Newsletter

January 2021

INDEX House View

First of all, we wish you all a great 2021, full of achievements and personal harmony.

Secondly, 2021 kicked off rather surprisingly in the US. While the Senate was hearing senators Schumer (Democrat, Senate minority leader), McConnell (Republican, Senate majority leader), Klobuchar (D) and Toomey (R), a hoard of Trump supporters were seen partying on the balcony of the Capitol – a sight never recorded in US history. A few minutes later, many of these supporters broke in the main building by smashing windows, strolled around the halls without any police resistance and spent some time in the evacuated Senate floor. Senators and congressmen were rushed into their respective offices and advised to hide below their desks. Most disgruntled by the Biden confirmation going on under vice-president Pence, and encouraged to go to battle by an even more disgruntled Trump, supporters made it as far as the office of House Speaker Nancy Pelosi. Since their intentions were not amicable, a confrontation with police ensued and left four Trump supporters dead.

Barring the 1814 torching of the US Capitol, yesterday's event is surprising on the grounds of late intervention by authorities. This is the latest expression of a strong destructive polarization in US society. As Churchill famously said "the strongest argument against democracy is a 5-minute conversation with the average voter" (Churchill). By now it should be clear that four years of Trump administration have given legitimacy to a section of American society, previously unheard or misrepresented, to express their point of view in an extreme fashion. This new reality is challenging democracy and social stability, which the Biden administration will unfortunately inherit.

Market opportunities

From an investment perspective, this social instability must be interpreted together with the domination of the Democrat forces in US politics. The Biden administration is now very strong and able to push through reforms will relatively low opposition in the two chambers. We believe to be unfounded the commentators' fears of (1) higher taxes to afford larger aids (a practical nonsense), (2) which will lead to an expansion in government debt (which is already way past its historical high and ranking 2nd highest among AAA-rated nations with 82.3% debt/GDP ratio), (3) a possibility of increased inflation (which we think will only manifest momentarily, not sustained in the long term), (4) which in turn will lead to higher interest rates. Any politician in the US is aware of the fact that higher rates mean higher corporate defaults, more jobless people, probable economic recession given the pandemic damage in 2020 and ultimately less voters.

In this mutated social and political landscape, markets are reacting positively. The 10-year US govt bond yield passed the 1% threshold, a significant move signaling risk-on mode. Equities continue their climb, including the tech sector. Gold has come up a bit these past two weeks, but there isn't much fuel for pessimism to push it higher. Cryptos, as in Bitcoin and Ethereum, are showing strong signs of market appetite for alternative assets, or simply risk-on mode – let's just remind our readers that fewer than 2% of accounts hold 95% of Bitcoin supply, so a few big trades can impact prices.

In the first innings of 2021, we already see concrete investment opportunities.

The first one is the delisting of Chinese telecoms from the NYSE. China Mobile, China Telecom Corp, China Unicom have been targeted by the exiting Trump administration for political reasons, not economic ones. These companies all have dual listings and trade in the Hong Kong Stock Exchange. From an economic perspective, results are surely not stellar, especially for the latter two. China Mobile displays a rather constant 2% YoY revenues growth and a return on invested capital of 8% for the past 10 years. Do these metrics grant a 1.10x 2022 EBITDA multiple? We do not see how competition might kill this company, as these are government monopolies.

The second one is still in China, this time with Alibaba and Tencent Holdings. Both are being targeted by the Chinese Communist Party (CCP) since both have started to display the same manias of global power that US tech companies have. The difference here is that the CCP does not want to let go of power, hence it is curbing its tech companies' dominance. The stop of Ant Financial's IPO means exactly that. Does that mean that Alibaba and Tencent Holdings will irremediably collapse under government pressure? We do not think so, as these two companies are the CCP's best weapon to fight American tech dominance and to push the Chinese economy towards global relevance. In other words, they are too politically precious to shut down – so they will be somewhat restricted.

A last comment on the state of global markets: equity overvaluation is still rampant across the board. The tech sector leads in this trend, with a valuation now over the one it had during the dotcom bubble (2000). However, the amount of cash around, the willingness of governments to expand debt ad infinitum, zero interest rates, the coming of a more efficient, cost-cutting, tech-based economy are all conditions that support, rather than discourage, an expansion in valuation. Surely politics in the US will influence markets going forward, but eventually expectations on fundamentals, although currently euphoric, will still have the major say in which ones will be the most expensive businesses. The pandemic proved exactly this point: great companies, with sustained returns and earnings growth, can only get discounted so much.

For further details, please contact:

INDEX & Cie Limited
Index Tower, 20th Floor, # 2001
Dubai International Financial Center
PO Box 507069, Dubai, UAE
www.indexcie.com

Tommaso Leodari
Chief Investment Officer
Email: tl@indexcie.com

Disclaimer

The information herein contained, including any opinions and any terms and conditions presented (the "Information") has been prepared and distributed by INDEX & Cie Ltd. (the "Asset Manager"), and is directed at, and related financial products or services are only available to wholesale clients (non-retail customers) who qualify as either Professional Clients (as defined in DFSA's Rulebook, Glossary Module ("GLO") or Market Counterparties (cf. GLO) under the Rules (cf. GLO) enacted by the Dubai Financial Services Authority ("DFSA"). This document is being furnished to the intended recipient solely for information purposes and no other Person (cf. GLO) shall act upon the Information. Any investment carries its own risks; the investor must be aware of the risks posed by an investment (cf. GLO) and is fully responsible for the risks incurred. The Information is not and cannot be understood as impartial investment research. The Asset Manager does not guarantee the accuracy or completeness of the information and the opinions expressed herein are the Asset Manager's opinions at the moment they are conveyed only and are subject to change without prior notice. The Asset Manager is not under any obligation to update or keep current the Information and the opinions expressed herein. Neither the Asset Manager nor any of its officers directly responsible for the Information (or a close relative - cf. GLO - of the latter) have a financial interest or material interest that relates to any on the investments herein recommended or suggested, nor the Asset Manager either, as far as the Asset Manager is aware of, any Asset Managers associate (cf. GLO) owns (unless stated otherwise elsewhere in this document) 1% or more of the total issued share capital of any of the Issuers (cf. GLO) mentioned herein. The Asset Manager does not act as a corporate broker to any of the Issuers (cf. GLO), although one of the Asset Manager's associates may act or have acted as such. The Asset Manager has not undertaken any corporate business with or for any of the Issuers over the past 12 months, nor has in the pipeline any future relevant corporate finance business initiative involving the latter, nor is a market maker (cf. GLO) in any of the investment recommended. None of the Issuers herein mentioned has a material shareholding in the Asset Manager. This document cannot be reproduced, in whole or in part, in any form or by any means, without the Asset Managers specific authorization and any distribution of the information on behalf of the Asset Manager is strictly prohibited. Neither this document nor any copy hereof may be sent or taken or transmitted into or distribute, directly or indirectly, in any jurisdiction other than the Dubai International Financial Center. Any failure to comply with this restriction may constitute a violation of the laws of the jurisdiction where the document is being redistributed. This document does not constitute or form part of, and should not be construed as any offer or sale or subscription of or solicitation of or invitation to make any offer to purchase or subscribe for any financial products or services and neither this document nor any part of it shall form the basis of or be relied on in connection with or act as an inducement to enter into any contract or commitment whatsoever. The Asset Manager does not accept any kind of liability for losses or damages which may arise from the use of this document or its contents, nor for the unlawful reproduction and/or redistribution of the same. The Asset Manager is duly licensed and Regulated by the DFSA.