Kgs Nytorv, Copenhagen
Saturday 28 March 2020 at 12.30

Normally a very busy place

APRIL 2020

Roadmap 2020
1Q update

And this, too, shall pass away

NORDIC INVESTMENT PARTNERS

Market update

A few weeks completely changed how the global economy and society function. We're looking at one of the deepest slumps since 1900 and all caused by a tiny virus.

The general media is much better to keep you updated on how things unfold, so this update will focus on previous episodes of sudden stops as well as laying out an idea of how the road looks once the dust has settled.

In early April 2020 it's impossible to forecast when the Coronavirus will go away and when economic activity can resume, but it's certain that it will at some point. Question is how much damage will have occurred in the period

Stocks walk up the stairs and take the elevator down

In the 2020 episode they simply jumped out the window

Market declines are great opportunity periods

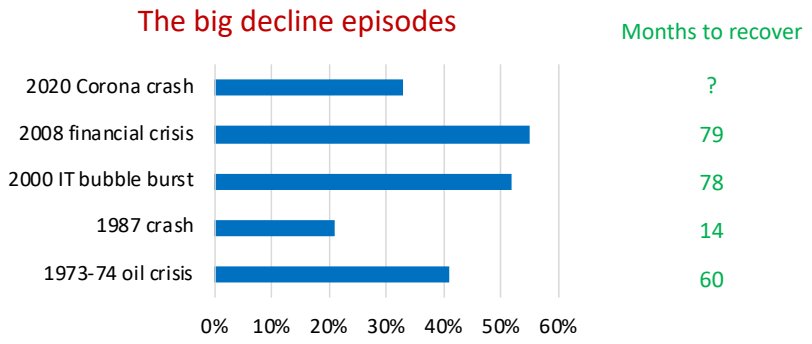
It feels awful when you see your investments (future spending opportunity) decline in value.

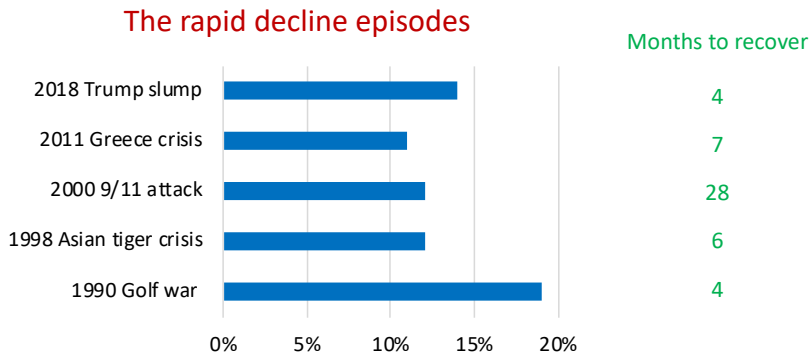
People like sales for the opportunity to pick up clothing or smartphone at a discount. The same pleasure psychology do not apply to investments, but it should.

Corona virus shall pass away, but we don't know when. But once it's gone and things start to normalize investors can look forward to a period of extraordinary high returns that typically last for 1-3 years.

Catching the bottom is the tricky part so on next slides there's some simple roadmaps that can guide you

After the market decline in 2020 the expected return towards 2025 has increased from 4-6% to around 10% per year





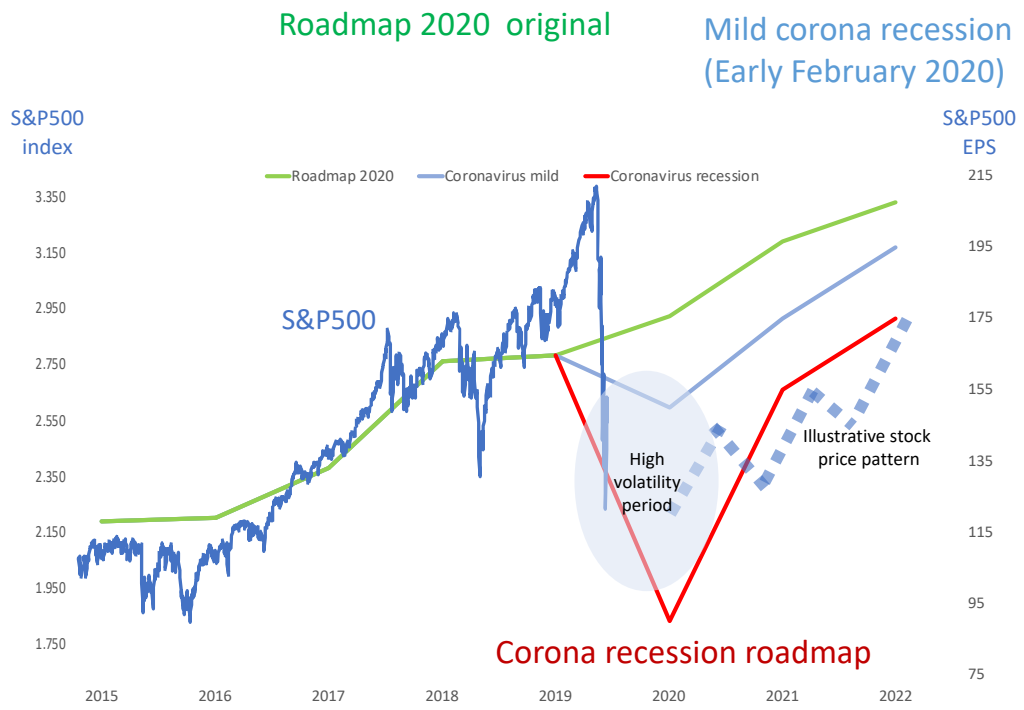
MSCI World data

Significant change to roadmap 2020-22

Going into 2020 the roadmap for S&P500 was for 5% earnings growth and EPS of 175$ for S&P500.

Lock-downs and sudden stop of economic activity are impossible to translate into a new earnings level for 2020. However, to get direction a 50% earnings fall has been penciled in (red line). During March, the low point was 2.237 and one should not be surprised if S&P500 falls to 2.000 level for a short while.

As things normalize the upside from 2.000 would be very attractive and by 2022 we would likely be back to 3.000 level for S&P500



Can older episodes give a hint of what's coming?

There's absolutely no way to predict if we're going into a prolonged period of poor performance in the global economy and financial markets.

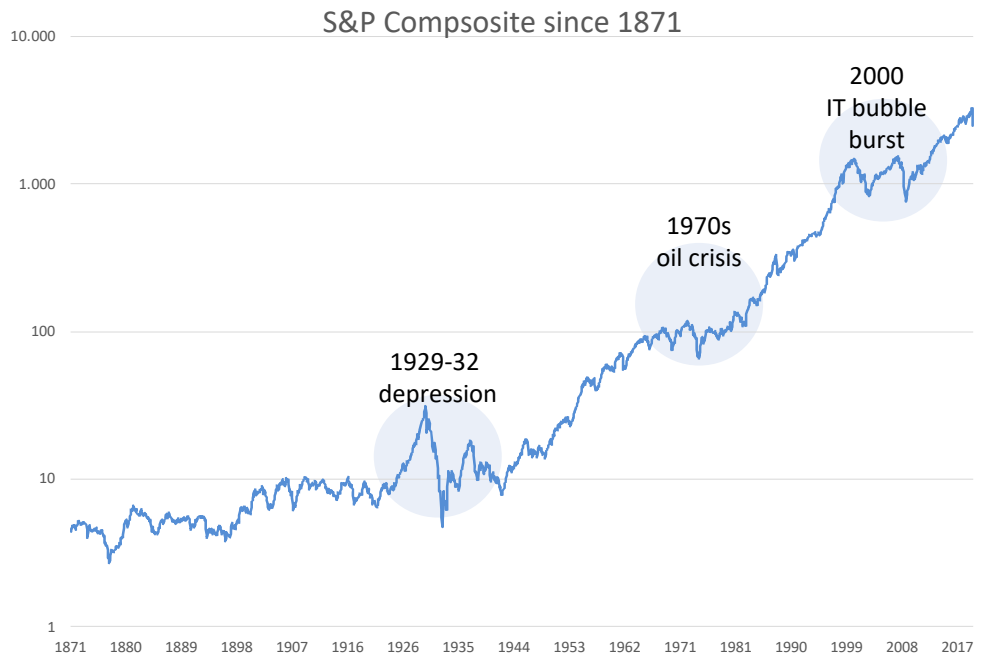
The best timeseries is the US market since 1871, albeit the data is not perfect, lines up a few episodes with multi-year low-return periods (blue circles).

A few stress-full periods have been lined up in the following slides

An observation of longer-term market movements after the episodes

USA is approximately 55% of global stock market capitalization. It's also some of the best timeseries and as such it's a good work horse for finding direction out of previous challenging episodes

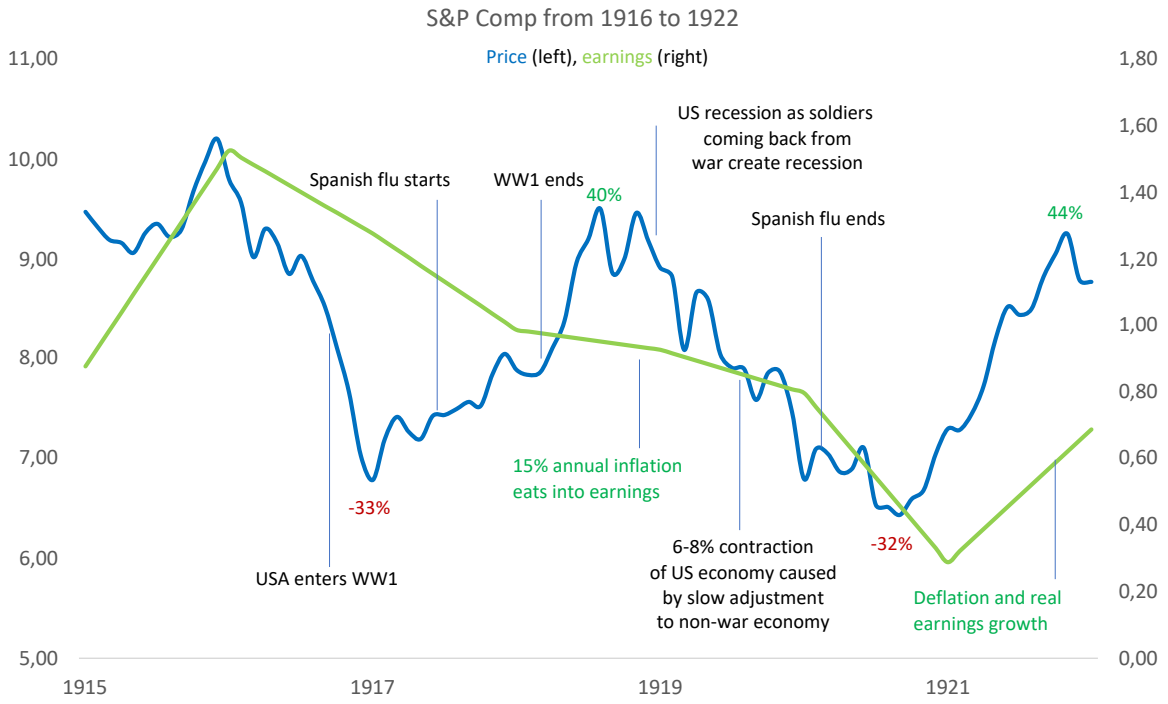
The British, German, French and Japanese timeseries are not as useful and the capitalization for those markets was at several occasions close to zero over the last 120 years



Source: Yale

Episode 1 – Spanish flu 1918

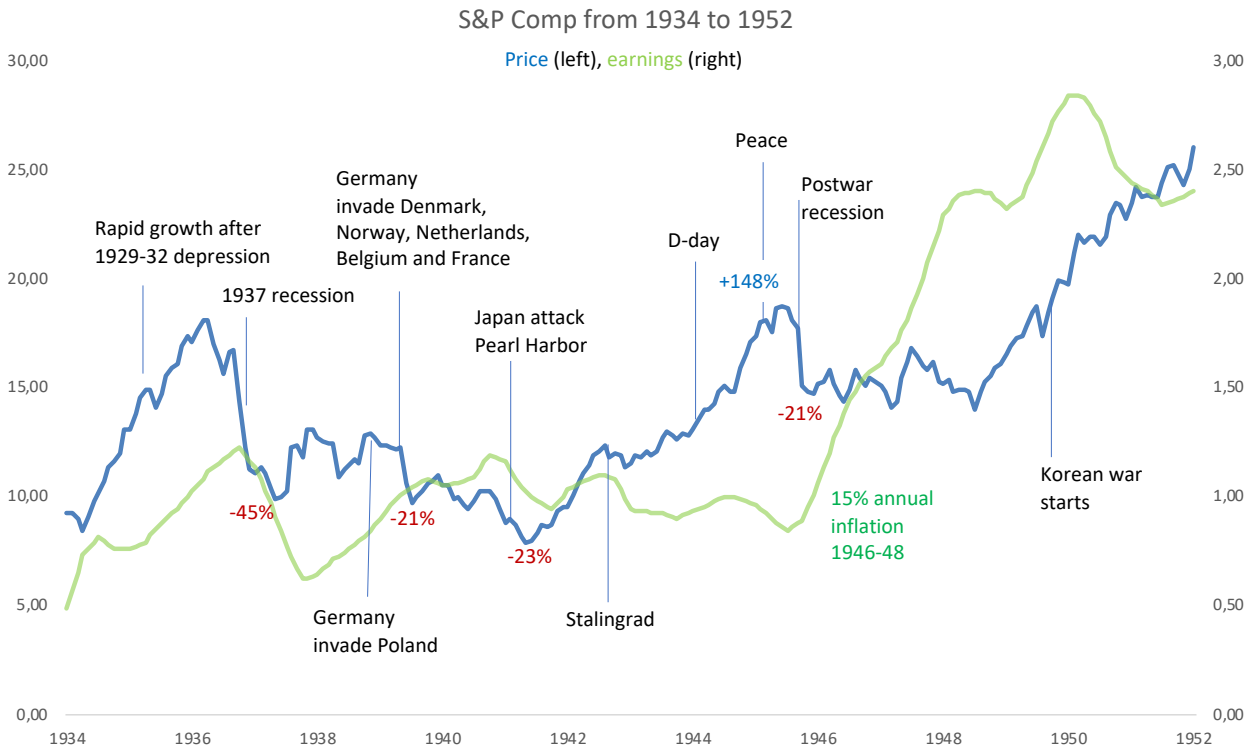
The 1916-1921 narrative was not just pandemic, but also US getting involved in WW1 and recession as the war ended. The comparison to the 2020 episode is therefore of low relevance



Source: Yale

Episode 2 – Second World War

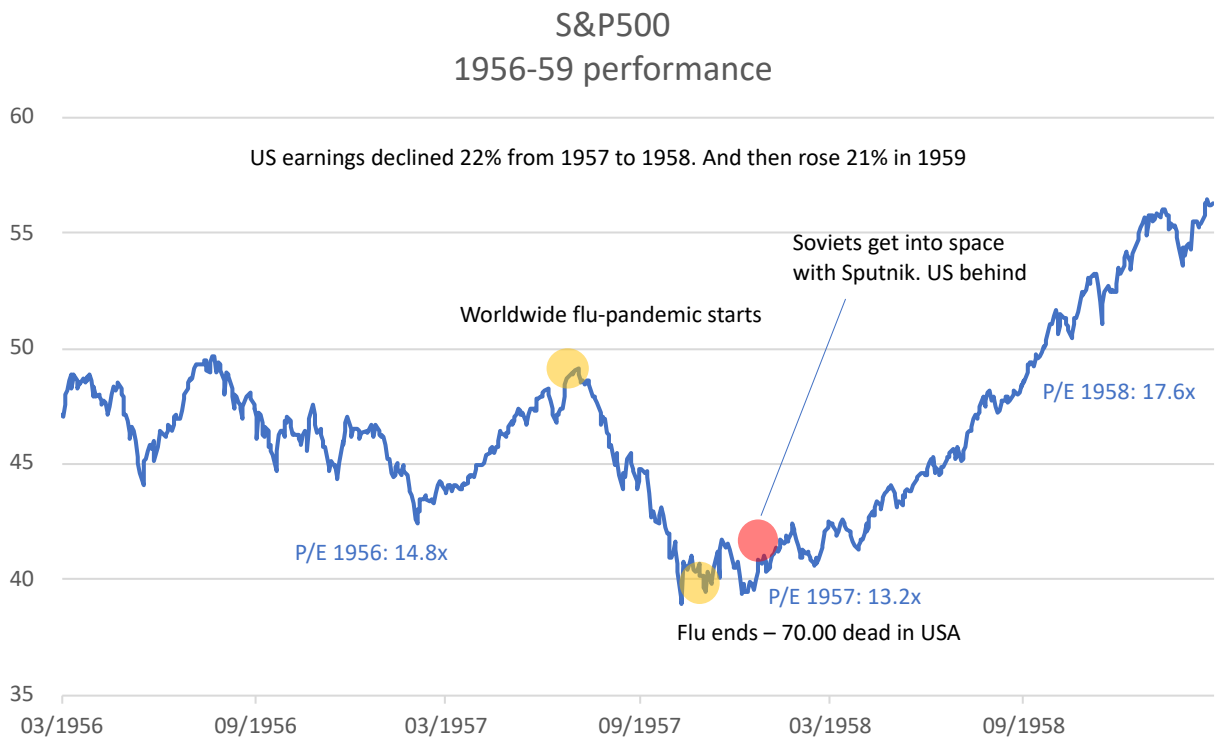
The very tumultuous 1930s decade continued into 1940s with even more tumultuous period with global war and low visibility. The economy came to a sudden halt in Spring 1940, which resulted in a 21% decline. Adding the Pearl Harbor event the combined decline was 35%. During 1942 it gradually became clear the war would end at some point and given war is a period with high economic activity then the stock price declines in 1940-41 were mainly increase in risk premium



Source: Yale

Episode 3 - 1957 pandemic

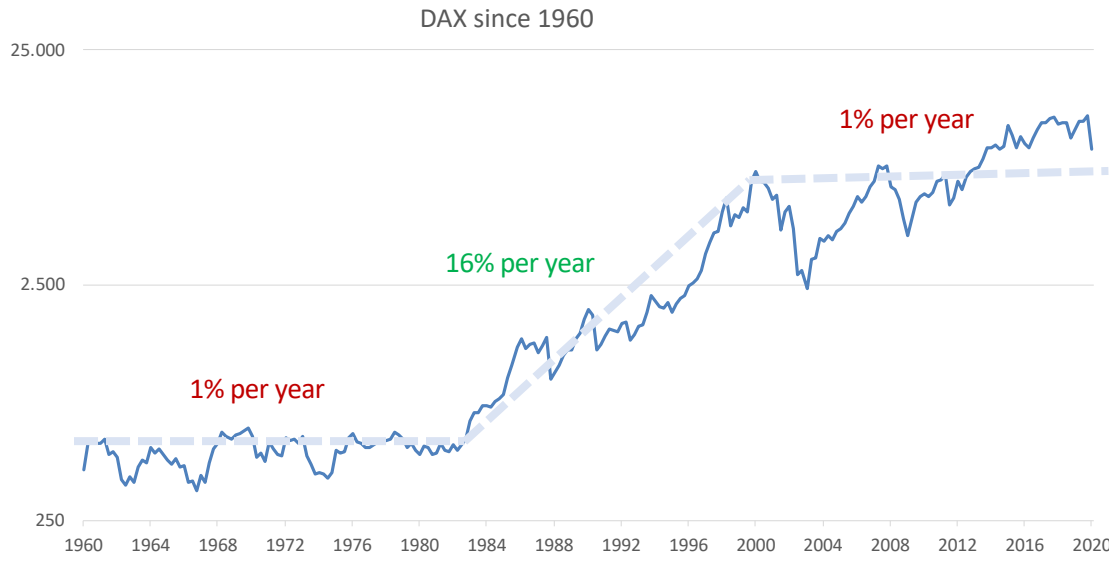
This is the episode that looks most like the events of 2020. External 'noise' was limited and while people isolated for a while and the economic activity declined, things worked out once the pandemic faded. The episode was a 21% decline and fully recovered in just 13 months



Source: Yale

Germany DAX

While observing long time series it occurred that sock markets seems to move in very long phases.
Over the past 60 years German stocks have risen 5.4% per year on average (plus dividends), but it has occurred in three phases as illustrated below.
There's obviously a lot of economic, political and corporate performance information for each period, so it's just a simple observation that we might be at the early stages of a new period with higher returns.
Remember the 1982 bull run started during high inflation, low growth and political change period

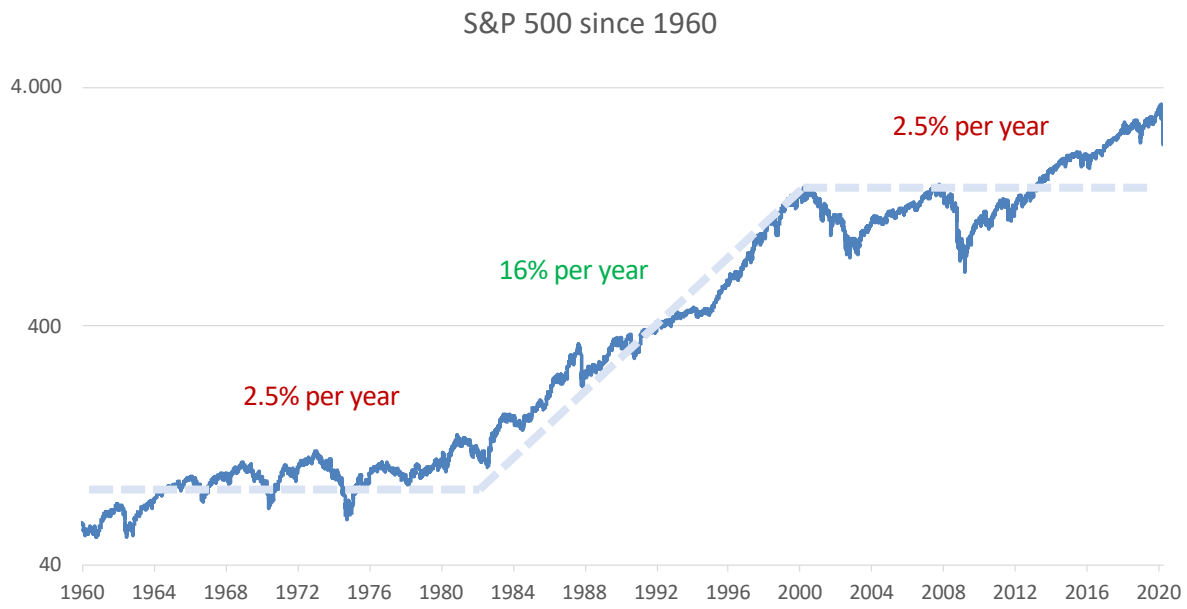


Source: Bloomberg

Price performance only

USA S&P500

USA has the same pattern as Germany for the last 60 years and over the period US stocks are up an average of 6.4% per year (plus dividends).
At the peak in 2000 US stocks were overvalued and had to spend the next 12 years to improve earnings and hence work itself out of the overvaluation episode.
The perception of US having very good performance is mainly justified by the performance since 2013 led by aggressive buy-backs, fast growing digital titans and with support from low interest rates.
Still, the 20-year return since 2000 peak is just 2.5% per year



Source: Bloomberg

Price performance only

The road forward

The historical episodes of severe stress have always resulted in better times afterwards. It's hard to imagine, but fact is the London stock market bottomed in June 1940 and before Battle of Britain started.

So watch the stock market for indications that things start to normalize

2020 road bumps has certainly changed the direction of traffic. Most people need to get immune to the coronavirus either with your own antibody response or with a vaccine (2021 event). The healthcare facilities cannot handle too many ill people at the same time, so amount of people ill at any given time is needed to be spread out.

Investors should prepare for 2 scenarios for the next 12-18 months;

1. The virus fades away during the summer of 2020 and do not re-emerge strongly next winter due to precautionary behavior. By summer 2021 things are back to normal and the economy jumps back and corporate performance the same. Stocks recover fast and almost back to February 2020 high by the end of 2021. However, many smaller and weaker business will unfortunately not make it.

2. The lock-down remain and off into next winter and the economy goes into a long recession. The financial system comes under serious strains as the production and service sectors struggle with basic survival and unemployment goes to levels not seen for generations

The regional performance will vary and as it looks now, Asia seems to be best suited for a normalization. Europe and USA will be impacted, but can handle it. Emerging Markets, without the resources to cope with the situation, face serious problems. Fortunately, their populations are younger and hence stand a better chance for getting immunized naturally without need for hospitalization

The geo-political landscape and roadmap for the 21st Century being the Asian Century stands firm and has probably gained traction in the last few months. If you want more insight on those matters recommended reading is found on Eurasia and Foreign Affairs

Asia – the region with the biggest absolute growth

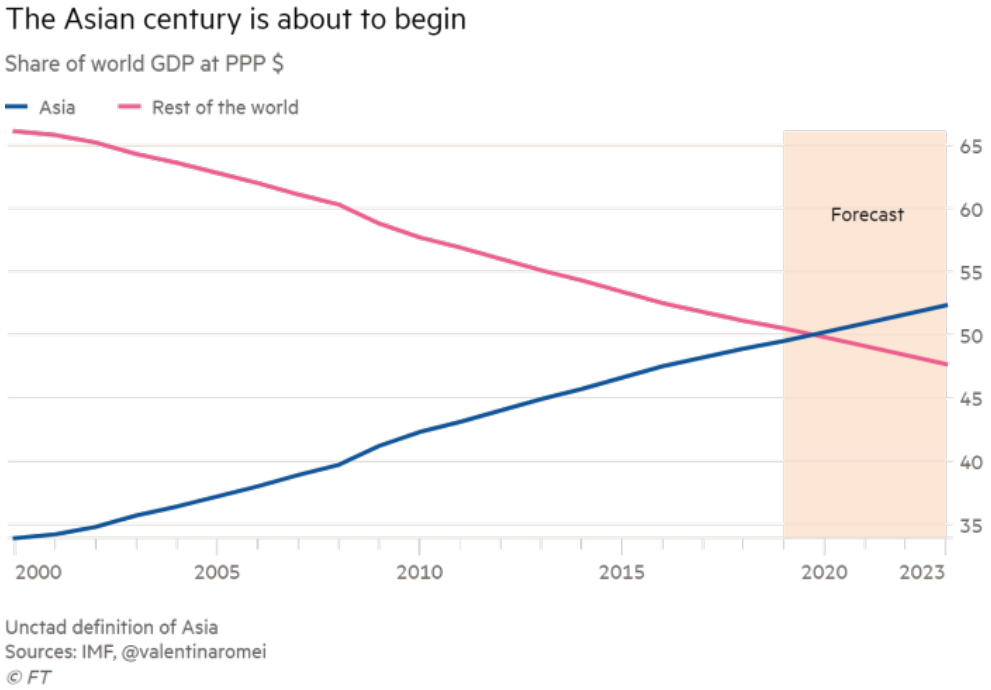
Out of the 7.5 billion people on Earth, 4 billion live in Asia

The living standards in Asia as on a rapid rise and inspired by the performance seen in Japan, Taiwan and Korea since 1960s

The level of affluence will increase faster in the 2020s and hence Asia as such offers the biggest absolute growth and will overtake the rest of the world

The pendulum of economic gravity hence swings to the East

Enjoy the journey



Key investment view towards 2030

Economic pace in 2010s have been highly dependent on fiscal and monetary stimulus provided in the aftermath of the 2008 crisis. The stimulus have however created imbalances such as government debts. This will probably continue even as it gets beyond sustainable in some countries

Global economic growth has been declining from 6% in 1960s to around 3% in late 2010s. Productivity and population growth points towards lower economic growth in the coming decades. The underlying growth in global affluence will however continue and with Emerging Markets in lead as those economies grow double the speed of developed markets

There's nothing wrong with modest GDP growth, but many investors have been accustomed to 8% annual earnings growth, while the realistic forward growth is more likely to be around 4-5%. Dividends of 2% comes on top. Annual swings are likely to remain in the 15-20% interval, so the occasional declines will continue

In an investment world on those conditions **Advice Capital Vision Fund** focus on identifying companies and business clusters with unique multi-year structural growth drivers and then invest in these when growth/profitability/valuation triangulation justifies it. The investment focus in Advice Capital Vision Fund is on identifying, holding and harvesting multibaggers based on these principles. Good stewardship and ESG applies to the companies invested in.

The traditional business and inventory cycle still applies, so from period to period growth and inflation will change. In a world with evermore data and analytics the efficiency of eco systems will likely reduce the magnitude of economic swings as end-to-end value chains reduce slack and inefficiency. Risks of financial mis-allocation of capital is the same

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