# Letter n°6

## What to do in the Stock Market ?

"*Never before has humanity gathered so much power with so much confusion, so many worries and so many toys, so much knowledge and so much uncertainty*" Paul Valéry in 1932.

1932, it was still the serious consequences of the crisis of 1929 and the words of Paul Valéry in his speech on history still ring true today. What are the political, social, economic and stock market consequences of the Covid-19 crisis? It is too early to consider all the implications because the duration or possible resurgence of the spread of the virus are not yet known, but one can think about the implications for portfolio structuring.

### From an economic point of view: what lessons can be learned for the geographical allocation of portfolios?

The hierarchy of powers should not be changed. The least indebted, most industrialized countries will remain the strongest. Switzerland, Germany, Sweden and South Korea come to mind. In the lead, Switzerland, with a public debt ratio of 26% of GDP before the emergence of this crisis, compared with 58% for Germany, 99% for France, more than 100% for the United States and 240% for Japan, has a lot of leeway to support sectors in temporary difficulty and revive the economy. No doubt, for investors, the Swiss franc will retain its safe haven character.

Second, the attractiveness of developed countries compared to emerging countries will last: OECD countries have the huge advantage of zero interest rates to finance support and stimulus measures while this is not the case in emerging countries. Furthermore, many emerging countries have had to suffer, as in every crisis, massive capital outflows, a weakening of their currencies and, already 85 of them have had to call on the support of the IMF, which estimates their needs at $2.5 trillion, an amount that the developed countries will not provide in the short term. Finally, these countries are not welfare states which can cushion the crisis and, according to the ILO (International Labour Organization), 60% of their workers are in the informal sector without a work contract. Let's take just two examples, India, with 7.5% GDP growth, running a budget deficit before this crisis, was forced to increase food aid due to increased partial unemployment. Africa, too, has only one advantage, the youth - less than 50 million inhabitants out of a population of 1.2 billion are over 65 years old as compared to 150 million in Europe. Beyond that, Africa also suffers from a low number of doctors (1 doctor per 10,000 inhabitants against more than 35 in the European Union), difficulty to organize containment, sub-Saharan African debt at 59% of its GDP (against 40% in 2010), considered excessive by the IMF, a fall in revenue following the collapse of commodity prices (oil, copper, cobalt) and a sharp rise in food prices likely to cause riots. Thus, the theme of convergence between emerging and developed countries, which we have often presented as a mirage, has suffered another blow.

Third, without fearing the end of globalization, without conceiving protectionism, which is harmful to competitiveness, purchasing power and inflation, we can nevertheless think of relocation and local investment in strategic sectors. Once again, the losers will be export-oriented emerging countries and the winners will be advanced economies.

Fourth, some economies, such as South Korea and even Singapore, should benefit from a faster recovery.

Fifth, the ability of United States to recover: only ranked 33rd in the global health indicator, with a shortage in hospital beds, despite a record health spending of 18% of GDP, the United States will be the last to emerge from the coronavirus crisis. In the meantime, weak employment protection will cause unemployment to explode. With 10 million more unemployed in two weeks, the unemployment rate could already reach 10%, compared to 3.5% last month, which was the lowest in the last fifty years with 5.8 million unemployed out of a working population of 164 million. But let's not downplay the United States' ability to bounce back. Let us remember that between 1941 and 1945, in the context of a war economy, they were able to multiply by ten the number of combat aircraft and increase the fleet of aircraft carriers from 6 to 95 (they have 10 today). Although the United States, with 330 million inhabitants, accounts for only 4% of the world's population, it spends more than 40% of its budget on health research and may well be the first to develop a vaccine. Let's forget Trump and let's consider the private sector's capacity: from Bill Gates' dedication to spend billions on finding a vaccine, to Ford's production of respirators, through the reconversion of 3D printers for the production of masks.

Lastly, the sharp increase in the debt levels of many companies (as a result of this crisis) could discourage investment, penalise future growth and lead to bankruptcies.

In short, an overweight of Asian advanced economies, South Korea, Singapore, Taiwan and China, a mistrust of emerging countries, an overweight of strong industrial economies and more broadly of European countries determined to mobilise huge resources to protect and revive, and a confidence in the Americans' ability to rebound.

## From the stock market perspective : a change in the portfolios' composition.

Portfolio liquidity, as we have said time and again, is key to wealth management because it enables portfolios to be restructured and positioned on themes that are now more promising.

This is not the case with private equity. The investor will suffer for several years and will not be able to rebalance his portfolio. Many start-ups with cash shortages may disappear and penalize the overall performance of funds. Leverage used to boost fund performances prove to be problematic. It is pointless to expect that an unlisted company will be worth more than a listed company. At the time of disposal, the notion of "peer group", the reference to the valuation of listed companies in the same sector, will persist. The difficulties of SoftBank, the world's leading technology fund with $100 billion in assets, heavy debts and with holdings such as Uber and WeWork, highlight the fact that even in certain promising sectors, refinancing is difficult and SoftBank has had to announce the sale of $40 billion in assets over the next twelve months. In other words, while private equity allows one to abstract from volatility, it offers little alternative to economic cycles and for many recent private equity investors, the hope of gains will translate into deferred losses and premature, impossible or costly exits.

Second, it will be pointless to expect a return to previous valuations. After the bursting of the technology bubble in 2000, telecommunications and media stocks never returned to their previous levels. They had lost 70% or more of their market capitalization and twenty years later, their previous market prices have not been reached. In the meantime, new companies have taken over the top positions in market capitalization rankings. Amazon was only created in 1994, Google in 1998, Alibaba in 1999, Facebook in 2005 and let's not forget that the average age of Nasdaq companies is 15 years.

One may wonder whether aeronautics, aviation, cruises, hotels ... will record the same growth rates and therefore benefit from the same price/earnings valuation ratios.

Some sectors, such as music streaming, a specialty of Vivendi, which also owns Canal Plus, video games with Ubisoft and Gameloft, and television series with Netflix, are benefiting from the current situation, but the question is whether such a trend is sustainable.

At the same time, certain emerging sectors such as telecommuting, online education and telemedicine, are benefiting from the lockdown and should see a growth acceleration. To take just one example, the American company Zoom has appreciated by some 100% this year and is worth $40 billion... Also, robotics and 3D printing will benefit from developments, thanks to relocations.

Adding to the list of investments to be maintained or boosted, more traditional sectors such as Health care, pharmaceuticals (Roche, Sanofi, Gilead Sciences), medical equipment companies (Getinge, Hamilton Medicare) and biotech will benefit from more support, encouragement and generous valuations. If health is today measured as a cost (salaries) in the calculation of GDP, everyone realises that it is a factor of productivity and deserves special consideration, just as education should not be neglected.

Other sectors raise questions: what is the future for office real estate if telecommuting in the tertiary sector develops? At the very least, there will be a restructuring of offices, fewer individual desks and meeting rooms if teleconferencing continues its trend. Next, we can look at residential real estate. A development of telecommuting offers people the possibility to leave expensive urban centres and move to the outskirts with more space. Investors in real estate funds need to consider such potential.

Finally, a word about energy, which is essential for the growth of economies. Prices will not be able to stay where they are. At current crude oil prices, investments in exploration and production, and investments in alternative energies are not profitable. Stock market valuations are bound to rebound but, in the meantime, many indebted US companies will disappear.

Let's not end without pointing out that the temporary abolition of share buybacks, $800 billion in the United States last year, and the suspension of dividends from many companies ($1400 billion distributed worldwide in 2019, including $500 billion in the United States, potentially the equivalent of 4 to 5% of capitalization) which is now less attractive for the markets.

## In Conclusion : «*It is always wise to look ahead, but difficult to look further than you can see* ». Churchill

A new cycle is starting, a new paradigm is to be defined. In light of these reconversions and the disappearance of activities, the portfolios will have to be rebalanced. In this context, we are at your disposal for reflection and investment. We have not mentioned all the themes and sectors we are focusing on, but will come back in future notes. We want to stress that tomorrow's world will be different from yesterday's world.

Bruno Desgardins

Geneva, April 6th, 2020

Bruno Desgardins
*Directeur de la Gestion*