MONACO ASSET MANAGEMENT

Global Research
Investment Strategy

MAM Insight No. 7

In this Issue

November 6, 2020

US Elections - Early Lessons

We anticipated significant uncertainty regarding the outcome of the US elections. Watching the US elections all night on November 3rd, we thought a Trump victory was imminent when Florida was projected as a Republican win **(Chart 1)**. However, mail-in ballots proved a major game-changer in many battle-ground states over the last two days. Joe Biden nears victory. Betting markets currently agree that Joe Biden will become the 46th president of the United States, with a 90% probability **(Chart 2)**. Today, Republicans are likely to maintain control of the senate, by a narrow margin. Such balance of power could produce less fiscal stimulus than in the other possible outcomes that were in play. More importantly, the fiscal stimulus could be delayed by a few months. In our view, financial markets have yet to price this in. Nevertheless, public opinion still favours a more expansionary fiscal policy. A divided House and Senate could incentivise a "grand bargain" raising spending while making Trump's corporate tax cuts permanent. The combination of continued easy monetary policy, modestly looser fiscal policy, and a progress on vaccine should be enough to keep global growth on an above-trend path next-year. We remain convinced our inflation thesis will play out in 2021. We remain overweight global equities and commodities relative to bonds. We are prepared to increase exposure to value stocks when clearer evidence on the latest wave of the pandemic is decreasing. As a strong believer in Climate Change, Joe Biden will push for the US to re-join the Paris Accord. This is very positive for ESG related investments in the medium to long term.

Chart 1. Road to 270 Map

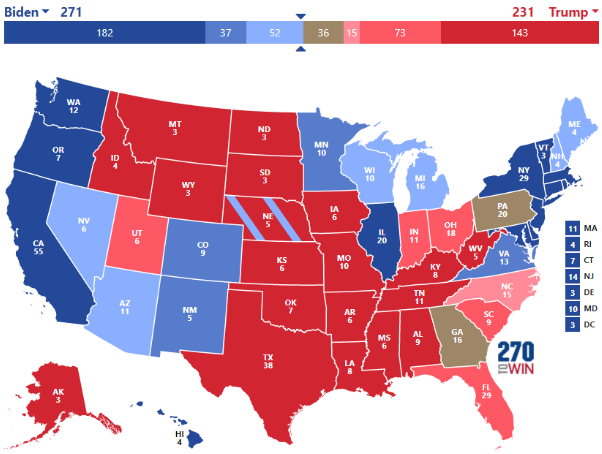
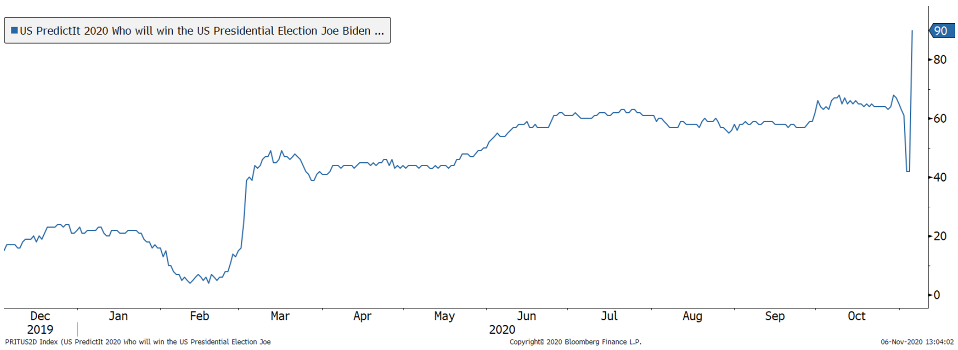


Chart 2. Odds of US Presidential Election - Joe Biden



Source. Bloomberg, MAM Research

The Questions

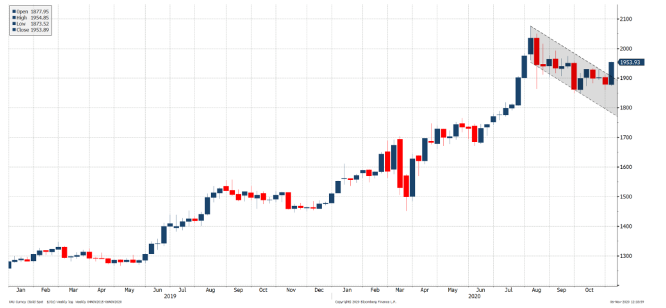
Senate Control. At the time of this writing, we side with betting markets on a divided government. Republicans keep control of the senate. However, we are conscious of a prolonged senate race. The blue wave is not dead. After days of counting, odds of a double runoff in Georgia keep on rising. If democrats win both runoffs, the senate would shift 50/50 and any tie-breaker on a vote would go to the new vice-president (presumably, Kamala Harris). Said outcome would put a large stimulus package early next year and tax hikes back on the table. This would be very positive to a reflation trade, but negative for equities and most notably growth stocks. Currently, democrats have an 18% chance to "win" the senate. Runoff elections will be held on January 5, 2020.

Fiscal Stimulus. Assuming republicans hold the majority in the Senate, the likelihood of tax hikes fades away. However, in the meantime, Biden would work to ease trade tensions with China. This is positive for equities. Conversely, odds of a large fiscal stimulus package drop. Republican senators averse to running large fiscal deficit by default would have even less incentives to give the Democrats the stimulus package they want. Uncertainty concerning the size and timeline of the fiscal package will generate volatility in the markets. This question will be driving markets in the next few weeks.

Financial Markets Implications

Inflation Thesis. While it may be delayed by a few weeks, the inflation thesis stays intact. Ultimately, lower rates and additional fiscal spending will drive inflation higher. We think the combination of further fiscal stimulus irrespective of political leadership and the Fed intension to keep rates lower for longer continue to support the reflation trade with gold already pricing it in **(Chart 3)**. However, we do expect some short-term headwinds. The pandemic's toll on the economy is likely to persist into the year end and H1'21. This will exert deflationary pressures for another 3-6 months. Longer-term though, all these economically supportive measures will begin to weigh in and exert reflationary pressures as early as H2 2021. Global growth pick up and higher inflation rates will come into play. Favour equities and commodities over bonds, mindful that not all equities are equal...

Chart 3. Gold - Supports Inflation Thesis (Weekly)



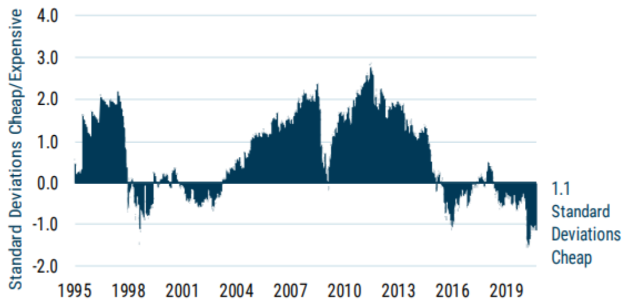
Source. Bloomberg, MAM Research

Emerging Markets. A wide range of external factors make the region attractive on a relative and absolute basis. A Biden administration should be positive to global trade, thus emerging markets. Whether the race ends up on a blue wave or tide, expect infrastructure spending boost in either scenario. This would lead to higher long-tenor US yields and a weaker US dollar, thus sending EM currencies higher and EM spreads lower. In turn, these macro-economics shifts support EM equities due to their deep value characteristics. Markets already begun to price a positive outcome for emerging market equities. Technically, they just broke out their latest resistance level **(Chart 4)**. Additionally, local currencies cheapness currently standing at their cheapest level since 1999 will provide further support. These are set for a mean reversion scenario **(Chart 5)**.

Chart 4. Emerging Market Equities Break Out (Weekly)

Source. Bloomberg, MAM Research

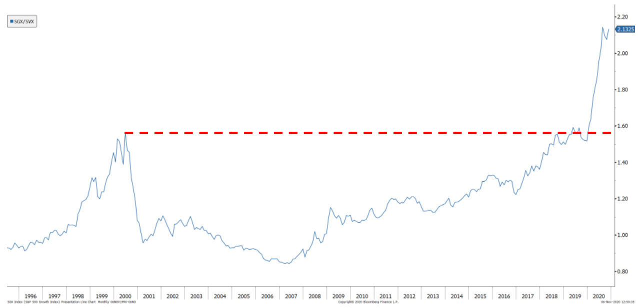
Chart 5. Emerging Market Equities Break Out (Weekly)



Source. GMO Research

Ready To Take Significant Exposure to Value Strategies Once the Covid-19 Pandemic Effect Lessens. In the late 1990s, "Value investing" was a sin. The Value style had been out of favour for more than half a decade. By 1999, the Russell 1000 Value Index had underperformed its growth index in 7 of the preceding 11 years. Countless academic papers were proclaiming the "Death of Value." Ultimately, of course, mean reversion worked, and Value went on to trounce Growth seven years in a row. From 1999 to 2006, Value beat Growth by a cumulative 99%. Fast forward to today, we feel we are in a similar place. The pain for Value investors has lasted even longer and performance spreads are even worse: Value has lost to Growth in 8 of the last 11 calendar years and by even wider margins. Add to this the Covid-19 Growth rally of 2020, which started on March 23 and continued all summer. From March 23 to August 31 – a 113-day run – Growth was up 77%, beating Value by 32% cumulatively (a 4.5 sigma event, which officially happens once every 403 years). This outperformance of Growth, importantly, has not been justified by the fundamentals, resulting in one of the widest valuation spreads. Mean reversion is a natural occurrence in financial markets, just as it did in the post-1999 period. A significant macro-economic shift such as a return of inflation can precipitate a mean reversion of performance in Value over Growth. The combination of further fiscal easing and a vaccine next year will be key drivers. We stand ready to position portfolios accordingly.

Chart 6. S&P 500 Value vs. Growth Index (Monthly)



Source. Bloomberg, MAM Research

ESG Investing Entering Secular Growth. The Biden Clean Energy Plan says that it will "put the United States on an irreversible path to achieve net-zero emissions, economy-wide, by no later than 2050". This was to be delivered partly by new technology-neutral Energy Efficiency and Clean Electricity Standards for utilities and grid operators. Biden also promised R&D money and tax incentives, while ensuring access to clean hydrogen at the same cost as conventional hydrogen within a decade as a clean fuel source for power plants. Hydrogen is a key growth area in Europe and is likely to see similar focus in the United States. We believe a company like Bloom Energy, our top pick, is likely to see long runway of superior revenue growth rate. More broadly as the United States will re-join the Paris Accord early in a Biden mandate, it is the whole "ESG-investing" sector that will be at the centre-stage. Capital will continue to flood in these strategies as US pension funds adapt to the "new green deal". ESG-related investments have outperformed traditional investments in the last 2 years. This trend is unlikely to change in the medium-term. We will continue to direct our research in this area as we offer 100% ESG mandates and investment funds. Feel free to get in touch with us on any ESG related queries.

Chart 7. Bloom Energy (Weekly)

Source. Bloomberg, MAM Research

As always, please feel free to reach out to us should you have any questions or comments regarding this research.

Kind regards,

MAM Investment Team.

Disclaimer

This document has been prepared by Monaco Asset Management (MAM). It gives a general overview of the strategies proposed by MAM.

This document is confidential and is intended solely for the recipient and may not be duplicated, distributed or published either in electronic or any other form without the prior written consent of MAM.

This document has not been reviewed or approved by any regulatory authority. It is not a personal recommendation. It is for your information only and is not intended as an offer, solicitation of an offer, public advertisement or recommendation to buy or sell any investment or other specific product. Its content has been prepared by our staff and is based on sources of information we consider to be reliable. However, we cannot provide any undertaking or guarantee as to it being correct, complete and up to date. The circumstances and principles to which the information contained in this publication relates may change at any time. Once published, therefore, information shall not be understood as implying that no change has taken place since its publication or that is still up to date. Furthermore, MAM is not under obligation to update the information contained in this document.

The information in this document does not constitute an aid for decision-making in relation to financial, legal, tax or other consulting matters, nor should any investment or other decision be made on the basis of this information alone. All recipients of this document are urged to carry out their own due diligence into any investment opportunity. They should form their own assessment and take independent professional advice on the merits of investment and the legal, regulatory, tax and investment consequences and risks of so doing.

We do not guarantee the accuracy or completeness of information which is contained in this document that may have been obtained from or is based upon trade and statistical services or other third party sources.

We disclaim without qualification all liability for any loss or damage of any kind, whether direct or indirect, which may be incurred through the use of this publication.

The above information concern this document and any associated documentation, including the e-mail or cover letter.

MAM is registered with the Monaco Chamber of Commerce and Industry under the number 99S03612 and is approved by the Commission for the Control of Financial Activities under number SAF/99-03.