CHAHINE CAPITAL
Performance Engineering

30/5/2020

# STRATEGY OVERVIEW

## Pandemic relief fuels a surge in asset prices


### Summary

Covid-19 restrictions are being lifted around much of the planet, and at rates that depend on when countries first suffered the pandemic. In Europe, glorious weather has buoyed households further as they emerge from lockdown. The Schengen free travel area within the EU has yet to be reopened, but once that is done Europe's links with the rest of the world will follow. Airlines seem to be aiming for a resumption of regular services towards the end of June, which could both salvage something from the summer tourist season and reinvigorate corporate managers keen to resume business relationships. There is still plenty of uncertainty surrounding the disease, particularly the prospect of an effective vaccine. The markets will simply have to live with the risks implied with contradictory statements from scientists over the chances of a 'second wave'.

Confidence over the end of the pandemic has enabled investors to look once again at the fundamentals. Avalanches of central bank liquidity have boosted asset prices again, including share prices for companies that continue to offer regular cash flows that will certainly revert to their former levels once the crisis is over. Mathematically speaking, an asset that generates perpetual cash flows in an environment of (effectively) zero interest rates has infinite worth… We would be winners today if S&P 500 profits were to revert to their 2019 level within 8 years!

Central banks will continue to print money for as long as their balances of payments remain close to zero. This is true for Europe and Japan, and while the USA is running an external deficit it is not calamitous and the dollar is the world's reserve currency anyway. Venezuela can print all the currency it wants, but it still have to convert it to dollars to pay for imports – its exports do not cover its foreign currency requirements. Isolated within its Brexit logic, the UK could suffer a much weaker pound if it prints currency too freely. Japan shows that major economies can print a great deal of money without upsetting their short-term equilibrium. The dollar has weakened slightly, reflecting the fact that the Fed has printed far more money than than the ECB has: its balance sheet is up $3 trillion, compared with a mere €800 billion in Europe. We believe that the US stimulus package is worth 20% of GDP; in France, national debt is set to rise from 98% to 115% of GDP as a result of higher spending and fewer receipts. More liquidity injections are on the way on both sides of the Atlantic, and there are hopes of a €750 billion EU stimulus package.

The market is not rebounding evenly. Healthcare and IT stocks are virtually back to their highs, but cyclicals such as travel and automotives are struggling badly. Energy and financials are in much the same position. The risks include mortgage REITs, which borrow massively from banks in order to lend it on to the real estate sector. Rising non-performance rates are keeping their share prices well down. Real estate does still offer opportunities, but there is no end of liquidity looking for a home.

World GDP could drop 3.2% this year, compared with a 1.5% drop in 2008. OECD countries will be the worst affected. In Asia, activity is weakening by less, and China is still looking at a 1.5% gain. Eurozone output is set to fall 6.6%, with France down 9%. The expected 4.7% rebound in 2021 assumes a resolution of the pandemic, of course. Some US macroeconomic indicators are up slightly, such as consumer confidence and the PMIs. But America's big problem is unemployment, given the relative lack of a welfare safety net there.

According to the consensus, S&P 500 profits will be down 24% in 2020. At Chahine Capital, we are looking at 28%. A 17% rebound is expected in 2021. Our theoretical objective for this index is 2,903 points, down from 3,092 points last month because of the uptick in interest rates. Given our model's extreme sensitivity to interest rates and the earnings CAGR, the drop in our objective does not worry us and we are maintaining our recommendation to overweight equities (an over 40% allocation, in our case).

*Jacques Chahine*

## Lockdowns start to ease…

Covid-19 restrictions are being lifted around much of the planet, and at rates that depend on when countries first suffered the pandemic. Children are trickling back to school and offices are opening up again, although teleworking remains the favoured option. The opening of restaurants and bars is a big step, but all the precautions that still have to be taken can create practical difficulties. In Europe, glorious weather has buoyed households further as they emerge from lockdown. There is still a long way to go, of course, and the next big step will be the reopening of the Schengen travel area within the EU, planned for 15 June and ideally in a coordinated fashion. A number of countries that depend heavily on tourism, such as Greece, Italy, Spain and Portugal, are calling for a swifter return to business as usual. Daily air services have resumed between Luxembourg and Portugal, for example, but that remains the exception rather than the rule. It seems that the airlines themselves will decide when they ramp up again. Ryanair says that it will resume its services on 1 July; Transavia starts on 26 June. The airlines never stopped flying in the USA, but distancing measures have complicated matters. Although there has been little demand for flights overall, no voluntary limitations have been agreed and American cabins have sometimes been packed.

With a bit of luck, Europeans will be back on the beaches of Marbella, Portofino, the Algarve, the Greek islands and the Cote d'Azur this summer. We would recommend the deserted beaches of Comporta in Portugal – the new Saint Tropez! Just thinking about a summer break has been enough to buoy morale, not to mention visiting friends and relatives once again.

## … but no end of uncertainty over this virus

As usual, equity markets had already priced in the good news, lifting the S&P 500 off its 23 March low at 2,237 points to over 3,000 points. Not many investors would have banked on that a month ago. A successful campaign against the pandemic is of course the main factor. There are now over 100 vaccines being developed worldwide, of which ten are being tested on humans. The biotech firm Moderna impressed the market with its announcement of encouraging human testing results: its share price multiplied threefold and its capitalisation to $23 billion, even though it has not yet realised a single dollar in sales.

Now that we are starting to assess the impact of the crisis, it is evident how many of the old certainties have been shattered and how far scientists themselves are divided on a number of issues. The WHO is warning of a second wave, for example, while the respected American Dr Fauci believes it highly unlikely. Unsurprisingly, this has left investors rather skittish. Professor Raoult and chloroquine offer another source of bitter debate. Plenty of studies have shown how ineffective and even dangerous chloroquine can be, but the good professor and his supporters continue to promote it, claiming its benefits in avoiding coronavirus complications. At one point we thought that herd immunity would deal with the disease, particularly once 50-60% of the population had developed antibodies, but unfortunately Swedish experience suggests otherwise. Like most other countries, it seems, Sweden – the most committed to this approach – has not managed to develop significant immunity, estimated at 5-15%. On the other hand, some researchers have come up with the idea of 'cross immunity', which means that antibodies resulting from influenza can deal with Covid-19, ensuring that the pandemic ends without further assistance. The picture is confused even further in South Korea, for example, where the virus appears capable of springing up again whenever restrictions are lifted. All that amateur speculators like ourselves can do is conclude that the market is simply faced with a natural risk alongside all the financial ones.

# Another massive avalanche of liquidity

Renewed confidence in the end of the pandemic has enabled investors to reconsider the fundamentals. And not for the first time, massive liquidity injections aimed at saving the world economy are presenting investors with a no-brainer: apart from gold, equities are the only real asset class offering investors any kind of return as well as protection against extreme liquidity conditions with unpredictable long-term consequences. It could well end up as higher inflation, but then again could go no further than a sterilised paper flow. Central banks can always print unlimited amounts of currency; in fragile countries such as Argentina and Venezuela, that currency will seek out goods and services of all kinds. Given that the national economy cannot meet all that need, imports fill the gap, and this currency therefore has to be converted into dollars. The catch is that nobody lends dollars against Mickey Mouse money or a currency subject to hyperinflation.

The USA is in the happy position of being able to print money indefinitely, so long as it can keep its external accounts more or less in balance. A continuous deterioration in the US balance of payments would eventually dent the dollar's attractiveness to international investors, resulting in imported inflation. The point is that for as long as foreign investors retain confidence in a country's currency and ability to balance its external accounts, the central bank has considerable scope to print money. It cannot be converted into massive imports, in other words.

Japan offers an interesting example in this regard. It is running a small trade deficit but a $700 billion balance of payments surplus as a result of its foreign investments. The Bank of Japan's balance sheet has swelled to $6 trillion, compared with government debt of $11 trillion, and is still rising. The central bank is effectively buying up most government debt without any ill effects: inflation is close to zero. The government debt to GDP ratio of 205%, suggesting that other OECD countries have a great deal of scope to borrow more than they do. Taken together, the euro zone is in a similar situation. Thanks to Germany, it is posting a trade surplus and an overall balance of payments surplus. For as long as this performance is maintained, the ECB can continue to print money to finance its government deficits. The Fed is printing money faster than it is, giving more credence to the idea that it can do more. The UK is in a more difficult position, with trade and overall balance of payments deficits. Brexit is not helping matters. The Bank of England's increasing use of quantitative easing could put the pound sterling under further pressure. The euro is already up to £0.90.

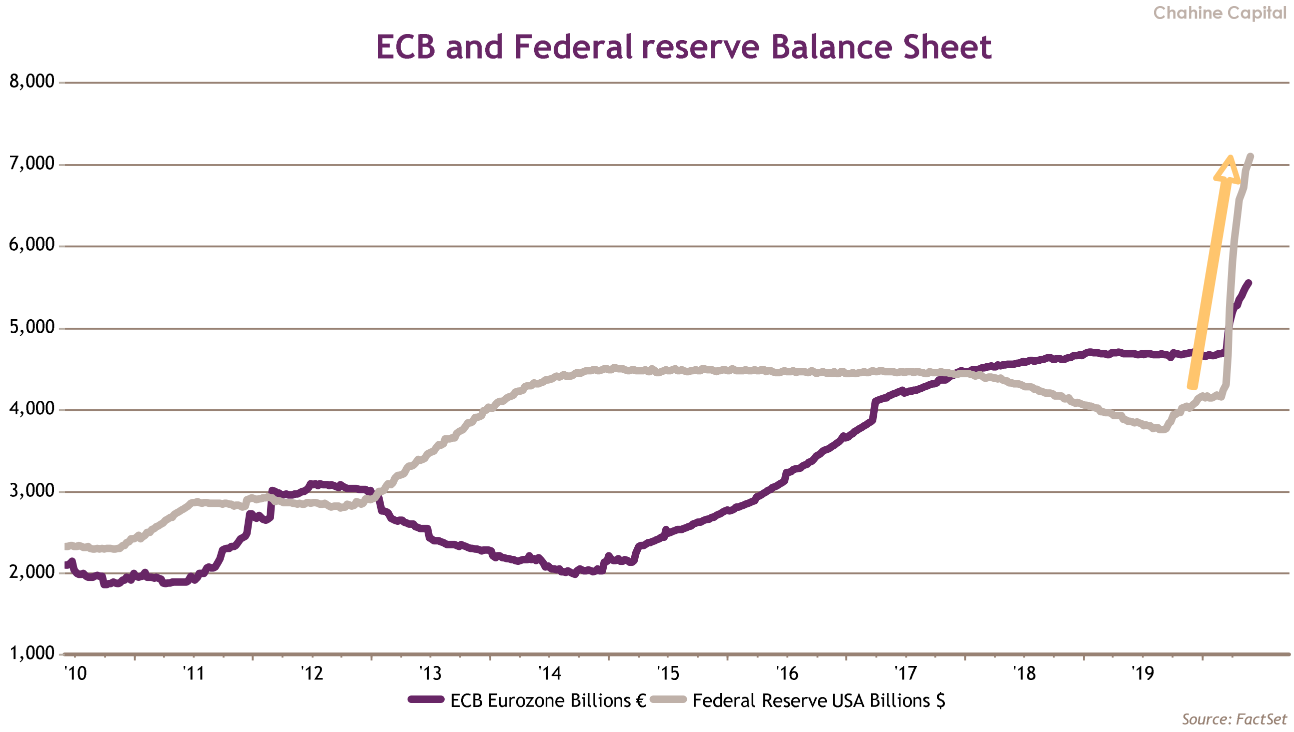
# Budgetary stimulus financed by central banks

Every country has reacted strongly to the crisis with all the monetary tools at its command. The Fed dropped its short rates to zero again, lowering the entire US curve, and central banks have stepped in immediately to buy the debt created by trillions of dollars' worth of government stimulus packages. The Fed's balance sheet has jumped from $4 trillion to $7 trillion, while the ECB's has increased from €4.7 trillion to €5.5 trillion. Most is in the form of government bonds purchased from the secondary market, although central bankers have been keen to intervene in panicky corporate credit markets as well. The Fed has gone so far as to buy junk bonds.

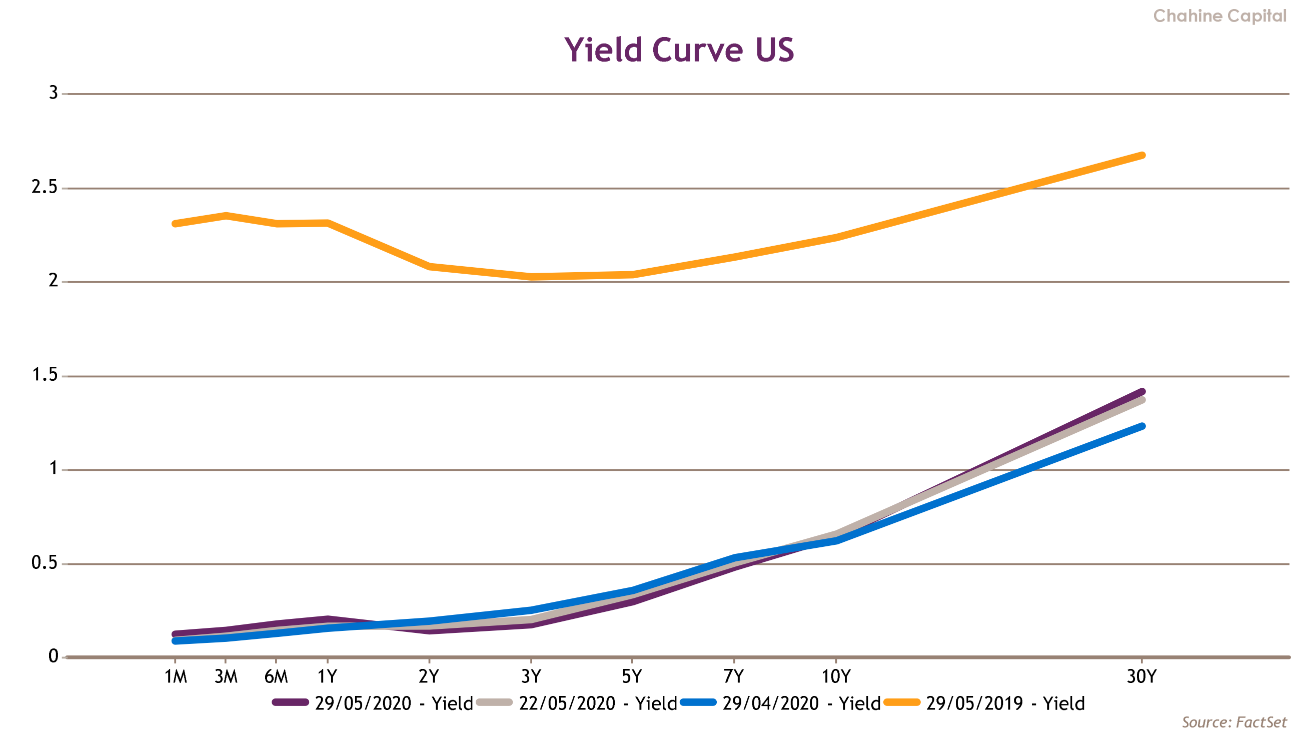
Yield curves have now stabilised, but we note a degree of tension at the very long end. That could suggest wariness among institutional investors over the chances of depressed inflation rates for such a long period.

The ECB has been more restrained than the apparently unbridled Fed, partly because the German courts are now demanding that it justifies any bond issues. Italy and France do not have central banks of their own that can print money, and some other eurozone countries do not have the same sort of liquidity requirements. These so called ‘frugal’ countries are less than happy financing countries that do not share their own self-discipline.

## Surging central bank balance sheets



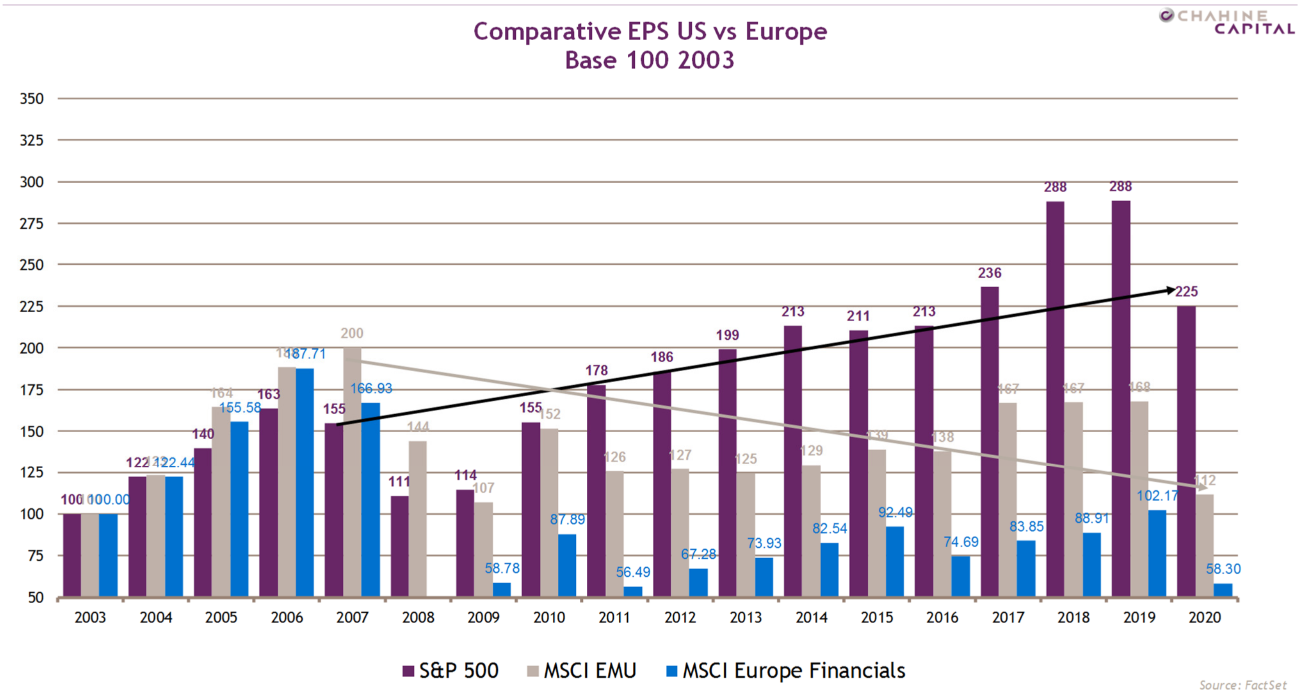

## The US curve stabilises at low levels



## Lower rates boost asset price inflation

In financial theory, an asset generating a return as low as 1% or 2% per year in a context of very low or zero interest rates has infinite value if we discount those returns out to infinity. For example, an investor can buy S&P 500 index futures with a 10% margin cost and a real cost of carry of zero (or an average 0.5% over 10 years). That futures contract will replicate the index with gross dividends and no frictional costs. Could the total return index generate 0.5% x 10 years, or 5% over that period? This is the question when interest rates fall towards zero. There is of course a risk that corporate profits decline continuously or in some one-off slump during the period; we have seen this year that a crisis depressed the US index 34% from its highs and we now expect profits to fall 28%. We get bumps in the road in every cycle and experience shows that profits rebound, but the past is no guarantee of the future. Remember that European companies have never recovered in terms of profits to where they were before the 2008 financial crisis. MSCI EMU EPS were at 200 points in 2007; they fell to 107 points in 2009, climbed to a high at 168 points in 2019 and are down to around 100 points today. Banks account for a very large share of European market capitalisation and have never got back to their condition of pre-2008 and ECB bailouts. Banks' EPS has halved since 2003, while S&P 500 profits were 2.9 times higher than their 2003 levels in 2019 (and 2.2 times higher even in 2020).

### European profits on an unimpressive run



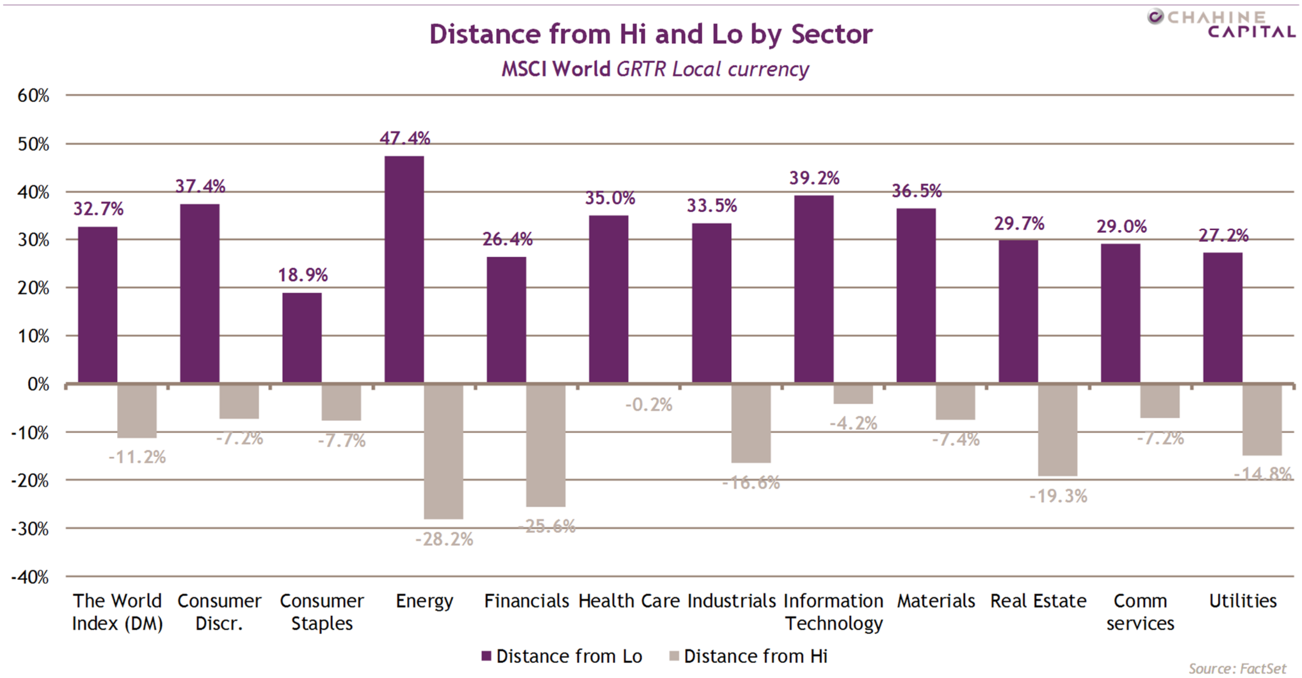

Apart from financials, the European market has been highly exposed to the energy sector. Its capitalisation share was 13.7% in 2003 and is now down to 4.9%. Financials have dropped from 27.2% to 14.8%. In the same time, the European economy has not innovated enough to make up for these declines, relying instead on the Americans for its digital transformation. GAFAM account for 18.7% of S&P 500 capitalisation all on their own and there is no equivalent of any of them in Europe. Thanks to protectionism, only China has been able to create genuine challengers. Europe is still more of a high-end industrial and bricks-and-mortar economy. As for the US digital leaders, we export their sales and they pump us for their profits.

## Real estate could cause a crash

Turning aside from the equity market's impressive rebound, we focus now on sector performances since the S&P 500 high at 3,386 points on 19 February and its low at 2,237 points on 23 March. Readers will recall that we switched from 15 months of underweight recommendations on equities to a timid overweight on 29 February, at between 2,750 and 2,850 points, and to a marked overweight at 2,600 points on 28 March.

The MSCI World is 11.2% off its all-time high, while the S&P 500 is off just 9.5% and the Nasdaq 3%. The MSCI EMU is still down 20% from its own high. Thanks to the coronavirus, healthcare is practically at its highs and IT is not far behind. Lagging sectors include energy, financials, real estate and industrials.

### Contrasting sector rebounds




For the benefit of our stock-picking readers keen on bargain buys, we list below a range of US stocks with 'residual' capitalisation of over $500 million that have still a long way to go before matching their highs. They include some animals that Europeans may be unfamiliar with, such as mortgage REITs. These real estate investment trusts are lightly regulated and act like banks in that they lend for real estate. They fund themselves via 'real' banks and other institutions via a repo system in which they offer their mortgages as collateral. The largest of them, MFA Financial, had $2.9 billion in equity at end-March and $19.3 billion in debt. Its capitalisation has since dropped to $1.3 billion, or less than half its equity. It suggests that the loans it has extended to the real estate sector are less than solid, which raises questions about the banks that financed them. MFA Financial is not the only REIT in this position. Some are in obvious difficulty, such as those financing shopping malls and hotel chains.

Our list also includes a number of listed oil companies; note that the biggest problems in the sector are among unlisted firms carrying huge debt. Unsurprisingly, we find cruise ship operators and airlines in the list as well.

Real estate includes some of the biggest sufferers among listed firms. That means hotels, but especially retail and office property. The default rate on loans extended to the hotels sector hit 35% in May. Residential property remains solid, however, and builders' prices have climbed 80-150% from their lows.

### Watch out for loan defaults in the real estate sector

| | GICS Level 4 Sector | Price | Market Cap. | Price as of 23/03/20 | Price as of 22/02/20 | distance form Hi | distance form Lo |
|---|---|---|---|---|---|---|---|
| MFA Financial, Inc. | Mortgage REITs | 1.69 | 766 | 2.70 | 7.90 | -79% | -37% |
| Macerich Company | Retail REITs | 6.81 | 964 | 6.85 | 23.70 | -71% | -1% |
| Two Harbors Investment Corp. | Mortgage REITs | 4.52 | 1 236 | 4.32 | 15.45 | -71% | 5% |
| Service Properties Trust | Hotel & Resort REITs | 6.75 | 1 111 | 4.51 | 22.64 | -70% | 50% |
| Redwood Trust, Inc. | Mortgage REITs | 5.35 | 614 | 4.24 | 17.44 | -69% | 26% |
| Occidental Petroleum Corporation | Integrated Oil & Gas | 12.95 | 11 655 | 9.69 | 42.12 | -69% | 34% |
| Spirit Airlines, Inc. | Airlines | 12.95 | 888 | 9.83 | 41.10 | -68% | 32% |
| Sabre Corp. | Data Processing & Outso | 6.97 | 1 920 | 3.65 | 21.88 | -68% | 91% |
| Transocean Ltd. | Oil & Gas Drilling | 1.33 | 817 | 1.16 | 4.16 | -68% | 15% |
| Coty Inc. Class A | Personal Products | 3.63 | 2 770 | 5.15 | 11.24 | -68% | -30% |
| Spirit AeroSystems Holdings, Inc. Class A | Aerospace & Defense | 21.67 | 2 287 | 21.20 | 65.39 | -67% | 2% |
| New York Mortgage Trust, Inc. | Mortgage REITs | 2.08 | 785 | 1.89 | 6.27 | -67% | 10% |
| Norwegian Cruise Line Holdings Ltd. | Hotels Resorts & Cruise l | 15.66 | 4 014 | 9.67 | 46.97 | -67% | 62% |
| TPG RE Finance Trust, Inc. | Mortgage REITs | 7.41 | 568 | 4.94 | 20.87 | -64% | 50% |
| Colony Credit Real Estate, Inc. Class A | Mortgage REITs | 4.95 | 636 | 3.12 | 13.92 | -64% | 59% |
| United Airlines Holdings, Inc. | Airlines | 28.04 | 8 144 | 26.25 | 78.01 | -64% | 7% |
| Newmark Group, Inc. Class A | Real Estate Services | 4.25 | 757 | 3.84 | 11.69 | -64% | 11% |
| Apergy Corp. | Oil & Gas Equipment & S | 9.07 | 703 | 3.02 | 24.77 | -63% | 200% |
| Kosmos Energy Ltd. | Oil & Gas Exploration & | 1.82 | 737 | 0.70 | 4.97 | -63% | 160% |
| Chimera Investment Corporation | Mortgage REITs | 8.31 | 1 597 | 8.54 | 22.52 | -63% | -3% |
| Signet Jewelers Limited | Specialty Stores | 10.55 | 552 | 5.84 | 28.33 | -63% | 81% |
| Kontoor Brands, Inc. | Apparel Accessories & Lu | 14.62 | 835 | 23.82 | 38.78 | -62% | -39% |
| American Airlines Group, Inc. | Airlines | 10.50 | 4 440 | 10.25 | 27.82 | -62% | 2% |
| Carnival Corporation | Hotels Resorts & Cruise l | 15.74 | 10 774 | 12.00 | 41.69 | -62% | 31% |
| Apache Corporation | Oil & Gas Exploration & | 10.79 | 4 072 | 4.31 | 28.40 | -62% | 150% |
| ARMOUR Residential REIT, Inc. | Mortgage REITs | 7.83 | 506 | 7.46 | 20.58 | -62% | 5% |
| Ryman Hospitality Properties, Inc. | Hotel & Resort REITs | 34.18 | 1 879 | 24.55 | 89.00 | -62% | 39% |

The vultures ready to circle foreclosed assets are not short of cash, meaning that bank auctions of such assets will not offer the same sorts of bargains that were to be had in 2008. The fact that the Fed has swamped the system with liquidity and is even buying up junk debt will also save companies that would otherwise be staring into the abyss.

## Trillions to save the world economy

As we have seen, massive budgetary stimulus packages around the world have sent central bank balance sheets into the stratosphere. It would be tedious to list all the measures already voted, but any readers interested in the details would be interested in the link below. In the USA alone, the Fed has a number of programmes all of its own, mainly to ensure that banks have plenty of cash to lend. It has lent to a huge range of financial institutions that can provide collateral, such as Treasury Bills, municipal bonds, mortgage bonds, government-guaranteed loans and corporate bonds.

https://www.investopedia.com/government-stimulus-efforts-to-fight-the-covid-19-crisis-4799723

Congress has voted Phase 3 of the CARES Act, which puts $2.3 trillion into a range of measures: cheques for $1,200 for each adult and $500 per child, unemployment benefits for self-employed and temporary workers until year-end, $600 per week for every unemployed person over and above existing benefit until 31 July, 6-month mortgage repayment holidays, $500 billion in loan guarantees to crisis-hit sectors, loans to small firms and subsidies to hospitals, States and universities. Another $500 billion has been approved to extend that effort. The $3 trillion so far voted by Congress could end up as $4 trillion, or 20% of GDP!

In France, that sort of support would amount to €480 billion. We have tried without much success to find out what the measures already taken by the French government amount to. According to budget minister Gérald Darmanin, government debt is set to rise from 98.1% of GDP last year to 115%, which would imply an additional 17% of GDP in debt, or €400 billion. That includes support measures but also the fact of reduced receipts. Southern European countries are in more or less the same position.

Given the difficulties of purely national stimulus based on new debt, France and Germany are backing an €750 billion European Commission plan. €500 billion of it would be in the form of subsidies. The Netherlands, Austria, Sweden and Denmark are unconvinced. We hope the plan is approved and helps to pull the EU together.

## World GDP to fall 3.2%

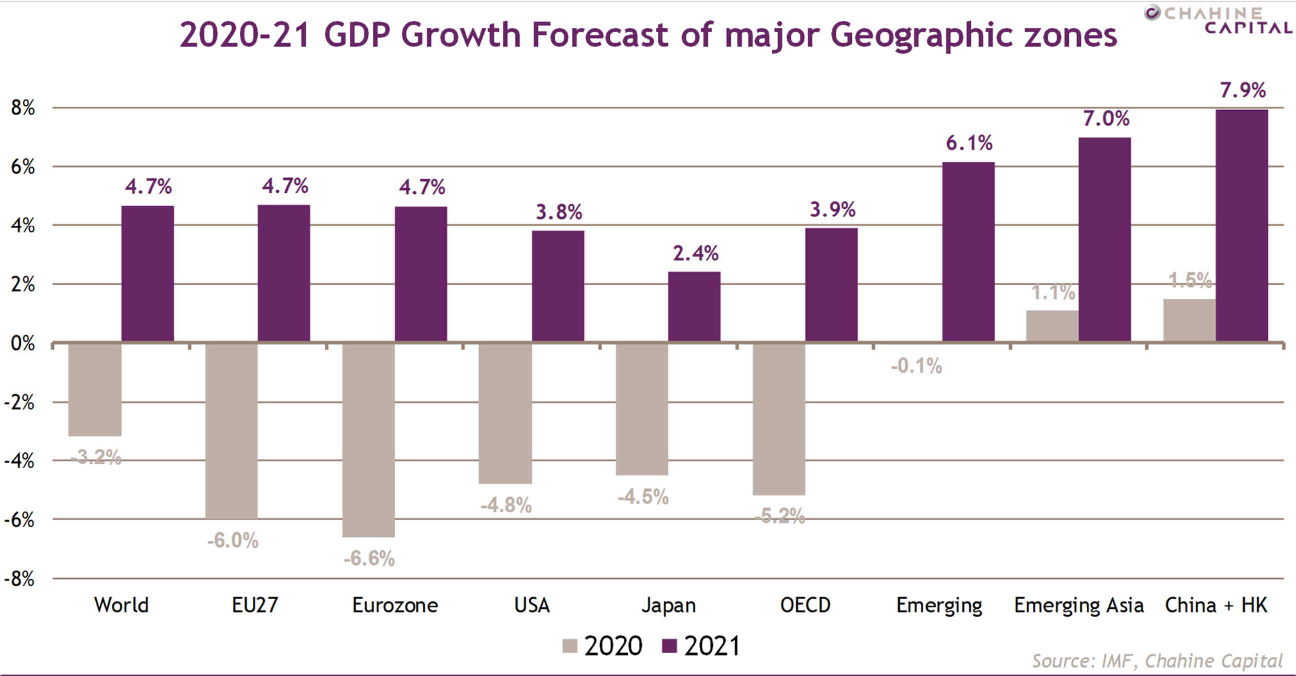
World growth forecasts are being lowered, leaving the outlook for GDP growth at down 3.2% in 2020 after a 2.6% gain in 2019. The 2008 crisis reduced world GDP by ‘only’ 1.5%. Economists expect a 4.7% rebound in 2021, but not much is certain to that horizon. The best we can say is that growth tends to sag at the start of every new cycle. Eurozone GDP is set to fall 6.6%, with France down 9%. The US economy is expected to shrink 4.8%. Asian economies are again diverging from OECD experience. China is expecting a 1.5% gain, down from the 5.9% the authorities were citing before the crisis.

Next year’s rebound will depend on how quickly normality can be restored as the pandemic wanes. An effective vaccine would do wonders for the financial markets, while continuing restrictions would hamper activity.

The various macroeconomic indicators have been derailed so badly that it is difficult to make much sense of them just now. Household confidence indices are down sharply, for example, not by nearly as much as they were in the USA in 2008 but by more in Europe. Lower energy prices and reduced consumption have dented inflation figures. Our US job creation graph collapsed after 20 million jobs were lost in April; we used to be talking about so many thousand new ones. New unemployment claims exceeded 40 million in a matter of weeks. American stocks of unsold homes have declined with the halt to construction, which suggests that house prices need not fall. PMIs rebounded in May, but from historical lows in which services suffered the most.

And yet equities have rallied, defying all these numbers…

## Asia is coping better than the OECD



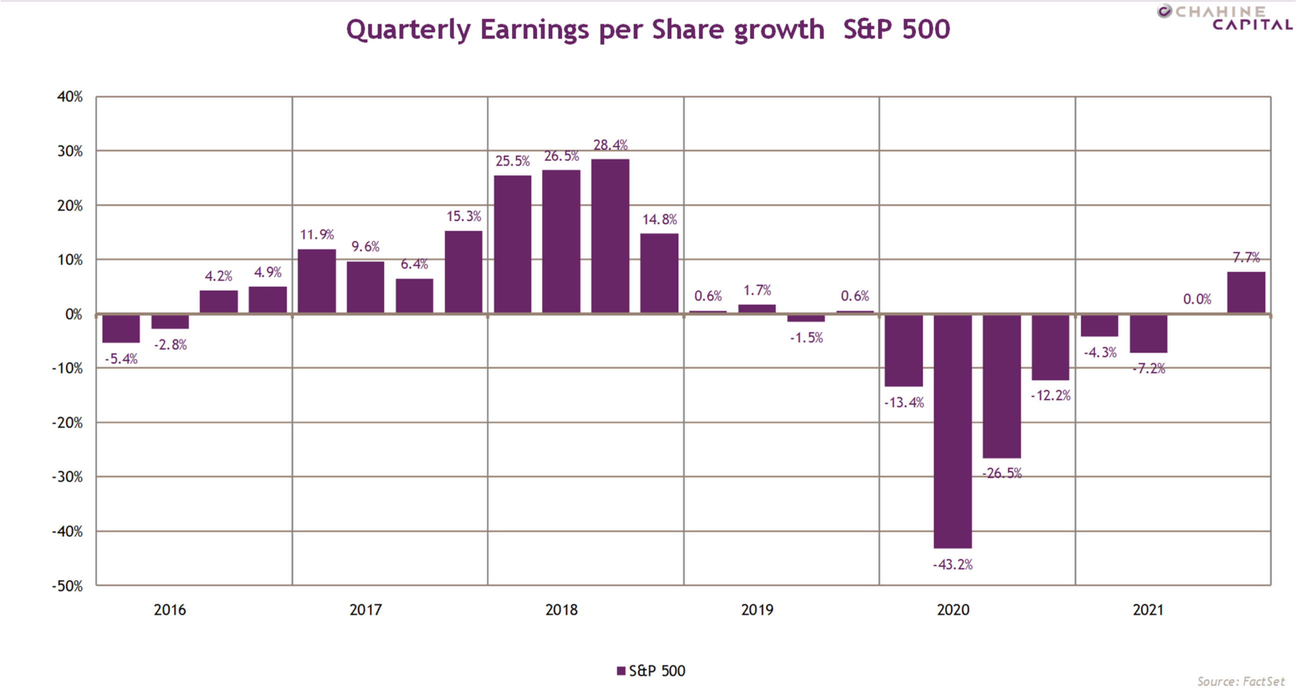

## US profits down 24% in 2020, 28% according to Chahine Capital

Estimates of S&P 500 profits are starting to take shape again after the end of the Q1 reporting season. Q1 itself saw a 13% year-on-year decline, with just March affected by the crisis. Q2 took the brunt of it, but even so there will not be an overall loss for the period. EPS is estimated down 41%, thanks largely to high-tech firms. Q3 is expected down 26.5% and the consensus is looking at a 24% drop for 2020 as a whole, compared with 17.8% a month ago. Our own estimate for the year is down 28%, compared with the 34% drop we pencilled in last month. Our figure is still a substantial drop, and would be identical to 2008. By sector, the biggest EPS declines are likely to be in energy (for an overall loss), financials, real estate and consumer cyclicals. The latter include travel, leisure and clothing. The heavyweight IT sector will return stable profits, as will healthcare and consumer staples.

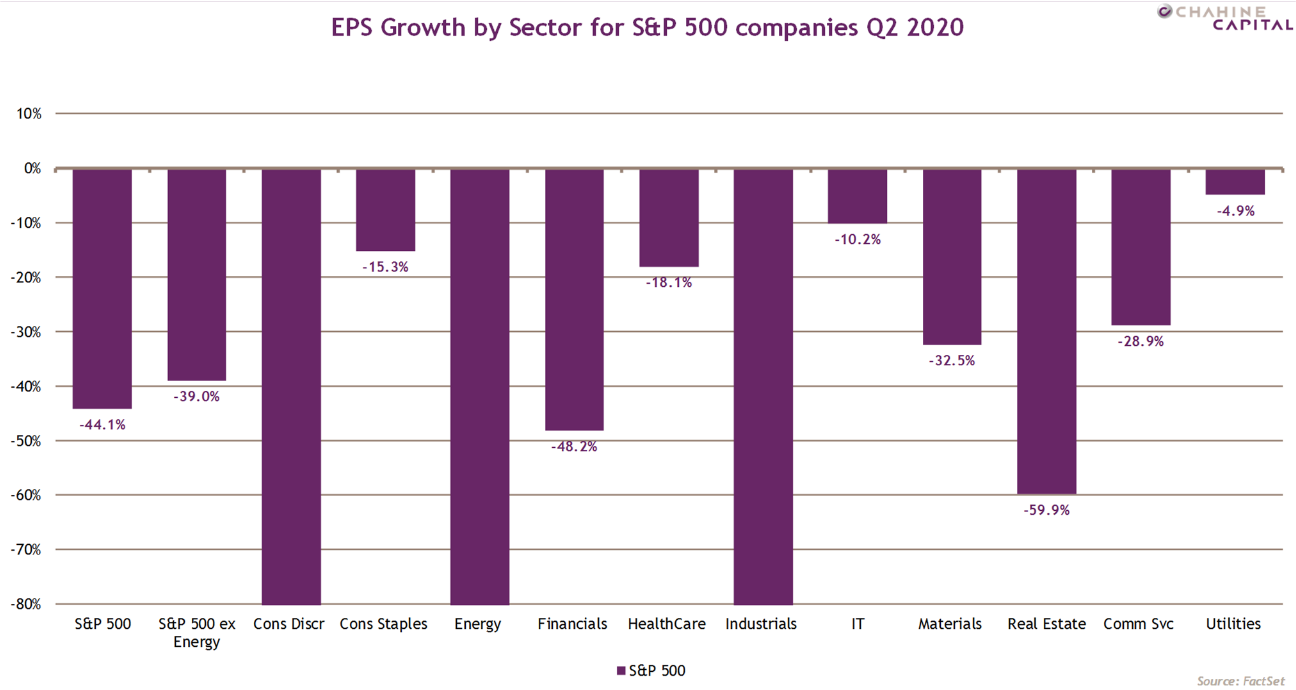
The consensus forecast for 2021 is EPS growth worth 28.4%; we are estimating 17.7%. The IT sector is estimated up 14%, demonstrating yet again its extraordinary capacity to generate cash. The market's PER is 24.2x 2020 and is expected to be 18.8x 2021, implying a 5.3% earnings yield compared with virtually zero returns on bonds. Despite everything, the US market will offer a 2% dividend this year.

# STRATEGY OVERVIEW

## A poor Q2, but not an overall loss




## Loss-making sectors include energy and cyclicals



## Market valuations

Despite modest revisions to our profits forecasts for 2020 and 2021, our S&P 500 valuation has barely changed over the past month. The 30-year has inched up from 1.2% to 1.47% over the past two months, explaining the dip in our valuation from 3,092 to 2,903 points. We would attribute a high degree of uncertainty to our assumptions, particularly long rates and recovery scenarios. Our model gives us an 8-year CAGR of -0.1% with a 2019 base, which means that profits will be the same in 2027 as they were at the 2019 cycle high. This is why this cautious estimate makes no difference to our overweight recommendation, especially as the sheer quantity of liquidity appears overwhelming. The big investors are perfectly aware of it too.

Naturally, new risks could suddenly materialise. Right now we are thinking of tension between China and Hong Kong and riots in the USA that highlight the country's extreme inequalities. Black people are three to five times more likely to die of Covid-19 than whites, reflecting living standards, access to education, skills gaps, differences in housing and often healthcare provision. The crisis is only aggravating these inequalities.

Brexit is another emerging risk, as Boris Johnson appears willing to ignore its perils. Sterling is slipping, and the pandemic could damage essential imports UK.

### Abundant liquidity is keeping Wall Street an attractive option

| **S&P 500 - Valuation end 2020 except implied scenario** | | | | | |
|---|---|---|---|---|---|
| *CAGR Compounded Annual Growth Rate from 2019* | **30 Years Gvt bonds** | | | | |
| | 1.00% | 1.25% | **1.47%** | 1.75% | 2.00% |
| **Deep recession: -30% in 2020, 14% in 2021 - CAGR -2.2%** | **2 814** | **2 622** | 2 471 | 2 300 | 2 164 |
| **Implied Scenario CAGR -2% over 8 years** | 3 460 | 3 227 | **3 044** | 2 837 | 2 672 |
| **Return to normal: -28% in 2020,18% in 2021 - CAGR -0.1%** | 3 310 | **3 082** | **2 903** | **2 700** | 2 538 |
| **Current Index S&P 500** | | | **3 044** | | |

The consensus forecast for eurozone EPS growth in 2020 is -34%, compared with -27% last month and our own estimate of -50%. For our model, we are retaining -40% with a 20% rebound next year. Interest rates are still absurdly low, but we have often pointed to poor European corporate profitability over a very long period. There are good buys requiring little outlay, and some governments (including in Germany) have set up schemes to prevent them falling into foreign hands. The market has a 'value' bias overall, albeit with a few growth stories in the luxury sector. Digital funds are a good means of playing this segment; they have long proved their ability to identify these nuggets and outperform significantly.

**MSCI EMU - Valuation end 2020 except implied scenario**

| *CAGR Compounded Annual Growth Rate from 2019* | 30 Years Gvt bonds | | | | |
|---|---|---|---|---|---|
| | 0.25% | 0.50% | **0.58%** | 0.75% | 1.00% |
| **Deep recession: -50% in 2020, 34% in 2021 - CAGR -9.7%** | **109** | **101** | 99 | 94 | 88 |
| **Implied Scenario: CAGR -9.3% over 8 years** | 120 | 112 | **109** | 104 | 98 |
| **Return to normal: -40% in 2020, 20% in 2021 - CAGR -7%** | 135 | 125 | **122** | **116** | **108** |
| **Current Index MSCI EMU** | | | **109** | | |

We are overweight equities relative to our benchmark at 40%, getting there partly with a few purchases and partly via the general rally in prices.

## Conclusions

Covid-19 restrictions are being lifted around much of the planet, and at rates that depend on when countries first suffered the pandemic. In Europe, glorious weather has buoyed households further as they emerge from lockdown. The Schengen free travel area within the EU has yet to be reopened, but once that is done Europe's links with the rest of the world will follow. Airlines seem to be aiming for a resumption of regular services towards the end of June, which could both salvage something from the summer tourist season and reinvigorate corporate managers keen to resume business relationships. There is still plenty of uncertainty surrounding the disease, particularly the prospect of an effective vaccine. The markets will simply have to live with the risks implied with contradictory statements from scientists over the chances of a 'second wave'.

Confidence over the end of the pandemic has enabled investors to look once again at the fundamentals. Avalanches of central bank liquidity have boosted asset prices again, including share prices for companies that continue to offer regular cash flows that will certainly revert to their former levels once the crisis is over. Mathematically speaking, an asset that generates perpetual cash flows in an environment of (effectively) zero interest rates has infinite worth… We would be winners today if S&P 500 profits were to revert to their 2019 level within 8 years!

Central banks will continue to print money for as long as their balances of payments remain close to zero. This is true for Europe and Japan, and while the USA is running an external deficit it is not calamitous and the dollar is the world's reserve currency anyway. Venezuela can print all the currency it wants, but it still have to convert it to dollars to pay for imports – its exports do not cover its foreign currency requirements. Isolated within its Brexit logic, the UK could suffer a much weaker pound if it prints currency too freely. Japan shows that major economies can print a great deal of money without upsetting their short-term equilibrium. The dollar has weakened slightly, reflecting the fact that the Fed has printed far more money than than the ECB has: its balance sheet is up $3 trillion, compared with a mere €800 billion in Europe. We believe that the US stimulus package is worth 20% of GDP; in France, national debt is set to rise from 98% to 115% of GDP as a result of higher spending and fewer receipts. More liquidity injections are on the way on both sides of the Atlantic, and there are hopes of a €750 billion EU stimulus package.

The market is not rebounding evenly. Healthcare and IT stocks are virtually back to their highs, but cyclicals such as travel and automotives are struggling badly. Energy and financials are in much the same position. The risks include mortgage REITs, which borrow massively from banks in order to lend it on to the real estate sector. Rising non-performance rates are keeping their share prices well down. Real estate does still offer opportunities, but there is no end of liquidity looking for a home.

World GDP could drop 3.2% this year, compared with a 1.5% drop in 2008. OECD countries will be the worst affected. In Asia, activity is weakening by less, and China is still looking at a 1.5% gain. Eurozone output is set to fall 6.6%, with France down 9%. The expected 4.7% rebound in 2021 assumes a resolution of the pandemic, of course. Some US macroeconomic indicators are up slightly, such as consumer confidence and the PMIs. But America's big problem is unemployment, given the relative lack of a welfare safety net there.

According to the consensus, S&P 500 profits will be down 24% in 2020. At Chahine Capital, we are looking at 28%. A 17% rebound is expected in 2021. Our theoretical objective for this index is 2,903 points, down from 3,092 points last month because of the uptick in interest rates. Given our model's extreme sensitivity to interest rates and the earnings CAGR, the drop in our objective does not worry us and we are maintaining our recommendation to overweight equities (an over 40% allocation, in our case).

***Jacques Chahine***

## Main ratios for markets and sectors as of 29/5/2020 (in local currency)

| *Data as of* | Weight vs | Perf | | Weighted P/E | | % Wted EPS Chge | | | Div Yield | Revision vs M-2% | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *29/05/20* | MSCI World | 2020 | 2019 | 2021 | 2020 | 2021 | 2020 | 2019 | 2020 | Fiscal 21 | Fiscal 20 |
| **MSCI The World Index** | **100.0%** | **-8.95%** | **25.30%** | **17.3 x** | **22.1 x** | **27.9%** | **-22.8%** | **-1.8%** | **2.32%** | **-2.8%** | **-5.4%** |
| | | | | | | | | | | | |
| MSCI USA | 64.3% | -5.16% | 29.20% | 19.2 x | 24.4 x | 27.4% | -21.1% | -0.6% | 1.90% | -2.0% | -3.8% |
| MSCI Japan | 8.4% | -9.50% | 15.70% | 14.2 x | 17.6 x | 24.0% | -3.2% | -28.3% | 2.57% | -5.7% | -11.1% |
| MSCI EMU | 12.6% | -17.20% | 21.70% | 14.1 x | 19.4 x | 38.0% | -33.4% | 0.4% | 3.09% | -4.0% | -8.0% |
| MSCI Europe | 23.0% | -16.46% | 22.17% | 14.5 x | 19.3 x | 33.2% | -32.0% | 3.7% | 3.23% | -4.4% | -7.4% |
| MSCI Europe ex Energy | 21.9% | -14.85% | 23.79% | 14.5 x | 18.7 x | 28.9% | -27.6% | 5.7% | 3.03% | -4.2% | -7.1% |
| | | | | | | | | | | | |
| MSCI Austria | 0.1% | -32.43% | 13.38% | 9.4 x | 15.5 x | 64.8% | -48.6% | -25.2% | 3.83% | -6.4% | -19.0% |
| MSCI Belgium | 0.4% | -28.85% | 19.36% | 13.6 x | 17.7 x | 29.6% | -34.0% | 10.7% | 3.22% | -5.9% | -10.2% |
| MSCI Denmark | 0.9% | 6.85% | 28.95% | 23.1 x | 31.5 x | 36.7% | -18.0% | -4.2% | 1.64% | -1.1% | -4.5% |
| MSCI Finland | 0.4% | -4.26% | 8.28% | 16.7 x | 19.5 x | 17.4% | -14.5% | -0.7% | 3.48% | -1.2% | -1.2% |
| MSCI France | 4.6% | -19.67% | 26.10% | 14.5 x | 19.7 x | 35.8% | -33.2% | 4.7% | 3.07% | -3.5% | -5.9% |
| MSCI Germany | 3.4% | -13.55% | 20.10% | 13.1 x | 18.9 x | 44.5% | -28.0% | -4.8% | 2.99% | -2.7% | -6.8% |
| MSCI Great-Britain | 4.6% | -19.69% | 11.37% | 13.2 x | 17.6 x | 32.9% | -34.2% | -5.2% | 3.94% | -3.0% | -6.2% |
| MSCI Ireland | 0.1% | -13.99% | 21.49% | 22.8 x | 59.9 x | 162.2% | -68.2% | -24.3% | 0.68% | -21.4% | -60.8% |
| MSCI Italy | 0.9% | -23.13% | 25.49% | 12.0 x | 18.6 x | 54.6% | -48.5% | -0.8% | 4.59% | -8.5% | -17.9% |
| MSCI Netherlands | 1.7% | -8.17% | 26.85% | 17.1 x | 21.8 x | 27.5% | -23.0% | -3.6% | 2.30% | -2.9% | -4.0% |
| MSCI Norway | 0.3% | -15.55% | 8.26% | 13.7 x | 21.8 x | 59.8% | -37.1% | -11.1% | 4.06% | -4.4% | -4.9% |
| MSCI Spain | 1.1% | -25.85% | 9.85% | 12.8 x | 16.9 x | 31.5% | -45.3% | 6.7% | 3.51% | -5.9% | -11.9% |
| MSCI Sweden | 1.0% | -7.99% | 25.01% | 15.4 x | 20.5 x | 33.4% | -43.7% | 68.0% | 2.87% | -9.1% | -4.5% |
| MSCI Switzerland | 3.3% | -7.31% | 26.97% | 16.7 x | 19.4 x | 15.9% | -8.0% | 9.7% | 3.13% | -0.7% | -2.5% |
| | | | | | | | | | | | |
| MSCI Europe Consumer Discretion | 3.1% | -19.24% | 30.01% | 15.8 x | 34.0 x | 114.3% | -58.7% | -11.4% | 1.40% | -7.9% | -23.5% |
| MSCI Europe Consumer Staples | 3.5% | -7.96% | 22.38% | 17.4 x | 19.2 x | 10.7% | -7.3% | 9.8% | 3.02% | -2.9% | -3.1% |
| MSCI Europe Energy | 1.1% | -38.81% | 3.55% | 13.6 x | 45.6 x | 235.0% | -82.0% | -14.7% | 7.12% | -8.1% | -22.0% |
| MSCI Europe Financials | 3.2% | -31.42% | 17.31% | 9.1 x | 12.4 x | 35.9% | -42.9% | 14.9% | 4.46% | -6.1% | -10.3% |
| MSCI Europe Health Care | 3.5% | 1.74% | 28.40% | 16.3 x | 18.2 x | 12.0% | 1.8% | 9.5% | 2.71% | -1.1% | -1.8% |
| MSCI Europe Industrials | 3.0% | -18.80% | 32.02% | 16.8 x | 23.8 x | 42.1% | -35.3% | 5.8% | 2.51% | -4.5% | -8.2% |
| MSCI Europe Information Technol | 1.5% | -3.44% | 36.00% | 20.6 x | 26.7 x | 29.7% | -8.4% | 5.0% | 1.10% | -1.4% | -2.2% |
| MSCI Europe Materials | 1.5% | -15.35% | 21.39% | 15.6 x | 20.5 x | 31.4% | -25.9% | -12.9% | 3.66% | -3.3% | -7.4% |
| MSCI Europe Real Estate | 0.3% | -24.62% | 18.93% | 13.9 x | 15.2 x | 9.5% | -26.8% | -15.5% | 4.48% | -4.6% | -3.3% |
| MSCI Europe Communication Serv | 1.1% | -19.16% | 0.60% | 12.6 x | 14.5 x | 14.7% | -16.4% | 2.6% | 4.48% | -5.9% | -6.5% |
| MSCI Europe Utilities | 1.3% | -6.39% | 24.29% | 14.6 x | 16.0 x | 9.6% | -7.8% | 24.1% | 4.80% | -1.2% | -2.4% |

*Benchmarks source iShares ETF - Data as of 29/05/2020*

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