SAM COMMENTARY
July 7, 2020

STONE ASSET MANAGEMENT LIMITED
Sleep well.

JOB #1 IS PRESERVATION OF CAPITAL

Economic experts have used letters to discuss various recoveries from the C-19 pandemic. At SAM we have not supported a V or U-shaped recovery and in our April 29th commentary we discussed our expectation that it will be a W. Today we attempt to assess the future for Wall Street (the stock market), Main Street (consumer behaviour), monetary policy (central banks) and fiscal policy (government spending).

The media tells you that Wall Street and Main Street have different risks, but both may have high levels of risk going forward. It is our perspective that monetary policy is attempting to support Wall Street, while fiscal policy is attempting to support Main Street. Monetary policy is a long-term strategy, while fiscal policy appears to be executed as a short-term policy and these two strategies are not sufficiently aligned to achieve the desired end result. This opinion is not limited to the North American economy, this is our perspective for the global economy. We do believe that the stock market is priced ahead of the results that will be coming from Main Street, and the reason Wall Street is so bullish is due to rapidly shrinking unemployment levels, high consumer spending, recovery in specific industries such as food and beverage, travel, and real estate. This has made us more cautious as investors than aggressive, and I will explain why through the balance of this commentary.

When attempting to manage through a crisis, it is more important to get the question right than to get the answer right. If you have the wrong question, you're only going to get the right answer by luck. If you have the right question, the wrong answer could still get you to a good place. It is our opinion that globally, countries are still struggling to get the question right between global economy and domestic economy survival.

When we entered the pandemic crisis in mid-March, fiscal policy (government spending) attempted to support Main Street with financial programs while offering short time horizon solutions of approximately 90 days to six months, and lending institutions offered deferral of payments on specific types of loans on a similar time horizon. Meanwhile monetary policy (central banks) have taken a long-term view and will do whatever it takes to ensure that banking and capital markets will survive this environment. This is a disconnect and we still do not know the unintended consequences either positive or negative going forward. Meanwhile Main Street struggles with high levels of unemployment, global work-from-home programs, a bipolar outlook of "do the right thing to protect my health" (a fear emotion) and "can we just go back to the way it was" (no lockdown culture), another disconnect. In an environment where emotional response ranges from fear to cavalier, governments are attempting to reopen their societies and economies, hoping that there will not be an increase in C-19 infection. While Canada's data is benign, the US is having a dramatic growth rate of infections. Randomly in the news, countries such as Brazil, India and Russia have had steady high infection rates while China and South Korea have had localized infection growth events. There is a global lack of clarity on the best policy to allow for economic recovery and conventional social behaviour – another disconnect.

Like all portfolio managers we have a crystal ball. Sometimes it is extremely clear, and the answer is bright and brilliant and easy to execute. Other times it is really cloudy and creates a struggle to find the best answer. When the four components of Wall Street, Main Street, central bank monetary policy and government fiscal policy are all cloudy, our crystal ball is too. In this environment we allow common sense to prevail, which as prudent people we define as:

1. Sticking to your investment discipline;
2. Recognizing that your job is to protect your clients' wealth which equals preservation of capital;
3. Keeping item 2 in mind, you do know that everyone wants some growth to offset the ravages of inflation and high taxation so they can maintain their lifestyle; and
4. Attempting to be paid via dividends or interest while being invested.

We are not aligned with the raging bull outlook (stock prices going higher) which is the current market condition. Our reasons: we just do not have enough clarity of what future Main Street behaviour will be and how that will affect corporate earnings. We believe that the current market is rich based on valuations because we have a bias that forward earnings will not be robust enough to support these stock prices. Meanwhile we are not raging bears (stock prices going down) because we truthfully do not see an end-of-the-world type scenario, we just expect a good market sell-off. The scenario we expect globally is for Main Street to provide false recovery starts, and each false recovery start will allow both monetary and fiscal policy to assess their results and modify their strategy so that they get it right. We expect they will become aligned and support Main Street with policies that allow consumer behaviour to begin to align with Wall Street. Through these Main Street false starts of economic recovery, we expect we will find excellent buying opportunities of specific types of businesses and that being patient – using common sense with a mandate to preserve capital – will allow our clients to acquire businesses at such attractive prices that they will be able to build wealth.

Tongue in cheek – in our daily investment management meetings we polish our crystal ball and hope to see through the clouds to a bright and brilliant answer. Unfortunately, it is really no less cloudy than 30 days ago, but we do have the benefit of more global economic information with Main Street having the opportunity to start consuming again. We still think there is more wish for a fast return to a more “normalized’ global economy than the capability. Looking forward we expect the restart of the global supply chain will have hiccups and until we get clarity of how to make the supply chain happen smoothly, we fear governments may seek to accelerate some form of economic isolation. We believe the US - China trade war is an example of a nation (the US) seeking to modify global trade to support an isolationist economic policy. We prefer not to write commentary about elections, except about policy and its impact on the markets. The presidential election is in November of this year, and the democratic presumptive candidate is Vice President Joe Biden. Solely from a stock market perspective, we would expect his election not to be good for stock prices.

So, in this complex environment we have chosen to use common sense and stick to our investment discipline. We have made our job number one preservation of your capital. I have not written much over the last few weeks due to my personal experience with C-19. Thankfully I was not infected, but I was in a six-week geographical lockdown while attempting to find clarity about the best thing to do for our clients’ money. But I’m now home and settled back into the new-normal routine of working from the kitchen table. As new data was released about the global pandemic, Main Street economy, monetary and fiscal policies, our decision tree for an answer would modify frequently. Our crystal ball was extra cloudy through that timeframe and we thought saying nothing would be more comforting than writing frequently and looking like we were flipflopping.

Through the balance of the summer you should expect some minor modifications to your portfolio to ensure we preserve your capital, provide access for growth of your capital, and earn income. We are not day traders or market speculators and while you see businesses such as Zoom and Nikola skyrocket, as well as big price recoveries for airline and cruise ship stocks, that type of market timing is not our specialty. Our expertise is managing a prudent portfolio designed to satisfy the long-term need of our investors’ capital to ensure they have the financial resources to live well. It is our position that we are not in a doom and gloom environment, nor are we in a world of perfect. Unfortunately we believe the stock market is currently priced for perfect, so we will be careful and as written earlier, you can expect to see some slight modification that will be our bias to being careful with your money. There is a stock market truism by Charles Sizemore that “overweighting a position, no matter how good it looks, is almost always a bad idea.” While the market’s high trade volumes present investors with the belief that there is easy money to be made, we’re not prepared to be fooled and we will stay patient.

As always, we thank you for entrusting your investments with us, and we are available for your questions at any time. We appreciate your continued support and we wish you and your loved ones good health in the coming weeks.

Kindest Regards,

STONE ASSET MANAGEMENT LIMITED

Richard G. Stone
Chief Investment Officer

Sleep well, knowing you’ll have the financial resources to live well.

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