Novel-Global Recession

The last several weeks have seen a significant uptick in volatility and negative headlines as the epicentre of the virus moves westwards towards Europe and the US. This has resulted in most countries (even the US) entering Bear markets – something that we have not experienced for a long time.

In the midst of this downturn, it is natural for you to be concerned not only about your investment portfolios but also the future of the world.

The scale of what has happened in the last few weeks from China to Europe and now the US has been startling and resulted in much economic pain.

Unlike the downturn of 2016 which saw much of the damage localised in the oil and gas sector, this slowdown has an appreciable and real impact on the general economy given that many industries such as Airlines and Hospitality are badly impacted.

Certain industries are most assuredly going into significant financial distress given the liquidity crunch that they are (and still) currently facing. Industries such as cruise ships and airlines have seen their businesses grind into a virtual halt as governments rush to control the spread of the virus.

This is perhaps a good time to revisit the basic fundamentals of all investing. We may sound like a broken record repeating the following mantra “To finish first, you have to first finish” but we still stand by those words.

This thinking is relevant not only when it comes to stock selection but overall portfolio construction when it comes to our families too. It comes to only using leverage judiciously and sparingly, it comes to our mindset when we select fixed income securities, it comes to how we approach new investment ideas or business opportunities.

Specifically, when it comes to stock selection, this means picking business models that are highly resilient and finding companies with strong balance sheets.

Just to give an example, despite the turmoil in Hong Kong and the general slowdown in China in 2019, many of our portfolio companies have reported strong results and maintained their dividend payments, while maintaining a strong balance sheet in the meanwhile. Many of these companies have large investment property portfolios that generate significant rental income that allows them to tide through market downturns.

The reason why they are positioned so is no surprise. Many of these companies have been in business for decades and been through far worst. With the controlling families owning significant stakes in the businesses, they are far more cautious to ensure business continuity.

In the midst of this market turmoil it may be tempting to tear up the old play book and to ascribe the reason that “this time it’s different”. The events that has unfolded over the preceding weeks make what has happened in Hong Kong in 2019 look insignificant in comparison.

And yet, as long-term investors our belief and confidence in our framework remains unchanged. Our goal is simple – find companies with strong competitive advantages and balance sheets that are able to earn a good return on capital.

It is certainly hard to find solace or joy at this stage of time with the outlook being so grim, but the same can be said of previous financial downturns. It is hard to make a case for an optimistic and bright future right in the depths of the Asian Financial Crisis, in the aftermath of September 11, during the outbreak of SARs in 2003 or the depths of the Great Financial Crisis of 2008 when the financial system was literally on the verge of collapse.

And yet each time, the economy and market has always rebounded and come back stronger and better than before. The key in each time has always been to maintain a calm head and to keep a keen eye on the future. As Li Ka Shing once said, when times are good don’t get too excited…and when times are bad don’t get too pessimistic.

We fully expect there to be financial distress in the coming months. Companies will have to restructured and staff costs will have to be rationalized for many businesses to keep afloat.

However, when this is all done and dusted, the remaining players will be in good place to take market share and expand once again. After all, this is what happened to leading companies like **UOB & OCBC**. In each successive crisis, they have only emerged stronger and more resilient with their long-term future trajectory unchanged.

Finally, many comparisons have been drawn to **The Great Financial Crisis of 2008**. In Singapore for example, bank valuations trade close to their trough (10% from their absolute bottoms, 5% if you include reduced one-year dividend payments).

Let us address this on several fronts.

First off, all banks are in much stronger and financial shape than in 2008 with regulators building in huge capital buffers. Secondly, the liquidity crunch has been met head on by Central Banks around the world. Thirdly, countries like Singapore are well placed with huge fiscal reserves to dampen and reduce the slowdown when it comes.

Any recovery will however be led by an improvement in situation from the current outbreak. On that front, there is reason to be optimistic. China is gradually re-opening after imposing draconian measures and all nations have awakened to the severity of the crisis.

The world has been through much worst before and has always rebounded back and stronger. There is no reason to believe that this time will be any different.

To end off, we have no view whether this will be L-Shaped, U-Shaped or V-Shaped recovery. However, we are sure that this too shall pass, and when a recover ensues, our portfolio companies will be emerge stronger and well placed to take advantage of it.