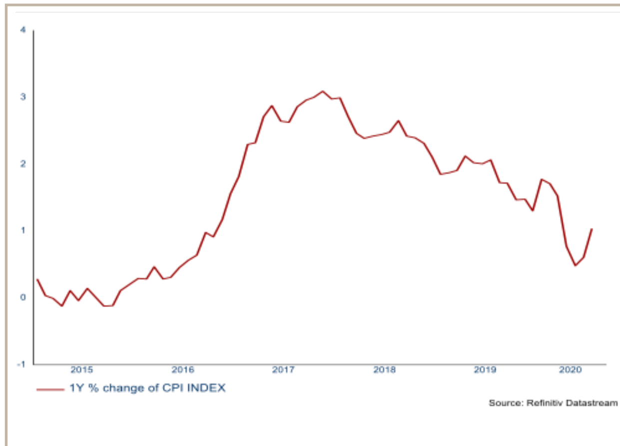
In August, global stocks rose by +6.7% (+4.5% in GBP). The best performing sectors were Cons. Discretionary and IT while the worst performers were Utilities and Energy. Equities were trading at 24.5x times forward earnings, 56.6% above long term average. Gold fell -0.4% and oil prices rose +5.8%.

Q2 global aggregate economic output contracted at the fastest pace in recent recorded history. The IMF predicted a 4.9% drop in global GDP for 2020, with risks to the downside. The global services sector has suffered the most because of the “Great Lockdown”, however manufacturing is also subject to a shard drop in activity.

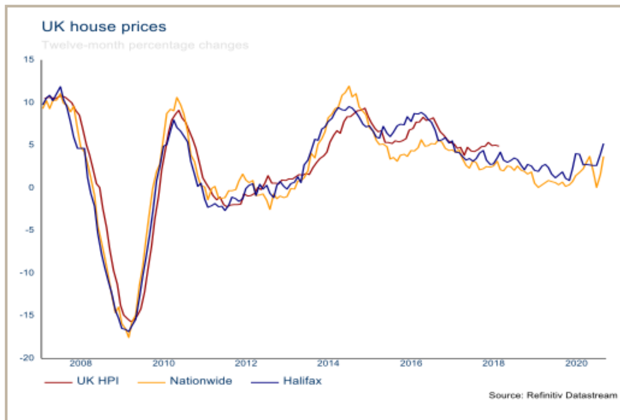
Despite dismal Q2 GDP data, indicators have shown a rebound in aggregate economic activity in early Q3 on pent-up demand, as economies have started to gradually reopen. Nevertheless, we would expect the economic rebound to slow down, as COVID-19 cases rise as stimulus in the US is delayed. US unemployment figures have come down somewhat, although they could still come back up after stimulus runs dry. The numbers in Europe differ significantly, but this is mainly because of furloughing (furloughed employees don't count as unemployed) and lack of mobility which doesn't classify a lot of workers as unemployed according to ILO standards. Inflation remains subdued, with central banks mostly fearing demand-driven deflation. Supply chain pressures from China have eased, as the country makes its way back to a “new” normal, but manufacturing shutdowns in Europe and the US have resulted in renewed supply pressures on certain industries. Global trade conditions have also deteriorated significantly. Supply chain disruptions could result in short-term inflationary pressures in some countries, like the UK. The crisis has seen record capital flight, especially from Emerging Markets. Responding to the crisis, central banks have floored interest rates and restarted Quantitative Easing to maintain market liquidity.

Charts Source: Mazars calculations

UK



Inflation rose unexpectedly to 1.0% in July, data revealed in August, as lockdown began to unwind. Inflation was driven up by rising clothing and fuel prices. However the Bank of England are not expecting a secular rise in inflation in the coming months.



Unlike the financial crisis of 2008-2009 there has been no major housing recession as yet during the coronavirus pandemic. In fact a 2% rise in August was enough to send homes to record valuations.

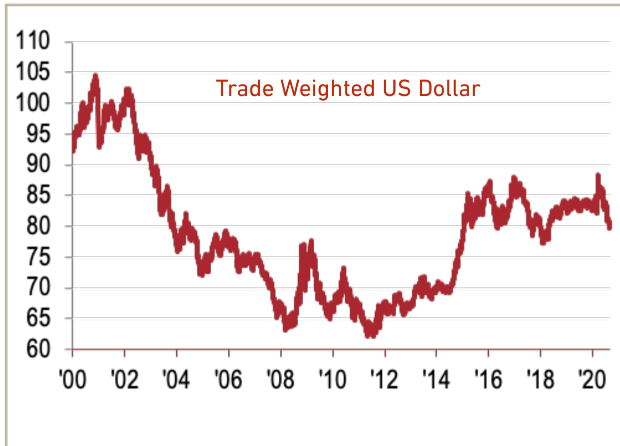
In August UK stocks rose +1.8%, falling well short of recovering their July losses. The best performing sector was Retail, as lockdown eased and schemes including 'Eat Out to Help Out' boosted footfall more than anticipated. Stocks were trading at 19.3x times forward earnings, which represents a 21% discount to the MSCI World. 10Y Gilt yields rose by 20.7bps to 0.311%.

PMI data in August showed the fastest expansion in over six years, but this good news was tempered by concerning labour market data underlying the headline figure. The rate of job losses accelerated in August as firms began to prepare for life after the Corona virus Job Retention Scheme. Inflation data released in August beat expectations, up 0.4% month-on-month, beating expectations of a slight fall. This was largely driven by the largest fuel price hike in a decade, and a fall in clothing discounts. The Bank of England is maintaining low expectations for inflation in the medium term. The housing market showed signs of recovery as UK house prices surged to record highs. A stamp duty holiday on residences valued up to £500,000 and pent up demand over lockdown have contributed to a 2% rise in August, a 16-year high for monthly gains. Due to a lower volume of sales, the house pricing index has been more volatile. However UK mortgage approvals accelerated in July according to data from the Bank of England supporting evidence of a housing market recovery.

Outlook: The economic outlook now hinges on Brexit expectations. The most recent round of negotiations ended in an impasse. With already low inflation expectations, any further weakening of demand could tempt the Bank of England to move interest rates into negative territory.

Charts Source: Mazars Calculations, Refinitiv Datastream

US



The US Dollar is trading near 2-year lows.

US large caps are at all time highs.

In August, US stocks rose by +7.2% (+5% in GBP). The best performing sectors were IT and Consumer Discretionary, while the worst performers were Energy and Healthcare. Equities were trading at 26.2x times forward earnings, 58.4% above long term average and 6.7% above the MSCI World. 10Y Treasury yields rose 18bps to 0.705%.

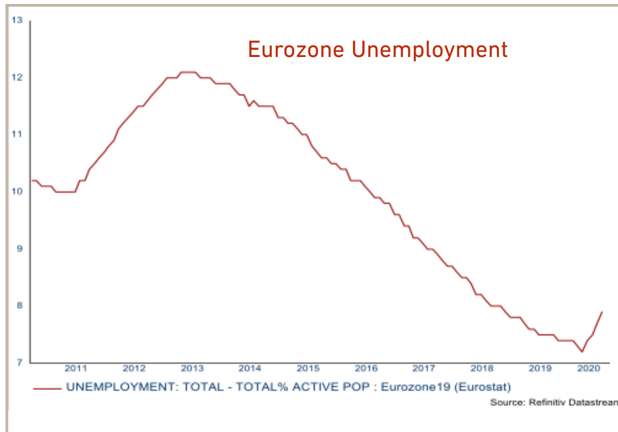
The US economy is slowing precipitously and entered a recession, losing 5% on an annualised basis in Q1 and down almost 10% year-on-year after Q2. Nevertheless data improved somewhat in the past few months. Unemployment slightly improved, from 14% to 8.4%. Inflation is still tame, but lack of demand hasn't pushed prices down with the supply chain suffering from COVID-related disruptions. Consumers and businesses appear to have a modicum of optimism about the future. For Q2, earnings per share fell 34% and projections for the year-end were suggesting a 25% drop in overall profits.

As a result, the central bank continued to print a record amount of money and shed its long standing 2% inflation goal, promising even more stimulus coming September.

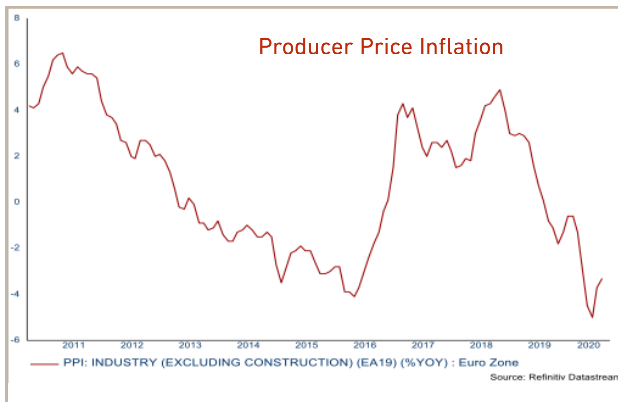
Outlook: The US economy is slowing at a rate commensurate to that of the rest of the world, and is additionally hamstrung by supply chain disruptions. However as the Fed remains dovish the outlook for US assets, which feature very high ROE (return on equity) companies, continues to remain upbeat relative to the rest of the world.

Charts Source: Mazars calculations

EUROPE



Despite the uptick due to COVID-19, Eurozone unemployment remains well below the previous cycle highs due to unprecedented government support for jobs.



Producer Price Inflation remains well in deflationary territory. This is ostensibly a good thing, however highlights the battle the region has had, and may continue to have, with deflation.

In August European stocks rose by +3.1%. The best performing sectors were Autos and Industrials while Utilities was the worst performing sector having been the best in July. 10Y Bund yields rose 13bps to -0.397%.

The growth outlook for the Eurozone is particularly uncertain, with several countries experiencing rising COVID-19 levels, leading to re-imposing of lockdowns in certain areas and continued travel restrictions. Unemployment across the Eurozone remains relatively low at 7.9% due to the extraordinary measures taken by governments to take on the burden of paying wages, however this is likely to rise as this support wanes. PMIs for both Services and Manufacturing remain marginally in expansionary territory at 50.5 and 51.7 respectively, although both came off slightly from July's figures.

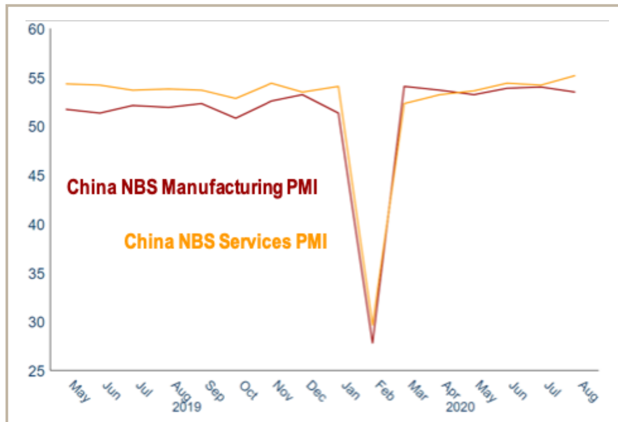
GDP fell –15% YoY in Q2, which was perhaps not as bad as feared, although Consumer Confidence remains extremely negative at –14.7.

EU leaders also face various geo-political issues, with the disputed elections in neighbouring Belarus, the poisoning of Russia's opposition leader Alexei Navalny as well as simmering tensions between Greece and Turkey. Not to mention that Brexit negotiations at this point appear to be going nowhere.

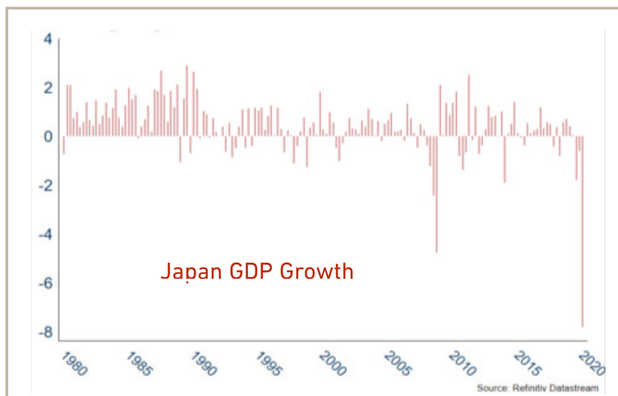
Outlook: Europe seems to be facing a perfect storm of geo-political issues but with limited ability of monetary or fiscal policies to help growth pick up following COVID. On a forward P/E basis it is also more expensive than all major regions aside from the US. Overall we remain neutral on European risk assets, although with an eye to reducing this if needed.

Charts Source: Refinitiv Datastream

JAPAN AND EMERGING MARKETS



China's Manufacturing and Services PMIs remained in expansionary territory as the domestic and global economy continued to recover from the pandemic.



The Japanese economy shrunk at its fastest rate on record as GDP fell -7.8% for Q2 2020.

In August Japanese stocks were up +5.9% and +8.2% in Sterling and local terms, respectively. Emerging Market stocks rose by +0.2% and +2.2% in Sterling and local terms respectively. Japanese and Emerging Market equities were trading at 20.5x and 18.2x times forward P/E respectively, higher than their long term averages.

In China, exports jumped by 7.2% YoY to USD 237.6bn in July 2020, accelerating from a 0.5% gain in the previous month and defying market expectations of a -0.2% fall. It was the fastest growth rate in exports since December last year. Manufacturing activity in August rose to 53.1 from 52.8 in the previous month. Total new work expanded at the sharpest rate since the start of 2011 amid reports of firmer client demand as the domestic and global economy continued to recover from the pandemic. Notably, manufacturers registered the first increase in new export sales since December 2019. The services sector reported a solid increase as well. The official NBS Non-Manufacturing PMI for China rose to 55.2 in August 2020 from 54.2 a month earlier, pointing to the fastest growth in a month since January 2018.

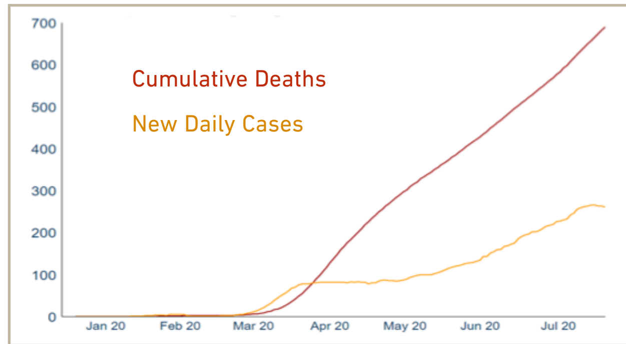
Shinzo Abe, the longest service prime minster in the history of Japan, announced that he is stepping down from his role due to health reasons. Mr Abe's departure has now triggered a race for the leadership of his ruling Liberal Democratic party, with the new PM to be elected in September. The Japanese economy shrank -7.8% QoQ in the three months to June 2020, after a -0.6% fall in the previous period. Japan's manufacturing sector improved further this month with the Jibun Bank Manufacturing PMI at 47.2 in August, rising from than 45.2 a month earlier. The latest reading pointed to a sixteenth straight month of contraction in the sector, as manufacturing remained under pressure amid the ongoing COVID-19 crisis. Services PMI was confirmed at 45.0 in August 2020, below July's figure of 45.4 and pointed to the seventh straight month of contraction in the sector.

Outlook: As a significant drop in global demand for goods and tourism hits Asia due to COVID-19, the risks for Emerging Market economies have risen. These economies have experienced significant capital outflows, but according to the IMF, overall liquidity provisions have balanced the outflows.

Charts Source: Mazars calculations, Refinitiv Datastream

OUR THEMES

MACRO THEME 1: COVID-19



As several countries have begun to see a second wave of COVID-19 cases, the global death toll has now crossed 700k.

After February 21, when it became apparent that COVID-19 was developing quickly outside of China, markets followed the "virus narrative". However, this did not last long. Traders and longer-term investors who have, for a decade, been conditioned to respond directly and primarily to central bank stimulus, began to focus on the $3tn and the €1.35tn of new money added to the markets by the Federal Reserve and the ECB respectively. Unsurprisingly, the financial and media narrative began to follow the stock market rebound, and investors started focusing on a more hopeful future. Both US and global stocks are near pre-COVID, February 2020 levels. More importantly, they are all trading at very high valuations versus projected 12m earnings, which suggests that traders are dismissing the COVID-19 related earnings drop and focusing on life after. However, we need to remember that this particular crisis is exogenous. Thus we believe that markets may have been too optimistic in their narrative so far.

A wide-spread use COVID-19 vaccination is nowhere near completion. The UK government has warned that it may never be found. In the US, some protocols have been accelerated. Even if and when a good vaccine becomes available, the world would still need to overcome two hurdles — the first being the 'anti-vaxxer movement', which has spread during the past few months almost as fast as the virus itself. Only 50% of Americans say they plan to take a coronavirus vaccine. That number would be too low to achieve herd immunity. The second problem is patriotism. Many of the world's biggest countries including the US, Russia and India have refused to join a collaborative WHO effort to work on a vaccine.

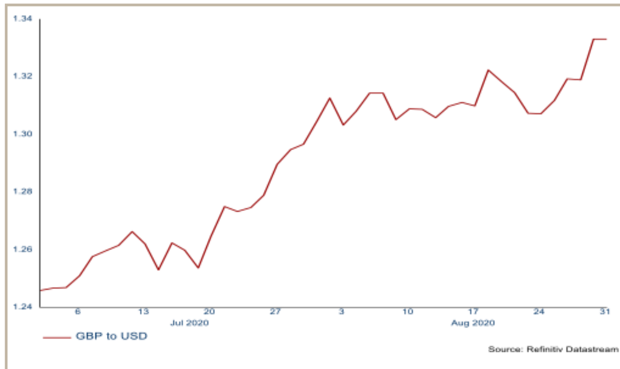
While the world awaits the arrival of a vaccine to help cure and prevent the virus, several countries are experiencing a resurgence of new COVID-19 cases, pointing towards the possibility of a second wave. While there is speculation on how intense this second wave could be, its economic impact might be very different from what we've witnessed so far.

Globally, the jobs hit of the COVID-19 crisis has been 10 times larger than the first few months of the Great Recession in 2008, based on the drop in employment and the reduction in hours worked among people who kept their jobs. According to the OECD, a second wave of the novel coronavirus around the world could leave 80mn people out of work in the world's developed nations. The US economy shrank by an annualized -32.9% in the second quarter of 2020, its biggest contraction on record. Several other economies also witnessed record GDP falls. Economists now predict that even if growth does surge in some sectors, overall activity will remain muted for a while. Sectors such as tourism, travel, entertainment, restaurants and accommodation won't return to normal as long as no vaccine or treatment is widely available.

We recognise that a good narrative is necessary for consumers and investors to have confidence. We also recognise, however, that exogenous events are not affected by the narrative.

Charts Source: Refinitiv

MACRO THEME 2: POUND STRENGTH OR BREXIT MYOPIA?



Sterling extended July gains against the US Dollar in August, surging to year highs, recovering the ground lost during the sharp risk-off environment and 'flight to Dollar' during the height of the corona virus crisis.

Even as Brexit negotiations once again reached an impasse in August, Sterling rose against both the Euro and the US Dollar in August. As the US Dollar slid on news of a shift in Monetary Policy stance in the US, Sterling rose to a 2020 high close to $1.35.

This Sterling appreciation is based upon markets reassessing the yield advantage of the US Dollar. Expectations are now that the Fed will not raise interest rates anytime soon. It is further supported by generally stronger than expected economic data.

Sterling strength is unlikely to last without some form of Brexit deal agreed by year end. As seen in chart 2, volatility in the currency (which is for the moment remarkably stable) spikes around trade negotiations. Sterling actually rose against the Euro over the course of the most recent round of unsuccessful trade talks. This provides some evidence that markets are expecting some sort of deal to be reached.

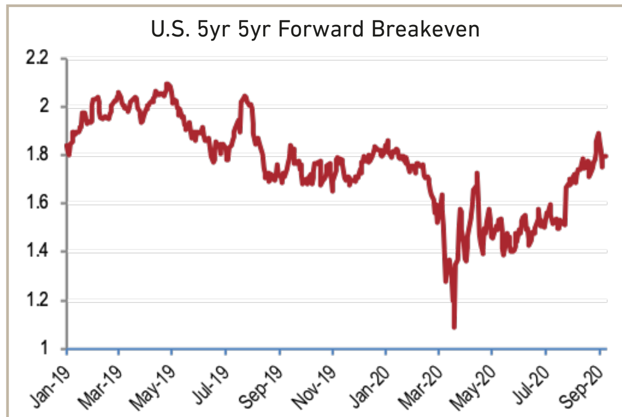
As has been the case thus far, it is likely any agreement could simply push deadlines further down the road. Coming in the form of either a delay or an extended implementation period. These scenarios, whilst not offering much in the way of upside for Sterling, are unlikely to cause too much downside risk.

There are two key risks to Sterling going forward: the first is if the UK leaves the EU with no deal and no extension period at the end of this year. The UK has typically kept the threat of no-deal as a bargaining chip, but if the UK shifts to WTO rules on trade, this is likely to prolong and make more severe the recession. This would act as a positive feedback loop into the second key risk: the Bank of England have stated negative rates are 'in the toolbox', and derivatives markets are pricing in this possibility. If this becomes a reality this would be a decisive factor in depreciating the currency. Fears of incoming corporate tax hikes to help pay for the extensive fiscal support during the crisis will only act to further disincentivise foreign demand for Sterling.

Sterling has been very volatile over the last three years, however despite major trade talks the currency was relatively calm during August. Far below its previous trade talk, and coronavirus, volatility peaks. Volatility is likely to pick up between now and December unless an EU trade deal can be ratified.

Charts Source: Refinitiv Datastream

MACRO THEME 3: THE FEDERAL RESERVE'S HISTORIC MOMENT



US (5 year) inflation expectations have risen.

The US Federal Reserve has put a long-standing 2% inflation goal on hold saying it will tolerate higher prices changes for some time. The move is an acknowledgment that more monetary stimulus is needed to stoke faltering demand.

However, there are many risks attached, either if it succeeds or not. Inflation, prices going up, has been often used as a tool to speed up purchases of many assets, especially expensive ones.

If the policy succeeds, combined with Quantitative Easing, it might wreak havoc in the bond market. On the one hand, investors will be faced with a very strong buyer, the central bank pushing yields lower, on the other inflation upping the opportunity cost for holding a bond.

An inflationary environment has traditionally been good for equities. However, with a lot of companies having re-leveraged, many of them below investment grade status, it remains to be seen how potentially higher yields will affect refinancing efforts, or whether higher inflation will make those bonds attractive at the low yields they need to refinance their debt.

We fully expect some real assets to thrive, like real estate and precious metals, but these markets are not deep enough to cater for global demand.

And then there's the probability of failure. While we would be surprised – the Fed is a very strong player in global markets and economies – the sound of that failure would be resounding and the US would be confirmed as a 'Japanised' economy. This could have a profound effect on the US Dollar, not in terms of initial trading reactions but it terms if its long term status as a reserve currency.

The truth of the matter is that the global economic system as a mechanism to allocate resources has been damaged. In the decade preceding the COVID crisis, savings rates rose, investments in capital expenditure fell, as real incomes stagnated. The term "secular stagnation" (as opposed to "cyclical") was very much thematic at the end of 2019. Inflation is a mechanism to prevent demand from drying up and reducing the real debt burden. But it cannot create demand for goods and services, anymore than a real estate agent can create a sale by imposing time limits on clients who don't really like the property in the first place.

The Fed has been instrumental and potent in fighting off financial crises. This crisis, however, is more economic in nature, and needs fiscal and policy responses far beyond the stability of financial markets. Until we see these responses, we remain in the same camp as markets and don't expect inflation to pick up materially.

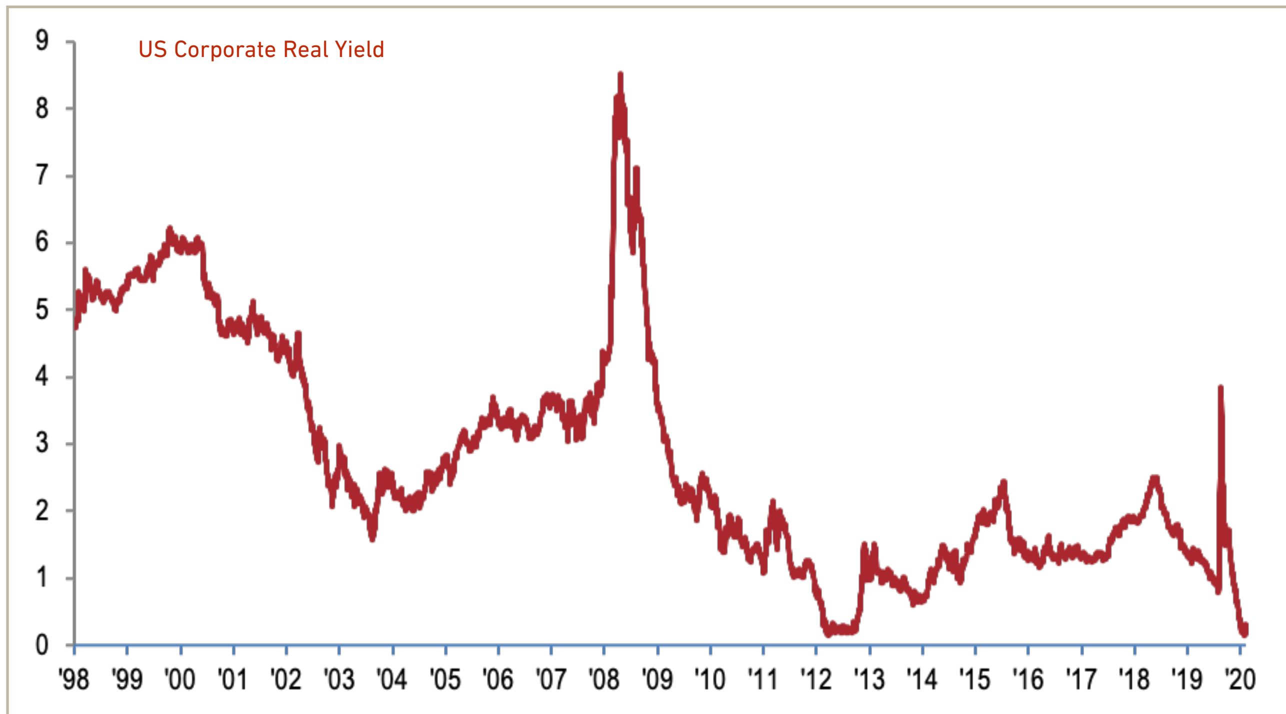
Charts Source: Mazars Calculations

RISK ASSET SPOTLIGHT: REACTION TO THE FED

After the US Federal Reserve stated that it would abandon its 2% inflation target, the immediate reaction was a jump in equities and long term bond yields as well as a moderate tightening in yield curves, consistent with a more inflationary environment. However, overall yields have remained low, as investors believe the Fed will increase the rate of bond buying operations, even if inflation expectations ticked higher.

As a result, US real corporate yields fell to nearly zero (or below by some metrics).

At this point, bond yields and implied inflationary expectations don't discount inflation much higher than 1.5%-1.9%, i.e. markets are waiting for the Fed to unveil more stimulus in September before they start pricing in the consequences. This is an indication that communication policies will not be enough to bring inflation, but that a successful package of monetary and fiscal measures will be required to stoke demand-driven inflation, a result of more investments and higher wages.



Charts Source: Mazars

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EQUITY SPOTLIGHT: TECH EARNINGS DISPERSION

As some (Apple, Amazon, Google, Facebook) of the Big Tech CEOs answered questions surrounding competition and regulation, the group's earnings each beat expectations. Against the backdrop of the worst ever quarterly fall in US GDP this is all the more impressive. Big Tech companies are the five largest US companies by market cap and account for the largest share of the market since the 1980s.

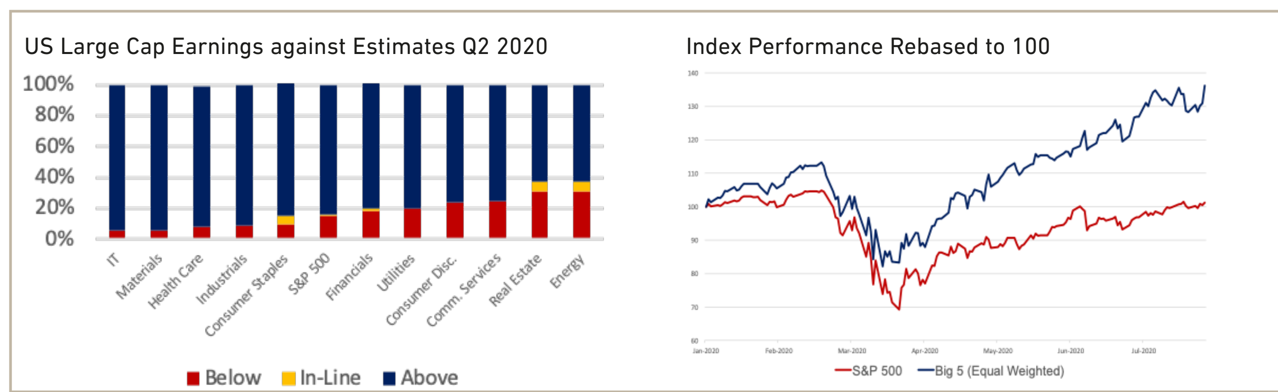
Amazon and Facebook were two of the clear winners during earnings season. Amazon reported diluted earnings per share (EPS) of $10.30 per share, with analysts only expecting $1.46. After tax profits at the online retailer doubled to $5.2bn. Facebook posted results of $1.80 per share, almost double its value a year ago and beating EPS estimates by 57%. Investors were concerned about the impact of the advertising boycott on Facebook, but revenue growth of 11% shows the firm isn't overly reliant on any source of income.

Alphabet, owner of Google, did actually see contractions in revenue and earnings, its first ever decline in sales, but ultimately beat expectations. Diluted EPS fell to $10.13 but still some way ahead of expectations of $8.34. Microsoft's revenue grew 13% on an annualised basis in the quarter to June 30, and marginally beat expectations on both revenue and EPS. Apple saw iPhone handset sales grow 25% despite the smartphone market contracting 14%; all other top five vendors had falling sales with Samsung's down 30%.

The table below helps show the strong performance of Tech relative to other sectors. Accounting for Amazon being included within Consumer Discretionary only helps to further this rising inequality between Tech and 'the rest'.

What we are seeing is a polarising market; even in the best performing sectors for earnings, less than half of companies saw earnings grow. At -35.7% for Q2 2020 looks set to post the largest decline in blending earnings since Q4 2008.

The graph below shows YTD performance of US large caps, against that of the top 5 on an equal weighted basis. Performance to March is fairly similar, but as consumers and investors have come to terms with the 'new-normal' it has been the big Tech companies who have benefited the most. Another possible explanation for the rise in big Tech has been the increased accessibility of speculation to the armchair investor. The rising inequality between the Big 5 and the US large caps in general coincides with the rising popularity of commission free trading platforms such as Robinhood where the Big 5 are often the most popularly traded stocks suggesting an increased role of amateur investors in the stock market rally.



Charts Source: Mazars Calculations, Factset, Refinitiv Datastream

GOLD AND CASH SPOTLIGHT: SAFE HAVENS?

A lot of investors are asking whether we can still trust traditional safe havens, like Gold or Cash. The narrative behind these questions has some merit:

Gold is an asset that has no yield, next to no industrial use and only has the value we ascribe to it. In a world of modern finance it may be considered outdated by some and its value is increasingly subject to speculation after the introduction of gold ETCs.

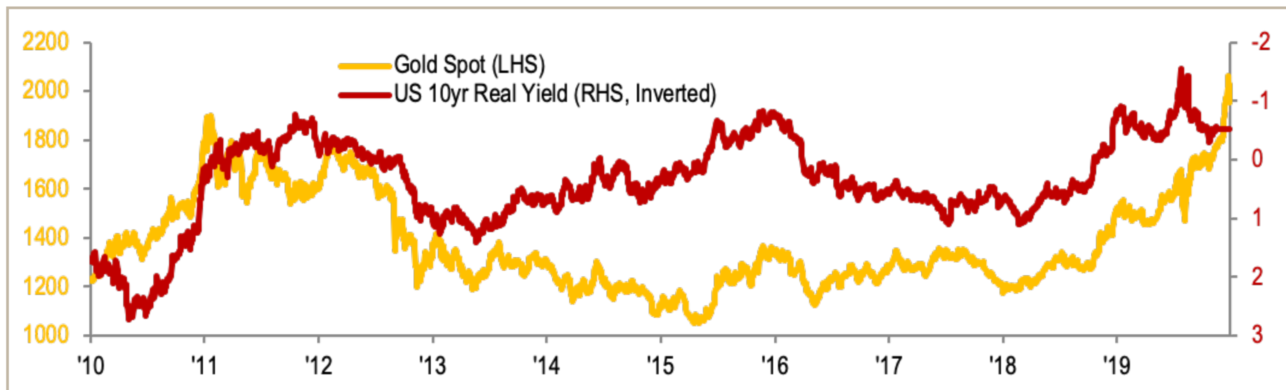
Cash is still, and will always be, king, especially in a liquidity crises. But Cash has a negative real yield (0% return and positive inflation) and, in a world where fiat currencies come under question, it might be a more dangerous asset than previously believed.

However, we still believe both assets have a place in portfolios for a number of reasons:

a. They both exhibit low correlations with traditional risk assets, which tend to increase in an age of quantitative easing. Low correlations are the foundation of portfolios.

b. Gold's value is behavioural, but that argument goes for most financial assets: Why pay 15-30x a company's earnings, when we have visibility only over the next 2-3 years, for reasons other than trust? Why include bonds with assured negative real returns in a portfolio over the longer-term? Because behaviourally they are a safe haven. When inflation is up and trust in fiat currencies erodes, Gold is still considered a safe haven.

c. When volatility spikes, cash pots allow investors on drawdown to live on the cash and not sell assets in distress, but rather wait for mean reversion. With markets propped up by QE (the post-crash recovery was the shortest in market history) mean reversion (a return to previous trend) is more likely than it may appear after a few bad days for the stock market.



Charts Source: Mazars calculations

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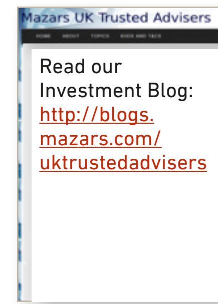

Investment blog

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