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CMEFS WEEKLY INVESTMENT NEWS

20-11-2020

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	- 1.03%	+0.42%
CMEFS Flexible Fund	+1.23%	+1.34%

The markets remain significantly overpriced and risk has not receded.

It has, in fact, increased significantly and continues to do so with each passing day.

This creates a dilemma for persons such as you and me as although this statement happens to be a FACT (well in my view anyway, and I am in good company in so far as this view is concerned) markets in the short to medium term (whatever that might mean nowadays) are not bothered by such things, and will continue to trade upwards for as long as it takes for the bubble to burst.

No one knows just exactly what the event will be that will bring the markets to this tipping point, and no one will ever know until after the fact.

But by then it will be too late for those that have taken aggressive positions in the market.

It is in my view a loss that they will suffer that will not be short-term in nature, but rather VERY long-term and by this I mean a recovery period definitely exceeding 10 years and very likely exceeding 20 years, or more.

Please note that I am not being pessimistic or negative here but rather just explaining once again why I remain as conservatively invested as I presently am, this being to preserve capital to be able to take full advantage of the opportunities that will present themselves later on.

It is just a question of continued patience.

This also does not mean however that you are earning less on your investment capital than you would have earned by simply "leaving the money in the bank".

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Not at all.

There are huge opportunities in the SA Bond Market right now and we are perfectly placed to take full advantage of this opportunity.

As always, however, even then we have hedged our bet a little bit by splitting the capital equally between money market and income funds.

And again, this position is not "forever", but rather represents a parking bay for your capital whilst we continue with our restructuring exercise in so far as personalising investment positions is concerned.

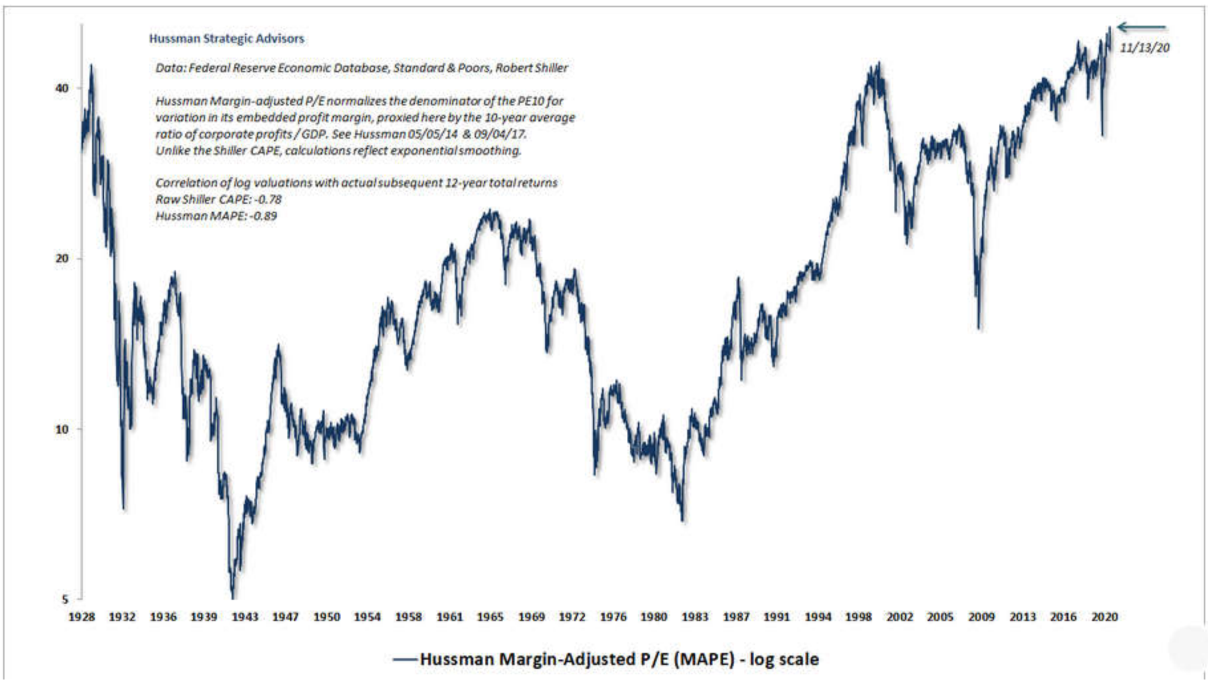
We are aiming to have completed this exercise by the latest end of Feb next year as there is a LOT of stuff to do to get where we want to go, but at least this journey of a thousand steps has begun.

But back to market valuations.

Consider this comment by John P Hussman President, Hussman Investment Trust in his November 2020 newsletter.

Some of it may sound like a bit of gobbledygook, but the point he makes is non-the-less as clear as crystal.

"The chart below shows our Margin-Adjusted P/E (MAPE), which is better correlated with actual subsequent market returns than nearly every measure we've tested or evaluated, aside from our measure of market capitalization to corporate gross-value added (MarketCap/GVA). The MAPE has a longer data history, which allows us to make an important point here. **The valuation of U.S. stocks has never been more extreme, even at the 1929 and 2000 market peaks. I should add that I've intentionally excluded the impact of pandemic GDP and profit weakness, which would otherwise make this measure even more extreme.**



It might be a bit small, but the point furthest left on the horizontal axis is the year 1929 and the point furthest right is NOW.

And it is worth mentioning again that he has DELIBERATELY excluded the impact of pandemic GDP and profit weakness as a result of the pandemic, otherwise, the graph would look a whole lot WORSE.

To explain the PE ratio he speaks of in VERY simplistic terms.

A PE ratio of 5 means that over 5 years you will get back, in income, the value of the capital you invested in the security/share.

So if you hypothetically banked those earnings and did not spend them, then at that point you would be “risk-free” as you would have received your original capital back.

To see this in numbers, if you invested R100 in a share, over 5 years you would have received R100 in earnings back from the share, so if you lost your ORIGINAL R100 invested and saved all of your earnings, you will be back in the same place you started.

Now historically, a P/E ratio of 5 – 7 years would be considered by most seasoned investors to be a reasonable period to be “on risk”, so anything exceeeding this (7) would start increasing the risk of actual loss of capital.

Now, look at the graph again.

The vertical axis starts at 5 and ends at 40.

These are years.

So in 1929, it would have taken on average 40 years to get back your original capital in earnings before you were “off risk”.

NOW if you simply place a ruler horizontally at the top of the right-hand side of the graph and then look to where the top of the ruler crosses the vertical axis on the left, the payback period would be roughly 50 years or so.

Again, remember that the effect of Covid-19 has been factored out of this calculation.

This is what John Hussman means when he says that “the value of US Markets have never been more extreme.”

Agreed. And the adage “When the US sneezes, the rest of the world catches a cold” is as true today as ever. This is why it is important to internalize what John Hussman is saying.

But it also underlines the comment I made at the beginning of this newsletter as to how markets totally ignore factual information. It's there for all to see. But the adage “There are none so blind as those who will not see” is worth repeating here.

I hope you enjoyed the read. Until next time then, do take good care of yourselves. Kind regards, Nine, Charles, and the rest of the team at CMEFS.