VALOR ASSET MANAGEMENT

Normalisation

The world is obviously going through a difficult economic period. Australia's GDP just contracted 7% in one quarter. The worst on record since 1959.

Many are focused on the short term. Few are thinking long-term.

What happens if the world normalises in the coming year? There are 88 vaccines attempting to tame this virus. There is a high probability more than one will be effective. 23 companies are in stage 2 testing and 5 companies are in stage 3 testing. The world may be returning to normal sooner than even the most optimistic expert predicted back in March.

What does normal mean?

Higher inflation?

Higher rates?

Central banks around the world are using their powers to lower rates. The US Fed is attempting to further jawbone the markets with their commentary. They are making promises to borrowers around lower rates for the years ahead. The issue with this guidance is that they don't know themselves. A moderate pickup in inflation could lead to interest rates climbing higher than current emergency levels. A number are not prepared for this scenario.

Deflation is possibly a higher risk than inflation in the near term. Our portfolios own some defensive positions for this scenario. Over the medium term, inflation may surprise. No one knows.

The short-term outlook for the economy remains difficult.

In a more normal world, interest rates will likely revert back to higher levels. Would this be the catalyst for the stock markets and property markets to revert to the mean? Most are assuming interest rates will not rise for many years.

When will people return to their "normal lives". When will everyone be back in the office? Will people be shopping less from home? Will air travel revert to its previous glory as has now already happened in China's domestic market?

Betting against normal over the centuries has been a poor bet. Is this time any different?

The release of two nuclear bombs in 1945 was a shocking event. Those that bet against normal would have missed the post war boom period.

If you thought the deadly Spanish flu of 1918 was going to permanently change human behaviour, then you would have missed the roaring 20's.

If you thought extreme inflation and interest rates of the 1980's would crush the economy, then you may have missed the 1990's boom period.

Valuation Risk

From our view, valuation risk may be the largest risk in the market today. The popular assets may disappoint and the out of favour assets may be better investments over the coming years. This has occurred numerous times in history.

"Be fearful when others are greedy and greedy when others are fearful" *Warren Buffett*

There are many examples in today's markets that resemble the folly of the 2000 Dot-com bubble.

Despite a general level of excess, we are purchasing assets that are trading at prices that we are very comfortable compensate for the obscurity of the times. Some of these out of favour assets will likely be "multi-baggers" in the coming years. We haven't seen such wonderful opportunities for nearly a decade. At peak folly in 2000, some of the best investments were available at bargain based prices. Berkshire Hathaway made around 65% return, whilst the Nasdaq index dropped 77% in the years following the Dot-com bust.

When no one knows what is going to happen, the only way to invest is to own great assets that are below their fair value under multiple scenarios. When we scour the world today, few assets possess a margin of safety and most are above any rational pricing level.

It is environments like these, that patient and rational investors should shine over the coming years. Our ability to directly invest globally and focus on what we consider reasonably priced assets and scour for the few remaining gems has been highly profitable for our clients over the years.

"Never waste a good crisis"
Winston Churchill

We continue to find great companies that have normalised earnings yields of high single digits and some well into the double-digits. When normal returns, these assets should be re- priced significantly higher.

Conversely, we see the stock markets at levels that would usually suggest anaemic returns for many years. This dichotomy exists because of the popularity of a few significantly overpriced stocks. Many of these companies are not profitable and will likely never be. This folly will one day be exposed and then suddenly the emperor's new clothes slip away and those who aren't wearing any clothes will be left in their birthday suits.