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Provider Licence Number 12833

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<u>CMEFS WEEKLY INVESTMENT NEWS</u>

<u>11-09-2020</u>

Hello and welcome to this week's edition of Investment News.

Before we go into this week's discussion, let's see how the CMEFS Flexible fund has done for the year thus far as compared to the All Share Index (ALSI)

Fund	Last week Thursday	This week Thursday
ALSI	-2.14%	-4.35%
CMEFS Flexible Fund	+0.68%	+0.60%

Without intending to be negative as we have had quite enough of that, here is an interesting extract from the start of John Hussman's investment newsletter of the 01/09/2020 [All emphasis my own and *my comments in italics*]

<u>Hussman Market Comment – Yikes!</u>

(Here's John) The most important observation about market valuations here is that while a **decade of zero interest rate policy** has encouraged yield-seeking speculation in stocks, the resulting **extreme in stock market valuations** has also driven likely **10-12 year S&P 500 total returns below zero.**

[Just to be very clear, if what John is saying here is correct, then in all likelihood, money invested in passive tracker funds tracking the American S&P500 index, will, over the next 10 – 12 years and ignoring inflation, deliver a return to investors of less than zero]

(Back to John) The same outcome accompanied the decade following the 2000 market peak.

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[Let's take a look at what this 2000 market peak looked like from a graphic perspective]

As you will see from the above, the S&P500 stood at a value of 1 465.81 on 15 September 2000.

Now let's look at what it looked like 10 years later.

As you will see from the above, the S&P500 stood at a value of 1 125.59 on 17 September 2010.

Using a simple rate of return calculation, the investor (who would historically have been viewed as a long-term investor – although this definition has now changed to 20 years plus, I think) would have earned a magnificent -23.21% return on his/her investmestment capital for the period.

In numbers, that means a million US$ invested passively at the time would have been worth US$767 900 ten years later, excluding inflation.

(Back to John) Our estimate of average annual nominal total returns for a conventional passive portfolio mix invested 60% in the S&P 500, 30% in Treasury bonds, and 10% in Treasury bills has declined to -0.95%, **easily the lowest level in history, including the extreme low associated with the 1929 market peak.**

[As a Ph.D., John says so much in so few words. But he now goes on further to say that even if one were not totally invested passively is stocks (shares) and were to diversify some of one's passive investment capital into Treasury Bonds and Bills, then we are still looking at a negative return of -0.95% for the period.

*Why John "bangs on a bit" about **passive** investing is that those who stand to lose the most as and when sanity returns to the markets are those who have chosen the "passive" rather than "active" investment route, such decision based mainly on perceived costs savings versus the costs associated with active investing.*

And as more and more funds are being diverted into these passive funds, so too does the risk of suffering significant loss of personal wealth increase across a wider demographic of the investing population – including pension funds – who are significant investors in passive funds.

In fact, in May of 2019, the assets invested in passive strategies for the very first time in the US equaled that of assets invested in active strategies.

So of the US$8.6 trillion invested at the time, US$4.3 trillion of this was invested in passive strategies.

In other words, US$4.3 trillion was invested in the shares of companies for no other reason than they form part of an overall index.

This is no different from you taking your hard-earned cash and investing it in (say) the top 10 companies by asset value listed on the JSE – without doing any research whatsoever into their continued viability or profitability.

This is not a great strategy to follow in this day and age(in fact in any day and age) given the rate at which the process of creative destruction emanating out of the technology sector has and is bringing about the demise of what were once considered to be "blue-chip" companies in so far as the preferred destination for investment capital is concerned.

Just as an aside and by way of illustration, just the other day I was thinking how quickly we went from vinyl records, to magnetic tapes, to cassette tapes, to walkman's, to CD's, to thumb drives to internet downloads on our computers, and then smart-phones to listen to our preferred music.

And the process continues unabated, just at ever accelerating speeds.

And every single one of them was an industry on its own at the time, even considered to be "Blue Chip".]

(Back to John) Last week, Fed Chair Jerome Powell announced a "commitment" to tolerate higher inflation, "averaging" but periodically exceeding 2%, without responding with higher rates.

This essentially amounts to targeting negative real interest rates.

[In other words, savers invested in cash will earn negative real rates of interest. And where America goes the rest of the world follows. Yes. Even under Trump]

End of John's introduction.

So it is not a good idea to get on board the passive investing bus, especially at this time.

It is also not a good idea to remain invested in cash as at best (in SA for now anyway) you are only just going to "pip" the prevailing inflation rate – provided you do not pay any tax on interest earned and if you do, then disregard this idea (investing in cash) entirely.

Keep in mind that the risk spoken of above lies in passive and not so much in active investing as active investing allows you to take opportunities as and when they arise but to hedge against risk at the same time.

This is the revised strategy we are currently researching, as we believe that this very distorted and abnormal economic environment is going to be with us for a very long time to come given the extreme debt excesses forced on both developed and developing economies as a consequence of the Covid-19 virus.

And as fragile as this is (whatever "this" is) it will simply be continued to be propped up by more and more money printing until we either "come right" or the ability to print our way out of trouble is no longer an option. (What then?)

As a lot needs to happen from both a research and systems development point of view, both of which are well underway, it will take a little more time before this new strategy can be implemented, but I have every confidence that it will be well worth the wait in the end.

I hope you enjoyed the read.

Until next time then, do take good care of yourselves.

Kind regards, Nine, Charles, and all of us at CMEFS.