INVESTMENT NOTES - February 26th, 2019

Written by Jane Siebels, Global Opportunities Fund

We remember wise advice from Sir John Templeton- "always follow the KISS (Keep It Simple Stupid) principle. If we analyze the global economic situation now, there are two main factors that will influence markets. The US/China trade talks (or if we will have a trade war) and whether the US Fed will continue quantitative tightening or not. As an investment manager, we also need to analyze what has been discounted in the market. Our portfolio has been positioned to profit from the favorable outcome of the US/China trade negotiations as we believe that is not priced in the market- especially on the Chinese side. We were overweight the US market on the equity side but recently reduced our exposure as we believe the pause of QT is fairly priced in the market.

Our friends at The Institutional Strategist, recently wrote that they believe a QE4 is on its way. If true, this is not priced in the market and would catch most investors off guard as cash is still at levels last seen in 2009. They give four reasons why they believe in QE4: 1. QT resulted in monthly blow ups starting with the NASDAQ, then oil and finally the S&P 500 in December. They argue that the lack of liquidity produced by QT caused these sell offs and consequently produced a change in the behavior of the economy, exemplified by the rundown in inventories and the lack of reordering. Therefore in order to avoid a recession, the Fed will need quantitative easing. 2. The yield curve is inverted pricing bad economic news in the long run. The stock market is pricing that bad economic news is good news in anticipation of the Fed easing. This is reflected in the sectors that have moved so far this year with the cyclicals and basic materials rising well ahead of the economic indicators. Treasury issuance and buying is on the short end- is the US economy not a good bet in the long-run? 3. The tax cuts of 2018 and stimulus spending have already worked their way thru the economy. Tax collections have remained flat even though GDP is increasing 3%. This is despite some people paying higher taxes due to state and property tax non-deductibility. Tax collections may be lower than predicted because the likes of Amazon are still paying no tax due to shifting tax payments to low or no tax jurisdictions. Or is the reason for flat tax collections inventory corrections, or lower than expected capital expenditures or a more cautious consumer? 4. After 2014, non-U.S. investors rolled their buying of U.S. Treasuries into Agencies and then they rolled their buying into corporates. Over the last 8-9 years, the U.S. corporate bond market has grown by approximately $3.6 trillion. Why did foreigners stop buying treasuries in 2014? Because quantitative easing stopped. The government bond market size has increased from $10 trillion to $22 trillion. The U.S. government needs to lure the foreign buyer back to the treasury market.

In summary, QE4 is necessary for the following reasons: 1. Markets need liquidity. 2. The economy needs help but another tax cut is out of the question. 3. A lower dollar, lower rates and lower oil would all help the economy. 4. The U.S. needs foreign buyers of treasuries which only happens when they know rates are coming down.

QE4 is not priced in the market. The market is fairly priced however without QE4. Therefore, for the near term, we are maintaining a cautious stance.

Jane Siebels