ROCKMAN CAPITAL UPDATE

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5th February 2020

The Global Recovery

As the world puts 2020 behind them, events in 2021 have picked up where we left off:

- Joe Biden was inaugurated as the president of the United States of America. Simultaneously, the new president announced a massive economic relief package of USD 1,9 trillion,
- The FAAMNG Bubble losing momentum,
- Global Markets recover as the US dollar weakens, on the back of COVID-19 global vaccine rollouts.

Biden inaugurated as the 46th US President and the Democratic Party wins control of the US Senate.

Biden's promised stimulus package is expected to increase disposable income for the American public from $600 to $2,000. On the back of this continued liquidity, the US GDP's recovery is anticipated to be sustained, with support from consumer and investment spending.

Significantly, the Democratic party were able to take control of the Senate, by winning the Georgia Senate runoff election. This blue senate victory improves the ability of the Biden Administration to enact their planned changes, especially with regards to increasing corporate tax and regulating the ICT sector.

Overall, as demonstrated from the table below, the last 2 Democratic administrations, have been largely positive for investor returns.

Inauguration Day	Final Day	President	Dow Total Return	Dow Annualized Return
3/4/1897	9/14/1901	William McKinley	62.7%	11.3%
9/14/1901	3/4/1909	Theodore Roosevelt	21.6%	2.7%
3/4/1909	3/4/1913	William Taft	-1.3%	-0.3%
3/4/1913	3/4/1921	Woodrow Wilson	-6.9%	-0.9%
3/4/1921	8/2/1923	Warren G. Harding	17.4%	6.9%
8/2/1923	3/4/1929	Calvin Coolidge	255.9%	25.5%
3/4/1929	3/4/1933	Herbert Hoover	-82.8%	-35.6%
3/4/1933	4/12/1945	Franklin Roosevelt	194.4%	9.3%
4/12/1945	1/20/1953	Harry Truman	81.7%	8.0%
1/20/1953	1/20/1961	Dwight D. Eisenhower	120.3%	10.4%
1/20/1961	11/22/1963	John F. Kennedy	12.2%	4.1%
11/22/1963	1/20/1969	Lyndon Johnson	30.9%	5.3%
1/20/1969	8/9/1974	Richard Nixon	-16.5%	-3.2%
8/9/1974	1/20/1977	Gerald Ford	23.4%	8.9%
1/20/1977	1/20/1981	Jimmy Carter	-0.9%	-0.2%
1/20/1981	1/20/1989	Ronald Reagan	135.1%	11.3%
1/20/1989	1/20/1993	George H.W. Bush	45.0%	9.7%
1/20/1993	1/20/2001	Bill Clinton	226.6%	15.9%
1/20/2001	1/20/2009	George W. Bush	-24.9%	-3.5%
1/20/2009	1/20/2017	Barack Obama	149.4%	12.1%
1/20/2017	1/19/2021	Donald Trump	56.0%	11.8%

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Stretched FAAMNG valuations

FAAMNG (Facebook, Apple, Amazon, Netflix, Microsoft, and Google) stocks were major beneficiaries of the COVID-19 induced lockdowns. Whilst the worldwide pandemic kept workforces locked inside their homes, as seen by the graph below, there was a massive upward movement for the FAAMNG stocks. These stocks powered the S&P and NASDAQ markets to historical highs despite the rest of the world tipping into recession.

US equity indices performances have been skewed, owing to the share price performance of FAAMNG stocks and the increased relative representation of these stocks, when measured as part of these indices.

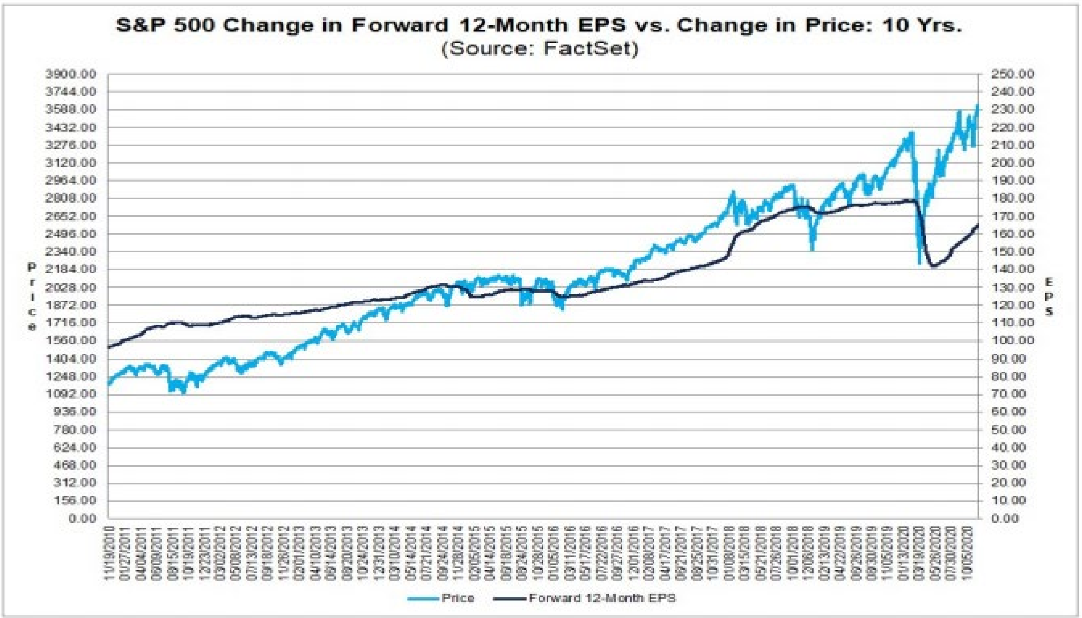
Whilst 2020 rewarded investors for staying long ICT, we have seen a change in momentum of the ICT sector. FAAMNG stocks appear to be stretched and expensive, relative to their expected returns. Global cyclicals and large-cap companies have started to rise again. The valuations of stocks in these sectors declined extensively, as result of a loss of business, brought on by the global COVID-19 pandemic.

The following factors have started to impact on the stretched valuations of the ICT sector:

- A Biden Presidential Victory, resulting in expectations of increased corporate tax and regulations for the ICT sector,
- Consumers returning to normalized trading patterns,
- Businesses returning to the office, resulting in decreased online activity.

A key component to understanding equity valuations, is that the earnings yield – that is the inverse of the price earnings (PE) ratio – is a decent forecast of expected returns on equities.

As you can see from FactSet's *January 2021 Earnings Insight* (refer to the graph below), equity prices have run ahead of earnings. If the market corrects, we see a correction back to long-term mean PE multiples. High beta stocks, such ICT stocks, will thus experience a bigger correction. This is versus low beta stocks, such as Consumer Staple stocks, which tend to experience lower volatility in their share prices.



For example: VISA, with a share price of USD 202 and on a PE of 46.6, has earnings yield of 2%. This implies that at the present share price, an investor will earn a future return of 2% on their investment. Nestle' share price of CHF 102 and a PE of 22.1, has earnings yield of 5%. This means an investor's expected return on Nestle is 2.5 times more than VISA, whilst taking on 50% less risk.

The Economist, in its article entitled, *the lion sleeps tonight - 9th January 2021*, sums up the present stretched valuations:

> *"If stock valuations are high relative to a measure of fundamental research, such as earnings, then subsequent returns tend to be low, and vice versa. A low earnings yield implies that investors are willing, at that point in time, to accept puny returns in the future."*

For bumper corporate profits to be sustained, one would expect profits to be bolstered through acquisitions, financed through corporate actions, such as new equity issuances. Considering rising treasuries yields, we do not see this as sustainable in the medium term.

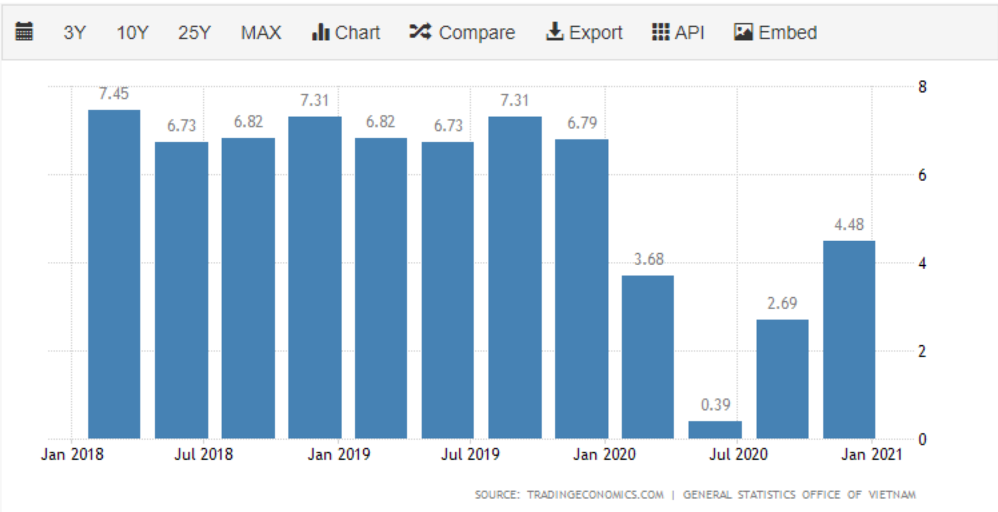
As the long-term dividend yield on the S&P500, of 1.55%, is still greater than long-term treasury yields of 1.115%, equities remain the preferred asset class.

Investing in Vietnam

Vietnam has been a leading frontier markets for many years. Throughout the 1990's Vietnam experienced major economic development resulting in the growth of many new and successful businesses. The local populace is rated consistently high on international surveys, as hardworking and innovative. This is significant owing to the relatively cheaper cost of labor in Vietnam: Presently, labor costs in Vietnam are 66% less than China.

PWC estimates Vietnam to be one of the fastest growing economies with an annual GDP averaging over 6%. It has also coped well with the COVID 19 pandemic.

Vietnam GDP Annual Growth Rate:



Going forward

- We remain in favor of equities in the short-term. However, we are cautious owing to high valuations, and
- We have positioned ourselves defensively looking for stocks that do not have stretched valuations, have low beta's, and provide consistent dividend yields.
- We remain focused on allocating out of US markets, into alternative asset allocations with less downside risk.
- To apply capital to other sectors and markets, which offer increased value versus their relative valuation, either directly or via exchange traded funds (ETF's).