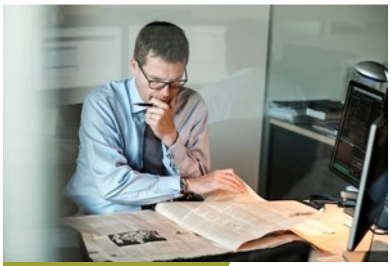

European Capital Partners

Friday Morning Coffee

Nr. 70 — Another brick in the wall

"Wrong, do it again! Wrong, do it again! / If you don't eat yer meat, you can't have any pudding / How can you have any pudding if you don't eat yer meat?" are the lyrics of 'Another brick in the Wall' by Pink Floyd. Are value investors now finally getting their pudding or will they be deprived of the sweet part of the meal as they have been skipping the quantitative easing hormone boosted main dish by avoiding the hyped growth stocks ? On Bloomberg TV we saw a graphical illustration this week of the wall of worries stock market investors currently need to climb. On that wall were listed in order of appearance: Trade War, economic slowdown, recession, global bond yields, negative debt pile, earnings recession, Brexit, Italian fiscal policy, central bank ammo, Hong Kong Protests and the US 2020 election.

On the one hand, we note plentiful concerns out there and the height of the wall of worries investors need to climb to invest 10 years into the equity bull market. On the other hand, we are somewhat surprised that one of the most important bricks of the wall appears to be missing, namely valuations. This leads us to the conclusion that equity investors are continuing to ignore valuations in the light of the other worries they are currently dealing with. So the pudding is currently being served to asset classes like gold or even bitcoin but certainly not to value stocks.

However there are some clouds on the horizon as more and more analysts start to question the established world order and are beginning to argue that some of the growth stocks are valued to a level of perfection that future earnings growth will not be able to justify. One example is US big tech where Société Générale came out with strategy piece this week on building the case for a short US tech position. The authors argue that tech stocks are likely to become less attractive going forward as their earnings momentum will resemble more and more to the one of the overall US stock market. Three reasons are given: 1) more scrutiny from regulators leading to tighter regulations and more fines 2) new taxation rules adapted to the data-driven economy and 3) further pressure on earnings momentum in the period of market turbulence we are currently going through.

The earnings momentum in US tech is slowing noticeably leading to recent underperformance of US tech stocks as can be seen from the graph below:

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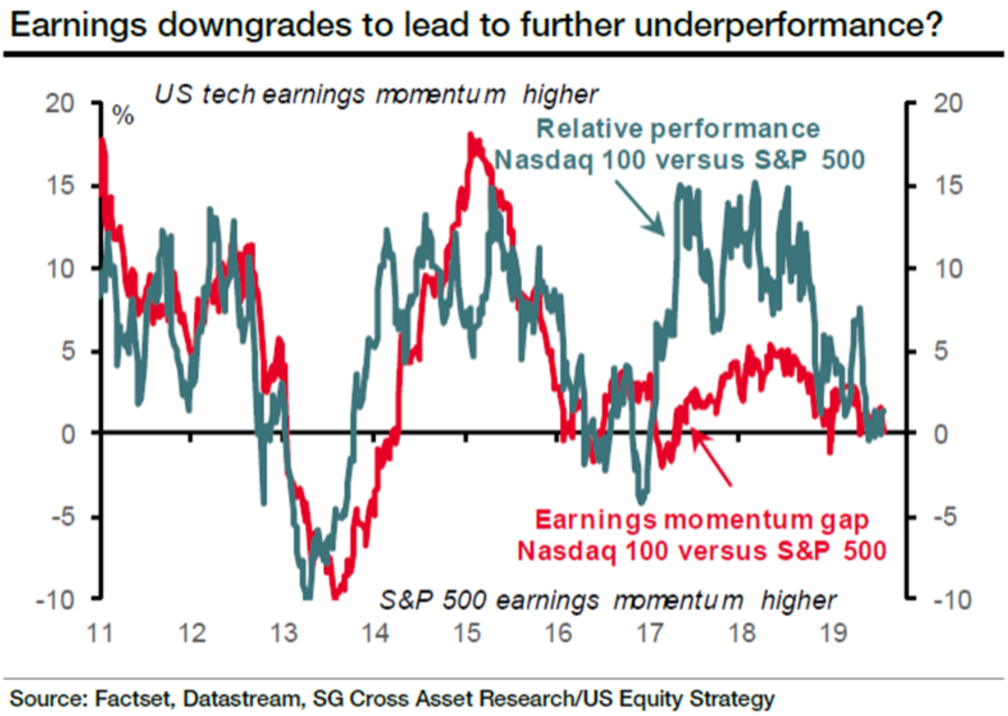

As we read in one Bloomberg article this week "Public markets aren't paragons of rationality, with the wisdom of the crowd repeatedly giving way to the mania of the mob.". As value investors we are sometimes scratching our heads looking at some of the valuations being paid for perceived stable growth businesses. That will eventually change going forward and we look forward for the pudding served to these who are investing in solid undervalued businesses.

I wish you a nice weekend,

Léon Kirch, CFA
Partner & Chief Investment Officer
August 16th, 2019