LHV Portfolio Management

Monthly review of investments

December 2019

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2019 was one of the most successful ones in the markets over the last years

If in 2018 none of the asset classes beat inflation then this year it was the opposite – there was no asset class that would not beat the inflation.

After the 2009 depression, pessimism was the dominating theme in the markets from all over the world, yet a decade later it has replaced with an extreme optimism.

LHV The Best Private Banking in Estonia

EUROMONEY 2018

Positive year in the markets

2019 was one of the most sucessful ones in the markets over the last years. Still, it is worth keeping in mind it was following a very weak performance in 2018.

The year end was very much the opposite to the end of 2018 when fear and pessimism were dominating themes. Today, there is a lot of optimism reflected in the markets. **Investors do not fear market meltdowns but are rather afraid of missing out the booming stock market. Practically every single sentiment indicator shows that retail investors' optimism is making new highs. Based on that, we expect the market volatility rather goes up in the short run, and we take that fact into account when making new investments.**

Same argument could be made when looking at previous decades. After the 2009 depression, pessimism was the dominating theme in the markets from all over the world, yet a decade later it has replaced with an extreme optimism. Decades tend to be fairly different. We believe that the actions taken place in one decade, set the grounds for the next one - that is why the outcomes are so contrasting.

Market indices	1 month	2019
Euro Area Bond Index	-0,9%	6,0%
Global Equities	0,4%	28,9%
North America	-0,3%	33,1%
Europe	0,9%	26,1%
Emerging Markets	1,8%	20,6%
Estonia**	1,5%	7,8%

* MSCI index return measured in EUR ** OMX Tallinn index

Financial repression is back

The past decade was characterized by low inflation and central banks printing money (via bond purchases programmes), which together with a record low interest rates boosted asset prices. As the consequences of that action are still arising in the future, we expect that the upcoming decade is greatly affected by that.

The years long period of low interest rates and inflation has resulted in governments thinking that deficit spending has no negative consequences. In the US, the government spending has increased sharply, resulting in government debt growing faster than wages. Modern monetary policy theory states that government can spend endlessly, central bank buy the newly issued debt back from the open market and there are no negative effects for the economy.

Nevertheless, we see that trade tariffs as well as rapidly growing government spending are actually causing inflation. Looking at the inflation change in 5 years, the speed of change is currently the fastest over the last years. Taking mentioned developments into account, we are moving from low and slowing inflation environment towards still low (at first) but accelerating inflation environment. **The debt levels are still so high that it is reasonable to assume that central banks will not be raising interest rates, nevertheless inflation is showing signs of recovery. It means financial repression where inflation is higher than interest rates and it basically works as a tax rate on savings as real interest rates are negative.**

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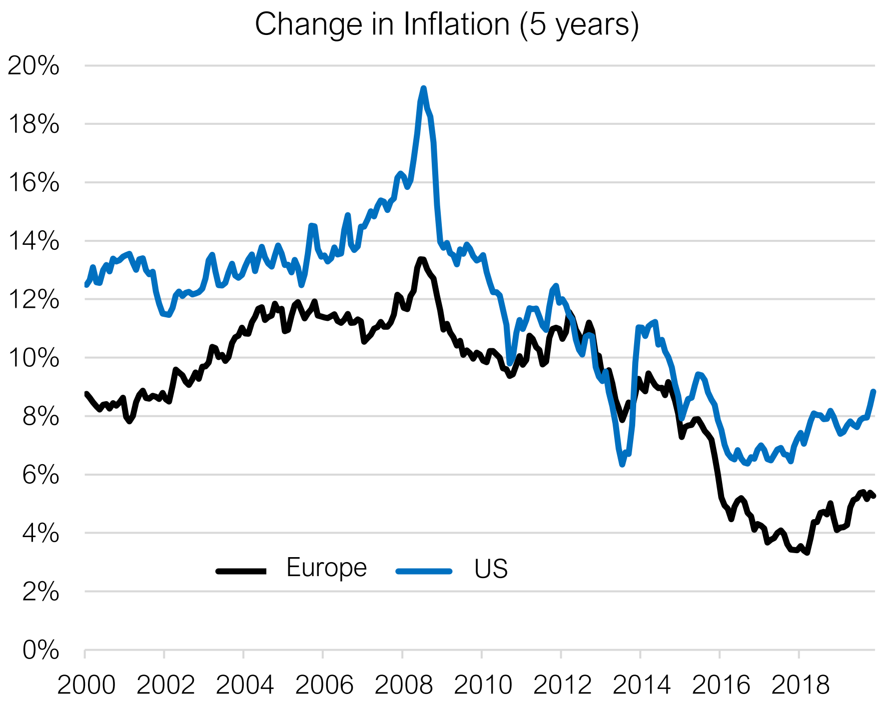
We see great opportunities in cheaper stock market segments which are out of favor and therefore attractively priced due to low inflation expectation environment.

In order to hedge risks we have added gold mining sector stocks to our portfolio that offer good protection from negative real interest rates.



Source: Bloomberg

That change means a crucial difference for the long-term outlook for asset prices compared to current low growth environment.
Meaning, strategies that were working the last ten years, might not anymore.

Regarding described scenario, in order to hedge risks we have added gold mining sector stocks to our portfolios that offer good protection from negative real interest rates.

Government bonds denominated in euros are trading at negative yields due to extensive asset purchase programs by central banks, therefore government bonds are not good for maintaining purchase power. Rather the opposite – investors are losing purchase power in the long term when holding such bonds. In fact, maintaining purchase power is our first priority.

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If over the last decade, the best performers were bonds and technology stocks then we believe that in this decade, more attractive risk-reward ratio lies in other places, namely in cheaper value stocks, emerging market equities and in commodities that are waiting for inflation rate to stabilize at normal levels. Additional liquidity from central banks and high government spending have laid foundation for that.

Wishing you the best,
Kaius Kiivramees and Mikk Taras

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