MASCAREIGNES
FINANCIAL MANAGEMENT LIMITED

MONTHLY BRIEFING JANUARY 2021

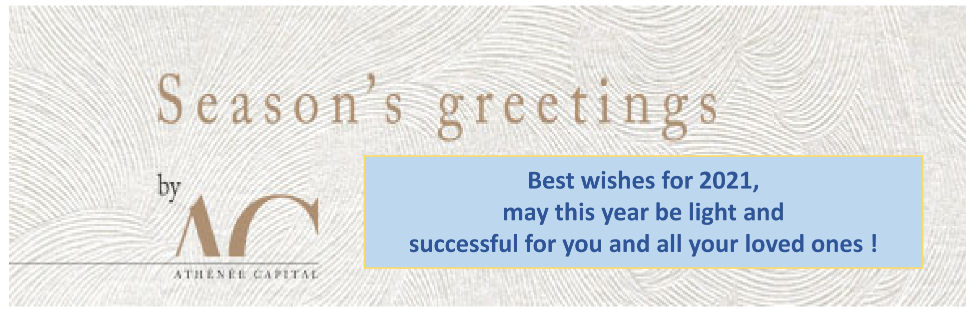
Comments (Portfolios and Mascareignes FM Model)

Inflation : stupid ! (*)

2020 was marked by universal asset price inflation, a direct consequence of central banks injecting trillions into the economy thanks to rate cuts and implementation of another massive Quantitative Easing (QE). In doing so, **central banks have created a huge price distortion (resulting in the current markets levels, i.e at all time high); to some extent central bankers kept feeding a monster they created in 2008.**

Their efforts to avoid a financial collapse in first semester 2020, to limit damages related to the pandemic, actually stored up problems for 2021 (inflation or no inflation, that is the question !) and central banks will probably be held accountable for the whole coming decade, particularly as they were already overextended prior to the Covid19 crisis (e.g. Mario Draghi with his perpetual « whatever it takes »), supporting a potential stock market bubble with the side effect of fueling inequalities (Main Street vs Wall Street, rings a bell ? And here we go again, *more of the same vs change *).*

So, there is a question we may raise for the coming months and years: **will the Fed or the ECB ever be able to raise rates again, at least take away QE gradually without causing painful stock markets drop?** Even a hint that the Fed might try to reduce its stimulus could be enough to depress equities, like it happened in the past. Remember the Taper Tantrum episode in 2013 when « young » Powell wanted to end the QE, calling for a plan to taper bond purchases and "ending them before year-end ». The market did not like it at all! And this kind of experience branded the current Fed Chairman : we hereafter attach **a link of a NYT article dated 2019**, for those who are too young to recall the event (or too old to remember this specific central bank misstep, midst of others). To make it short Mr. Powell acknowledges that… *"The taper tantrum left scars on anybody who was working at the Fed at that time,"…and the lesson Mr. Powell took from it, is that the Fed should strive to be clear and predictable.*



And here we are, the US central bank said in December it would give plenty of warnings before tapering its bond purchases – and reiterated the message beginning of January. Jerome Powell had promised no rate hikes before 2023 ; indeed**, there are little signs that the Fed or any other central bank has the desire (or the ability ?) to raise interest rates in the short to middle term – thus providing the conditions for continued stock market gains !**

These are reliable ammunitions for those who believe that **recovery from pandemic will add extra impetus to risky assets, beside other supporting factors : more fiscal stimulus ahead, low borrowing costs, hope that vaccines will end the pandemic lockdowns**. All these elements are fueling very optimistic projections. In fact, vaccines should allow people to go back to work at some point in 2021; and if that happens, growth should surge, confidence should be back, and earnings rebound – turning an expensive market (current S&P500 EPR : 22 vs an average level of 16) into a reasonably priced one (to be compared to an EPR of 30 in 2000 before the dot.com bubble burst).

MFM/Athénée Mercury Certificate (International Stocks Long Only)	**+20,11% (from 27/03/2020 to 31/12/2020)**

https://www.nytimes.com/2019/01/11/us/politics/federal-reserve-jerome-powell.html : Effects of the 2013 'Taper Tantrum' Linger Over Fed Policy by B. Appelbaum (11.01.2019) New York Times

MASCAREIGNES

— FINANCIAL MANAGEMENT LIMITED —

MONTHLY BRIEFING JANUARY 2021

Comments (Portfolios and Mascareignes FM Model)

We can't ignore, though, the very explosive cocktail we are currently dealing with: stratospheric valuations, struggling mom and pop stores (fostering inequalities and social unrest, as seen last week in Washington), unjustified zombies competing with healthy businesses, frenzied IPOs and **hysterically speculative investors' behavior**. Such greedy positioning is particularly illustrated by **mania for bitcoin or equities like Tesla** (or remember once upon a time: Nikola !!!).

These assets performances look unstoppable and disconnected from reality. Sometimes, we have to pinch ourselves to believe it is true – but yes, it is, and it is called momentum! Needless to mention **all confidence indicators are almost at their highest levels, which is definitely a red light for us**: lack of fear, when trading risky assets, has always been bad omen in the past.

So, this is where we stand beginning of 2021: just torn between optimism (fostered by liquidities) and necessary caution due to classical metrics and common sense. But for now, the focus is on reflation: **in other words, USA, EU and China are willing to stimulate economic growth, via monetary and fiscal stimulus, while triggering a pleasant level of inflation (but not enough to panic the central banks).**

Performances	2020	2019	2018
STOXX600	-4,04%	+23,16%	-13,24%
CAC	-7,20%	+27,86%	-11,93%
SMI (CHF)	+0,82%	+25,95%	-10,15%
S&P500 $	+16,26%	+28,88%	-6,24%
NASDAQ $	+43,64%	+35,23%	-3,88%
MSCI Emerging $	+15,84%	+15,42%	-16,63%
EUR / USD	+8,94%	-2,22%	-4,48%
Gold $	+25,12%	+18,31%	-1,56%
Yield / 10 year USA	0,9132%	1,9175%	2,6842%
Allocation Tracker Classique	**-0,83%**	+7,05%	-5,07%

Under these circumstances we adopt a two-step approach:

1. **On the very short term, as long as liquidities remain ample and T-Note yield under control, we recommend to buy any deep (5% or more)– specifically as we adopted quite a defensive stance end of 2020.** We like commodities (particularly grains) and stocks (special situations, reopening equities such as leisure, industrials, banks etc.), including Chinese equities.
2. Once we eventually see the light at the end of the tunnel, or even before, **we shall closely monitor Central Banks' rhetoric which may trigger a major asset reallocation.** Actually, getting back to work may be a turning point for the market, against all odds: when economies reopen, stimulus should be gradually cut back, people will have less time to speculate, more important: size of QEs may shrink. That may well signal the party is over!

Though that won't necessarily be the case, and nobody can predict the future: for now, market conditions remain favorable. There are huge liquidities to boost consumption and investment so TINA *(There Is No Alternative)* prevails. But we can't prevent ourselves to raise a question: **how long will central banks (or governments) let stimulus inflate the equities bubble, while real economy is lagging?** Should it continue this way, it could well look like the Japanese situation end of the 80s : frantic equities bubble followed by several decades of deflation crisis. Or on the contrary, inflation may come back and then we will have to deal with the monetary tightening headache !

All in all, central bankers will have to stand up with tact to challenges ahead - just like investors (who currently behave more like a kind of steamroller). So, let's get prepared to ride once again the dragon !

(*) James Carville's three recommendations, still valid : *Change vs more of the same.* ***Economic, stupid .*** *Don't forget health care.* – Carville was *one of Clinton's adviser during the 1992 presidential campaign, aimed to inspire campaign workers to win elections.*