Four Exaggerated Concerns

“Invest for the long haul. Don’t get too greedy and don’t get too scared.”
– Shelby M.C. Davis

Keep Calm and Carry On was a motto developed by the British government in 1939 in preparation for World War II. The mantra was posterized to raise the morale of the British public, who faced mass air attacks on major cities. Although 2.45 million copies were printed, the poster was rarely displayed in public and was pretty much lost until a copy was rediscovered in 2000 at a bookshop in Alnwick, England.

The motto and associated poster made a massive resurgence in the 21st century, taking on many forms and functions to convey several prevailing zeitgeists. (My personal favorite for the present-day is “Keep Calm and Carry On Working Remotely.")

In a world that’s increasingly unpredictable, it can be challenging to heed the time-tested advice, especially for markets, which fluctuate within seconds based on tweets and news conferences these days. Because of this, the market’s jitteriness can be unsettling when looking through the myopic lens of short-term results. But, when evaluating markets with a long-term mindset, the fluctuations can also reveal significant opportunity.

Take Tuesday as an example. The White House abruptly halted discussions around a new stimulus deal, which resulted in a precipitous drop across stocks, almost without exception. Later in the evening, a series of tweets by President Trump pointed to a willingness to revive stimulus talks, which led to a rebound in stocks the following day.

This week, readers will get the chance to hear from Will Denyer at our partner firm Gavekal, on four concerns that are front-and-center for many investors right now, namely that:

1. The Fed is out of ammo.
2. The economy cannot survive without more fiscal support.
3. A disputed election will rock the markets.
4. Risk assets are stupidly expensive.

While these concerns are not without merit, as Will points out, their long-term impact is likely overstated. (Note: Although his note was written over two weeks ago, we believe his essential points are still valid.) That isn’t to say there aren’t specific securities that are crazy overpriced, as highlighted in last week’s missive by David Hay. Yet, as David also observed, there are a multitude of CUPS – Crazy Under Priced Stocks – to choose from presently, including some of America’s finest businesses. Consequently, Evergreen feels the mantra to Keep Calm and Carry On will likely prove prudent for investors, even as the world once again faces an extremely trying, and generation-defining, moment.

As if markets weren’t nervous enough, US policymakers have been fueling the nervousness. On September 23rd, a series of remarks spotlighted a number of the main concerns currently troubling investors, including that the US Federal Reserve is out of ammunition, and that

disputes over the result of November's upcoming presidential election could drag on into the new year, plaguing asset markets with additional uncertainty. This focus appeared to contribute to the -2.4% slide in the S&P 500 on September 23rd, a fall which brought the sell-off since the market's September 2 peak to -9.6% (as of September 24th).

The question investors face is whether this sell-off is simply a healthy correction following an overextended rally, compounded by normal pre-election jitters, or whether it is the start of a more serious long post-stimulus hangover. The answer is that it would be premature to turn bearish on the US; four of the most prominent concerns troubling investors are overstated.

1. **The Fed is out of ammo.** No, it is not. On August 27, the Fed redefined its inflation target in a way that implies policy will remain easier for longer. It then disappointed markets when it refrained from using its mid-September meeting to ramp up its asset purchase program, which is currently running at "only" US$120bn per month. But this does not mean the Fed is out of ammunition. The Fed didn't step up its easing because in its view economic and financial data are moving in the right direction, with both inflation and inflation expectations picking up. If in future the Fed sees a need to increase purchases, it can.
2. **The economy cannot survive without more fiscal support.** Yes, federal top-ups for unemployment benefit have fallen from US$600 per week to US$300. And they are set fall to zero when Donald Trump's stop-gap measure runs out of funding soon. With the Senate now focused on whether it will confirm a new Supreme Court judge in the coming months, the probability that Congress will authorize fresh fiscal support before the November election, or even before the new Congress sits in January, is greatly reduced. This will cause hardship for many households, but the lack of additional fiscal support is unlikely to kill the recovery. The US is reopening, employment is falling, and consumer confidence is rebounding. These factors should be enough to offset the decline in fiscal support.
3. **A disputed election will rock the markets.** Yes, this is a risk, but it has been overstated. On Wednesday, September 23rd, Interactive Brokers said it was raising margin requirements to protect itself and its clients against a potential increase in volatility over the election period. This may have contributed to Wednesday's sell-off. But the US system is designed to force a result within weeks of the election. If he loses, Trump cannot cling on in office. And while there is a risk that an unconvincing or unpopular result will trigger street protests, a long series of precedents over the last 50 years suggests any unrest will have little or no effect on markets.
4. **Risk assets are stupidly expensive.** Yes, and no. In general, financial assets are expensive, which is a good reason to own significant holdings of cash, short-term TIPS and/or gold. But most money managers cannot put a large share of their portfolios in any of these. Instead they must largely choose between stocks and bonds. And while equities no longer have a substantial valuation advantage over bonds, neither are they at the sort of relative disadvantage which in early 2000 led to a major repricing.

So, in conclusion: yes, there are reasons to reduce risk on the margin. Policy easing has moderated from stimulative to just supportive. And risk assets no longer have a significant valuation advantage over cash and treasury bonds.

But policymakers were bound to dial back their support at some point, and they are doing so now in part because their efforts have been successful: as lockdowns have eased and the dampening of real interest rates has boosted demand, the economy has begun to recover. And while lower long term rates caused growth stocks in general and tech in particular to rip higher, relative valuations for equities in general are nowhere near as out of line as they were

immediately preceding past shakeouts, such as the 2000 tech bust. So, while it may make sense for investors to trim risk at the margin, there is no call for them to bail out of risk assets altogether.

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