# MARKET INSIGHTS

**THIRD QUARTER 2020**

> ***If life were predictable it would cease to be life, and be without flavor. - Eleanor Roosevelt***

**David W. Griffis, CFA**
*Principal & Portfolio Manager*

Reflecting on the former first lady's comment, 2020 proved anything but predictable. In what unfortunately was a deadly serious year, there is little need to dwell on what everyone has endured. Rather, suffice it to say that mother nature reared her head and reminded us that life is precious, and that neither a clock nor a vaccine process can be hurried along.

Along with the human drama, the financial markets endured their share of havoc, as crude oil turned negative for the first time (-$37 per barrel WTI Crude 4.20.20) and blue-chip stocks acted like penny stocks with double digit pricing gaps, dispersions not seen in our team's professional careers. Those irregularities were reactions from the pandemic-induced panic that effectively froze the capital markets at the end of the first quarter. Then, by mid-summer, the chaos abruptly softened with a rather economically-disconnected stock market recovery that was further followed by a "relief rally" in the fourth quarter. The "relief" being a highly anticipated vaccine announcement, the conclusion of a divisive election, along with further stimulus promises. The sum of those various whirlwind periods could be compared to riding a roller coaster for the first time completely blindfolded. As one CEO described it, by the end of December it felt like the world aged 10 years in 10 months.


With the economic scarring still visible, foundational preparation has again proven itself a critical cornerstone in our investment process. For both the companies we invest in as well as our individual clients, those who adhere to the elementary practice of maintaining an accessible "safe" liquidity component at all times, coupled with a low debt profile, tend to weather storms with less angst. Having that sound foundation in place helps keep errant emotions in check when the inevitable financial crisis hits, curtailing damages from ill-timed decisions. It also allows those who are prepared to act offensively when the markets are most irrational. These axioms were made crystal clear throughout the past year.

With 2020 behind us, what are the positioning strategies for the coming new year? Let's first define the current playing field. According to a recent article in The Wall Street Journal,* global borrowing increased last year by $15 trillion to around $272 trillion. That is 3.6x times the world's annual GDP and a peacetime high. At the same time cash on the books of non-financial companies grew to the highest level ever recorded, $2.1 trillion, increasing 30% from the year before and a logical derivative from the tidal wave of debt issuance. Additionally, U.S. money markets now house an estimated $4.5 trillion, earning basically zero and presumably awaiting a higher purpose. Bearing those stats in mind, (a boatload of debt floating on a sea of liquidity), as life normalizes we may see the following trends emerge in the coming quarters:

- Corporate debt starts to be repaid, firming up balance sheets with less emphasis on refinancing or new issuance. Reduced supply with consistent demand dampens a portion of the duration risk.
- The repayment of massive government debt issuance driven by pandemic spending will likely be more difficult. A portion of this is a lack of political will, and a portion is driven by economic factors.
- Corporate leadership, fresh off pandemic wounds, seeks to strengthen business strategies. This plays out as fresh capital flowing into process modernization (think robotics and automation), supply chain diversity, and technological-led upgrades, all of which serve as an economic amplifier.
- Inflation, long presumed dead and buried, is resurrected and starts an upward trek, perhaps moving at a faster pace than formally recognized by the global reserve banks.

- Post-vaccine and post-U.S. election drama allow for a renewed spotlight on developing domestic economic opportunities. All things “Tech” (including BioTech and MedTech) along with ESG themed positions are examples of politically mollifying sectors that should be capital beneficiaries.
- A reshaping of world economic leadership starts to crystallize. Continuing efforts to separate the strengths of China, the U.S., and Europe will become evident, with technology serving as a catalyst.
- Highly productive and fiscally disciplined countries garner influence and strengthen their currencies, while the spending profligates and perpetually ineffective fall further behind.
- Pent-up demand by a global consumer weary of confinement and restriction may hyperdrive all manner of commercial activity and energize consumption.

The summary outlook within the framework of our investment segments is for caution with bond and interest rate sensitive securities, while broadly supportive of our equity segments. The new year should bode well for continued dividend growth as earnings recuperate and collective balance sheets recover. Also, non-dollar exposures - in both the developed and emerging markets - offer a more compelling absolute valuation opportunity for new monies.

With an everchanging economic backdrop, we thought it relevant to mention the leadership changes taking place within the institutional investment landscape. Over the past decade, newly empowered asset management firms have emerged and are exerting their acquired influence on boardroom decisions with their shareholder proxies. **BlackRock** ($7.4 trillion of Assets under Management “AUM”), and **Vanguard** ($6.2 trillion of AUM), are two of the firms that have gained significant ground and are redefining Wall Street’s center of gravity. The power shift is away from the traditional leadership of investment banks (think **Goldman Sachs or Morgan Stanley**) and into the hands of the institutional investment firms who then control the support for any number of diverse amendments. **BlackRock, Vanguard,** and others are overseeing a tremendous amount of perpetual investment capital, driven by inflows from sovereign wealth funds as well as world pension assets; the latter are estimated to be now valued at roughly $46.7 trillion ($46,700,000,000,000).** For perspective, below is a short list of the world’s largest pensions shown with their staggering portfolio valuations:

1. Japan Government Pension $1.55 trillion
2. Norwegian Pension Fund $1.06 trillion
3. South Korea Pension $637 billion
4. U.S. Federal Retirement Thrift $601 billion
5. Dutch Public Pension APB $523 billion

These are dynamic, politicized, and power yielding entities in their own right, which organize and pool capital from the expanding payroll of active government/state employees, as well as distribute benefits to retirees. Closer to home, **Florida’s Employee Retirement Pension** assets topped **$173 billion while California’s Employee Retirement Pension (known as CALPERS)** now has $**384 billion** of investment capital. As we consider equity market opportunities today, we are mindful that as workers are paid in the U.S., and around the world, a fixed percent of monies is set aside in a retirement vehicle and then channeled into public market securities. This is capital that did not budge in March and April; rather it was business as usual averaging into markets during both undervalued and overvalued periods. These consistent inflows are a critical part of what supported security valuations during such an oddly stressful economic year. Furthermore, we strive to monitor the direction and end targets of the perpetual cash streams for a number of offensive and defensive strategies within our portfolios. Ultimately, analyzing the impact these monies represent within the global capital markets has been a profitable exercise for our clients.

A final point to mention is we did experience dividend cuts and temporary freezes from a modest number of our portfolio holdings early into the pandemic. However, business resiliency within our stable of companies was on display as a majority were able to maintain their dividends, and by year end 28% had actually increased shareholder distributions. As we work to offset inflation’s costly impact on our clients’ finances, consistently rising dividends are an integral part of the secret sauce.

2020…It was a year like no other, and frankly will anyone miss the awful looking little germ ball with protruding crowns on every magazine and website? As the vaccines are now being allocated, we relish the day we can say “so long Corona virus, may we never meet again;” and may we instead heed Waldo Emerson’s words to “live in the sunshine, swim the sea, drink the wild air.”

*The Wall Street Journal, 12.5.20

**Pensions and Investments, 9.7.2020

VERO BEACH GLOBAL ADVISORS
Registered Investment Advisor

verobeachglobaladvisors.com | (772) 213-8000
4625 Florida A1A, Suite 9 | Vero Beach, FL 32963