This Month in the Markets

January 2021

EQUITY COMMENTARY

Speculative Explosion

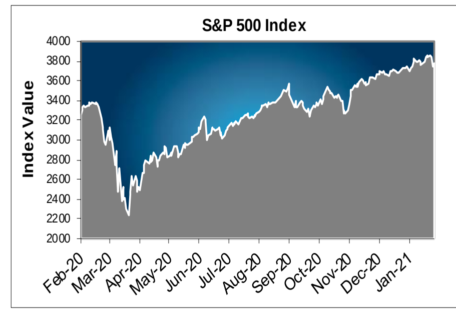
Although the equity markets started January out strong, they rolled over by the end of the month. Market volatility associated with a retail induced short squeeze (see below) and concerns over virus mutation and stumbles in the vaccination distribution process likely led to the selloff. COVID-19 has not been eradicated, and its persistence is pressuring economies as they grapple with various forms of restrictions and lockdowns.

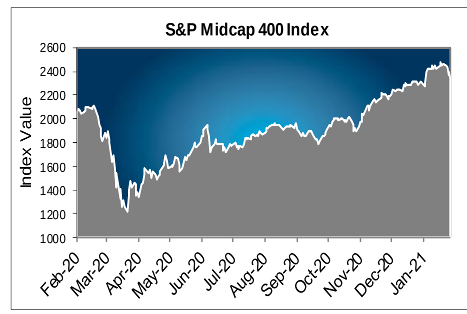
The MSCI ACWI Net Total Return Index slipped 0.5% during the month. The S&P 500 fell slightly by -1%, and international markets represented by the MSCI EAFE Net Total Return Index fell by 1.1%. Value and growth posted similar performance – both falling by around 1% as measured by the MSCI World Net Indices. The MSCI ACWI Energy sector was the largest gainer for the month, with a 1.8% rise. The worst sector, the MSCI ACWI Consumer Staples Sector, posted a loss of 3.9% in the month. Our best performer in the month was Tencent Holdings, which rose over 24% on the back of a series of analyst target price boosts, reflecting its strength in a world of "onlineification." Our biggest detractor in the quarter was Visa, which fell 11%, after hitting an all-time high at the end of December. The weakness may be attributed to fears of further weakness in cross border payment activity from restrictions in travel due to the virus.

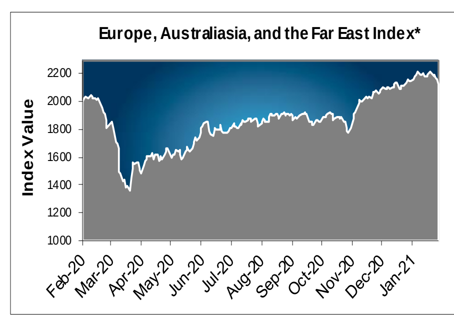
Last month we witnessed another market anomaly. The Reddit army waged war against select hedge funds, driving an enormous short-squeeze in the shares of GameStop and other heavily shorted names. GameStop, for example, had short interest far above the float outstanding. Hedge funds have proven once again that they can offer uncorrelated returns, with the likes of Melvin Capital purportedly falling 53%. Shorting, to say the least is very hard. Shorting often gets the glamor and prestige in movies or publications. Still, its long-term success seems ephemeral in most cases. The returns are asymmetric – stocks can only go to zero, but they can theoretically rise to unlimited heights. The quote attributed to John Maynard Keynes seems worthy of repeating when considering leverage in investing: "The market can remain irrational longer than you can remain solvent."

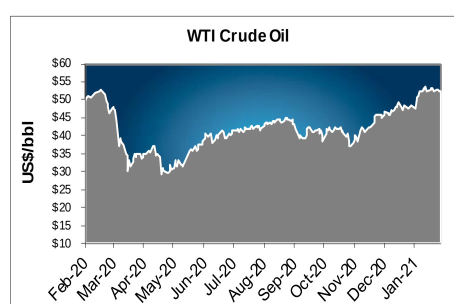
During the month of January, we decided to sell one name: Keysight Technologies ("KEYS"). KEYS was a position we only held for three months. Still, its 46% rally brought it to a price where our valuation work suggested it had become fully valued. It is nice when the market agrees with your assessment – even more so when it does so almost immediately after you buy. We wish this could always happen.

We had two new buys in the month. Oshkosh Corp. ("OSK") is a market leader in various specialty vehicles. It builds a portfolio of vehicles such as fire trucks, garbage trucks, cement mixers, tow trucks, military vehicles and even aerial work platforms. We favor how half its business generates stable cash flow with large backlogs, while the other half provides potential cyclical lift that we hope develops through increased infrastructure spending. It has increased its dividend by 10% for the past 7 years, has reduced its share count by 25% since 2012 and lastly, its valuation and growth profile is also attractive compared to other machinery peers. FedEx ("FDX") was our most recent buy during the month. Being a household name, most will be familiar with this trucking and air freight company. The shares recently corrected from their highs, and we view the company as a great way to play the recovery in economic growth and cross-border commerce. Fedex benefits from its best-in-class logistics and ground network and will continue to ride the pandemic induced tailwinds. We believe the e-commerce boom is a long- term secular trend that has become further entrenched in people's lifestyles because of the virus and its forced mobility restrictions. Due to the proliferation of "onlineification", management recently indicated that they see a tripling of packages delivered by 2026.









*MSCI EAFE Index

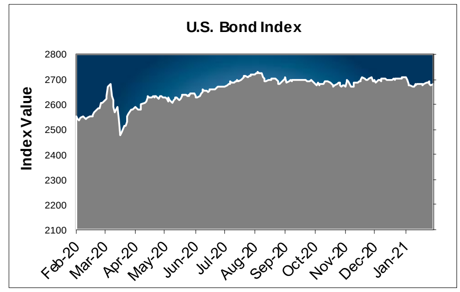
FIXED INCOME COMMENTARY

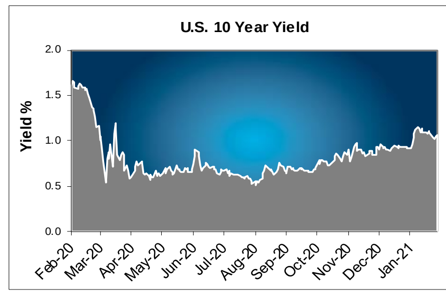
Staying Vigilant

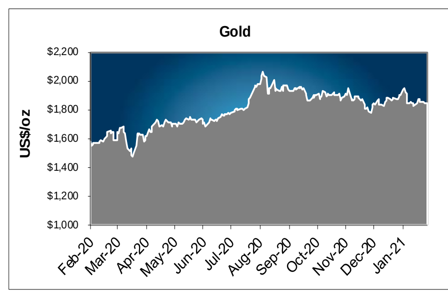
The dollar weakening trend that gathered pace through the second half of 2020 paused in January as evidenced by the DXY index. The currency move reflects the renewed lockdown in major European economies which has flowed through to economic data and consumer sentiment. For example, the U.S. Markit purchasing managers indices (PMI), both the manufacturing and services components, continue to rise (both are currently >57, well into expansionary territory). While the German measure for manufacturing remains in expansionary territory, it is trending downwards. The German services PMI has been declining since June 2020 and is in contractionary territory (46.8). Another layer of support for the USD is the hedged yield advantage that U.S. treasuries now offer Japanese Yen and Sterling denominated investors compared to their local currency government debt. In both cases the spread (approximately 0.60% for a 10-year government bond) has not been this attractive since 2018. Over the medium to long-term we expect the dollar to resume its weakening trend driven by heavy government spending and rising inflation expectations, however a period of dollar strength or consolidation around current levels cannot be ruled out. We remain comfortable with our exposure to the Norwegian krona and Singapore dollar.

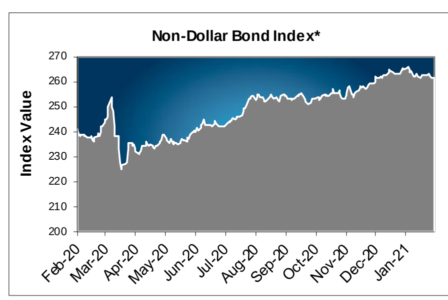
Given the rise in equity market volatility, as evidenced by the VIX index, which rose to levels last seen in October 2020, one could have expected to see some negative impact seep into the corporate bond market. However, this was not the case. Corporate credit spreads ended the month largely flat from the year-end 2020 levels, while new issuance volumes remained elevated. The muted reaction suggests credit investors are looking through the short-term noise to the economy steadily returning to normalcy as vaccine roll-outs ramp in the coming months. A dovish Fed and democratic controlled congress suggest that both accommodative financial conditions and supportive fiscal policy are firmly in place. On top of this, it was only 9 months ago that the Fed backstopped corporate bond markets, essentially saving many firms from bankruptcy. These factors in conjunction with historically low treasury rates have led to a strong bid for corporate credit as we are firmly entrenched in a reach for yield environment.

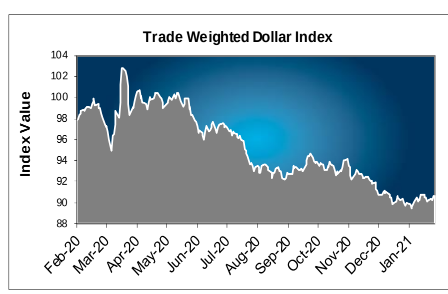
Credit spreads rallied aggressively in the latter half of 2020, driven by strong investor demand. However, on the whole companies' leverage has increased as corporate bond issuance exploded in 2020. Companies issued bonds for liquidity purposes and in many cases to address their debt maturity schedules by calling/tendering shorter term debt using the proceeds of longer tenor bond issuance. As a result, the duration (a measure of interest rate risk) of the ICE/Bank of America investment grade corporate index now stands at an all-time high (8.3). By the same token the ICE/Bank of America investment grade corporate index rose +$675 billion (+10% YoY) and is now approximately $7.4 trillion in size. The BBB component, the lowest rated cohort of the investment grade index, accounts for half of the index. As such, the investment grade credit market is larger than it has ever been, has the highest interest rate risk it has ever had, and is dominated by BBB-rated credit. While we do not expect a violent sell-off like that of March 2020, the risk/reward trade-off is stretched at present. We prefer to be patient and monitor market activity and act accordingly when an opportunity presents itself as opposed to extending ourselves to pick up a few extra basis points... An excerpt from Benjamin Graham and David L. Dodd's book Security Analysis is particularly apt: "Bond selection is primarily a negative art. It is a process of exclusion and rejection, rather than of search and acceptance."











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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