



Relativity

August 2018

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PM Capital Limited

ABN 69 083 644 731

Australian Financial Services Licence 230222

Level 27, 420 George Street

Sydney NSW 2000

Ph: 02 8243 0888

www.pmcapital.com.au

The Question

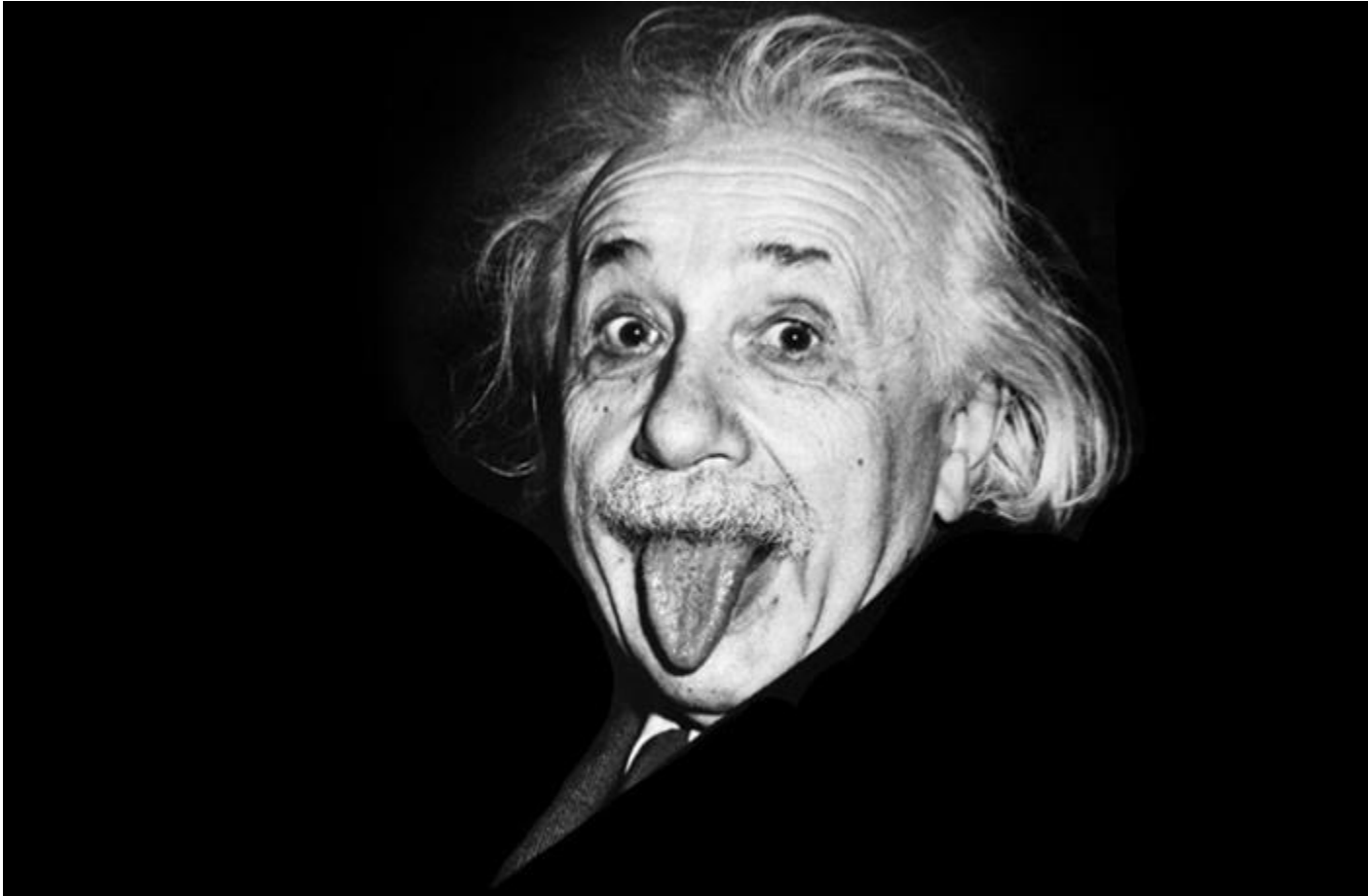
Is it different this time?

“The four most expensive words in the English language are, this time it’s different.”

Sir John Templeton

But is it this black & white?

Theory of Relativity



Law of Investing

The best way to preserve and enhance your wealth is to buy a good business at a good price

Understand how the **business works**

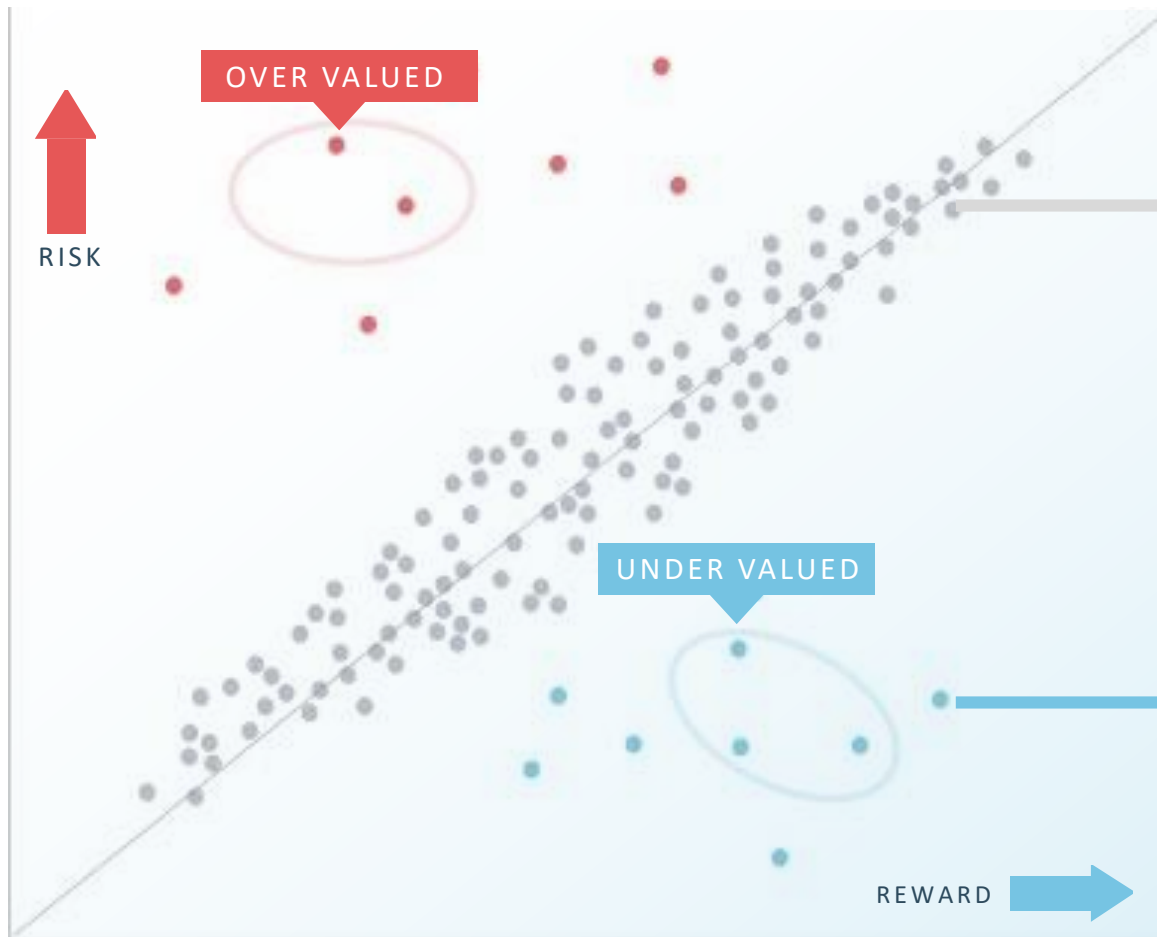
Understand **management's philosophy** in managing the business

Understand the **characteristics** of the business that determine its **intrinsic valuation**

What is the reasonable price a **rational business person** would pay for the business?

The key to successful investing is good business judgement in combination with the ability to control your emotions

Anomalies



The majority of the market is well researched and fairly valued. Limited opportunities are available for investors

The greatest investment anomalies present themselves where significant change or new information is misunderstood by the broader market.



Global

Changing environment

Post GFC Cycle

- Sceptical of sustainable economic growth
- Two steps forward one step back recovery
- Short-term price action
- Monetary Stimulus ceased to help...detrimental negative rates
- Structural reform to drive productivity
- Productivity initiatives increased confidence

Post Trump Cycle

- Coincidentally, cyclical growth trends inflecting
- Trump moving with the tide of pro-growth
- Absolute risk has changed significantly
- Bondnado
- Inflation



Cash

0-2%



Gvt Bonds

0-2%



Property

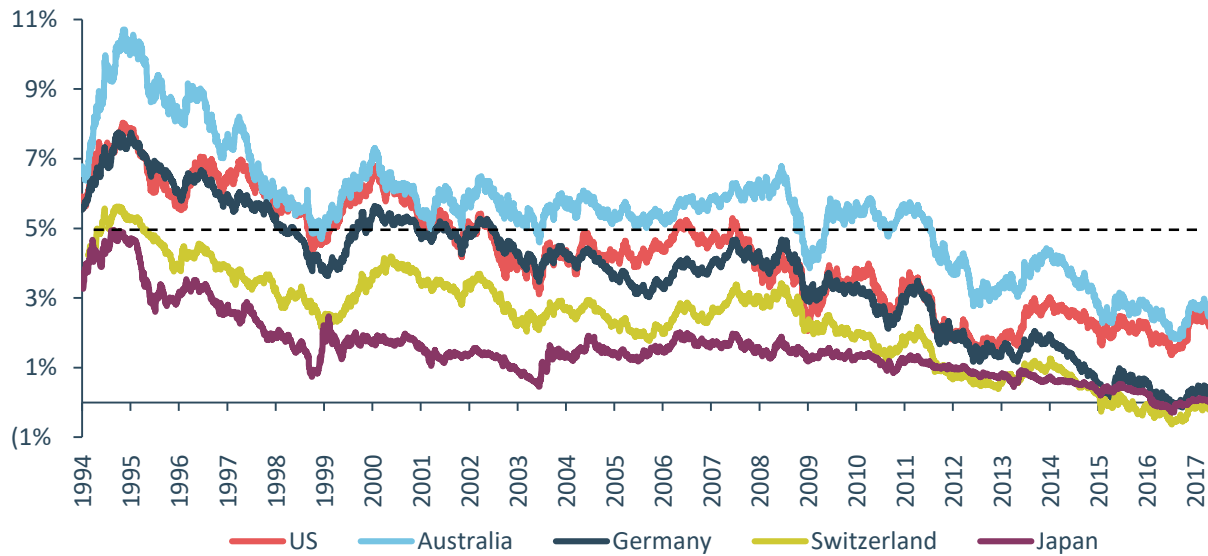
3-5%



Equities

5-6%

Interest Rates



- Germany/ Japan/ Switzerland – 10yr fixed rates still effectively 0%
- Decade of aggressive stimulus – US solid, Europe improved considerably
- Point of inflection: 2016 – pre the GFC the US cash rate ave ~5% (now 1.75-2.00%)
- Market convention – index with 5 year duration
- Enhanced Yield Fund positioned for higher global rates – double positive

Interest Rates

Central banks – the train is leaving... left?

UK (BoE)

- Nov 17 – raised rates for first time in ~10 years.

China (PBoC)

- Rumblings around reducing holdings of US treasuries

US (Fed)

- Rates from 0.25% to 1.75 - 2.00%
- Reducing ~\$5trn balance sheet – ~\$US 1Trillion over next 2 yrs.
- Budget deficit – CBO estimates suggest \$US300-500bn hit next 5 years

Europe (ECB)

- Jan 18 – 50% cut in bond buying program from EUR60bn to EUR30bn per month

Japan (BoJ)

- Jan 18 – buying fewer long dated Japanese treasuries

Bondnado

The fundamentals

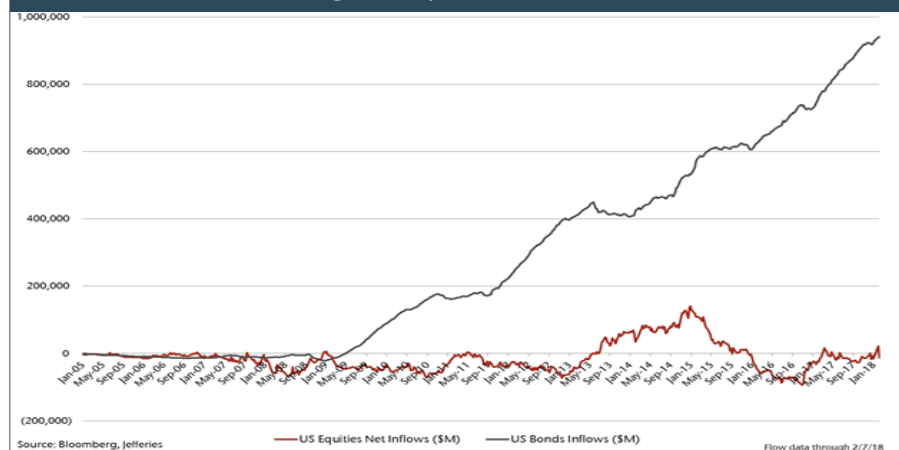
Quantitative

- **Absolute return makes no sense**; zero return - hard to make a positive return!
- **Real return**; inflation – priced as an impossibility!
- **Risk adjusted**; defaults – priced as an impossibility!

Qualitative

The bigger the crowd the bigger the risk

Cumulative inflows to US FI and Equity Mutual Funds and ETFs (\$M): 2005 - 2017



Bottom line

Financial system does not work with negative rates – mis-allocation of capital - *It had become ridiculous*



Asia



Why invest direct into Asia?

**Epicentre
of global
growth
over the next
decade**



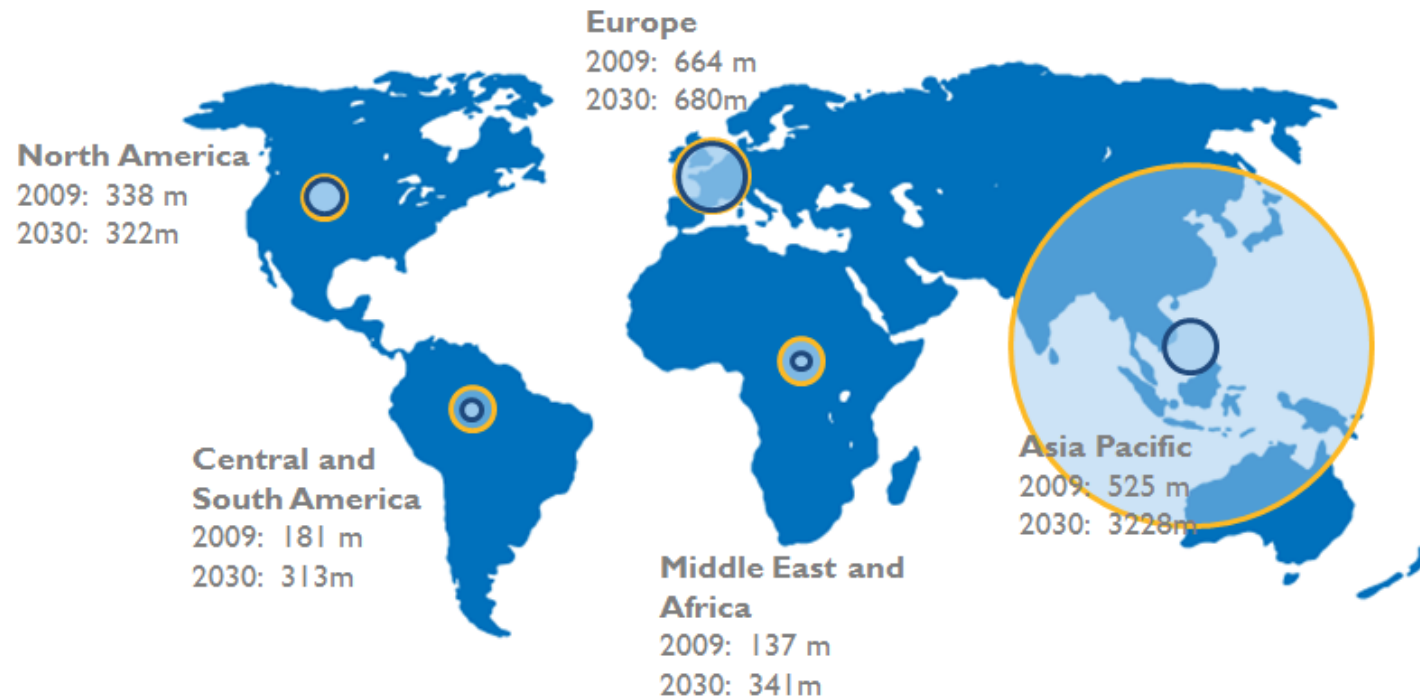
- % global GDP growth today, expect this dominance to continue
 - Demographics dividend
 - Unlocking of the underleveraged consumer as significant wealth is create
- Structural growth with in high quality industries – opportunity reminisce of US and Australia 10-20 years ago.
- Quality of the opportunity subset improved considerably – no longer just low quality commodity industries and companies.
- Diversity exists – Asia is a group of unique and disparate economic jurisdictions with varying growth dynamics, not just a China play.

**Traditional
approach
to gaining Asian
exposure less
relevant today**



- Global equity indices overweight United States so ‘passive’ global investing does not provide adequate exposure.
- Regional benchmarks overweight of a handful of companies which are typically leveraged to the wrong sectors.
- Australia – the easy option – become less of a proxy as Asian economies shift to consumption.
- Buying global brand names is not the answer. Asia will create its own champions.

Demographic dividend & wealth creation



Note: 'Middle class' is defined as those households with daily expenditures between US\$10 and US \$100 per person. The blue border circles and orange border circles depict the size of the middle-class population in 2009 and 2030 respectively.

Asia is adding 2.5 billion+ middle income earners



Considerations

What are the risks?



Absolute risk has changed



Business risk



Emotion



Size



Inflation

But biggest risk is... a short term horizon

Positioning

Invest globally – otherwise leaving too many opportunities on the table

Lazy Asset Allocation - may need re-think accepted wisdoms

Look forward – it is what's ahead, not behind, that matters

Interest Rates - don't underestimate the destructive power of higher rates

May be the greatest impediment to wealth building over the next 10 yrs

Credit Markets

- Focus on the fundamentals
- Ignore the herd

Ignore the noise – macroeconomic & political forces

How are your client portfolios positioned?

Never black or white



It's not easy



A lot of work



Simplifying the complex



Last 10% makes the difference

Summary

Relativity matters

Fundamentals don't change

**It's not easy but there are still
opportunities**

Clear need for advice

This time it's different/not different
