INDEX & Cie

Newsletter

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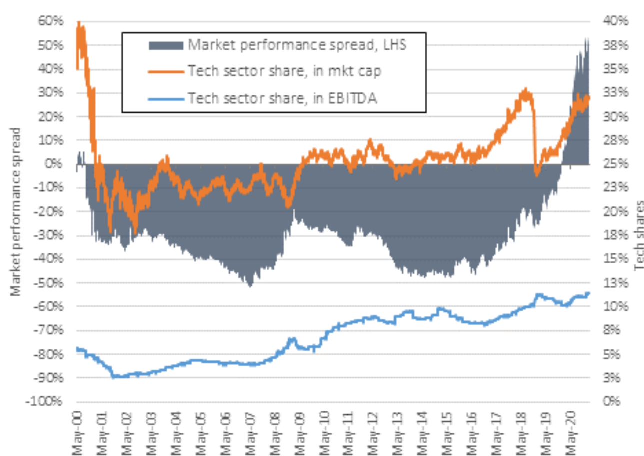
# INDEX House View

January's market behavior continues to confirm there is simply too much money looking for growth.

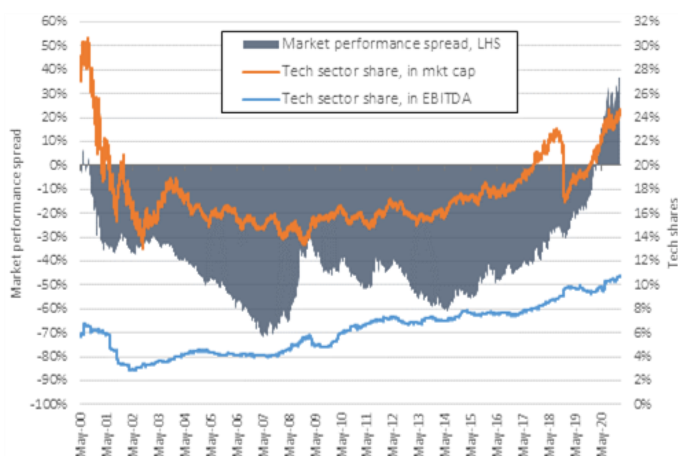
Western public market trends show that the attraction for anything tech, or web-based, is consolidating. This is not at all unexpected, nor driven exclusively by investors' greed. Our graphs below track and measure the relevance of the tech sector in comparison to the rest of industries, both globally and at a US level. The tech contribution and growth in fundamentals is undeniable, as it is the share of earnings that tech is gaining globally over the rest of industries.

**Tech share of earnings and market performance**

Global




United States




Source: MSCI World indexes, Bloomberg

In a time when retail participation in global markets is increasing and making them more volatile, it is interesting to see how the narrative of professionalized institutional investors is still hung on macroeconomic indicators that have little chance of having an influence in market trends. In particular, there is a great debate going on around inflationary pressures that are feared to trigger a substantial rise in interest rates and a consequent correction in equities. We are rather confident these pressures, if they appear at all, will not trigger a rate adjustment upward within the next three to five years as no president, prime minister, politician party and central bank chair want to have an economic catastrophe in their hands.

From a consumer perspective, yes, the lockdowns have reduced consumption in certain sectors – leisure and hospitality, among the others – and many people lost their jobs and their purchasing power. However, there has been a concurrent rise in online demand, as per Amazon's and other web retailers' earnings results in 2020. It might be the case that the overall demand for goods and services has shifted balance among industries, rather than reduced in absolute terms. If this is true, then an end to lockdowns will not be followed by a tsunami of pent up demand, coming from exasperated consumers now free to go wild. In case this spike in demand happens, then yes, there could a spike in inflation. Will it be a permanent state of heightened consumer demand that drives prices higher for a long period of time? Hardly so. It will probably be a two-quarter spike, as long-term consumer inflation in developed economic blocs tends to flattened within a range of zero and 3% per annum – similarly to the flattening, or plateauing, trends seen in many macroeconomic indicators such as GDP and industrial production.

From a manufacturer perspective, employees have been fired, capital expenditures for business expansion have been suspended, contracts have been cancelled and eventually business has been shrinking – in some industries. If the expected demand picks up all of a sudden, there is a chance supply will not be able to cope with it in the short term. Employers will have to quickly hire people to expand capacity and meet demand. This will trigger a decrease in unemployment, but a momentary rise in prices of goods and services as capacity ramps up – there's always a time lag during which supply and demand adjust, just alike commodities, leaving room for prices to swing. Things could get messy if vaccines do not provide the immunity expected, which seems to be an issue in certain countries where aggressive variants have taken place. Uncertainty on business conditions will be difficult to navigate throughout 2021, but that is as long as we expect it will last.

Rebus sic stantibus, we expect monetary policy to be only accommodative of markets. Debt will just be kicked down the road, perpetuating a leverage cycle that will be almost impossible to unwind and ultimately held both at institutional and retail level. A huge debt pile will still cost money to be serviced, and this will weigh on earnings – the risk is to turn into a zombie company, see Thyssenkrupp. The best chance any and all industries have to continue growing in this environment is to become more efficient from a cost perspective, or have no debt. This is why

we are already seeing many industries going through a web and tech transformation, which ultimately leads to cost efficiency and technological advancement.

With global monetary policy stability, a tech shift engulfing more and more traditional industries, and markets noticing, we decided to focus our research increasingly on revolutionary themes. Our style has always been long-term in nature, and we always keep an eye on what the world will look like in five to ten years. Valuation metrics had to be adjusted to understand the value of businesses that do not yet produce cash. So we began 2021 by placing our bets on five industries of immediate interest, all of which have begun manifesting rapid earnings growth and concurrent markets' interest. We also believe that valuations in these industries and companies are still not reflecting their full potential, as many of them are at an infancy stage. We expect this portion of our portfolio to perform particularly well during the next three years.

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