Aviator Update – June 2021
Lindsey Lawrance

AVIATOR CAPITAL

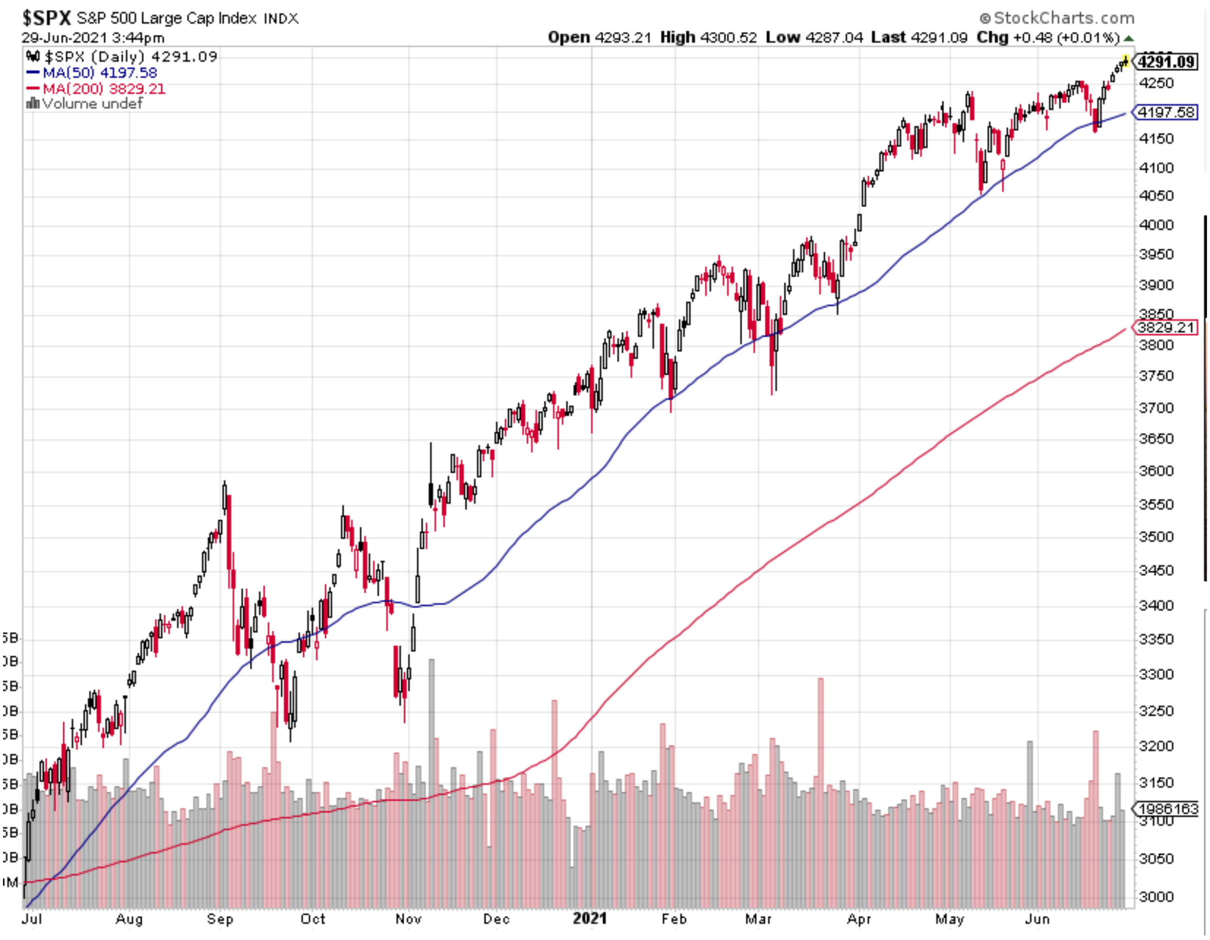
Mid-year Stocktake

Where did the first half of the year go? It only feels like a few weeks ago we were enjoying the warmth of summer and some fairly normal life after Covid lockdowns. Now it's late-June… and large parts of the country are back in some form of lockdown!

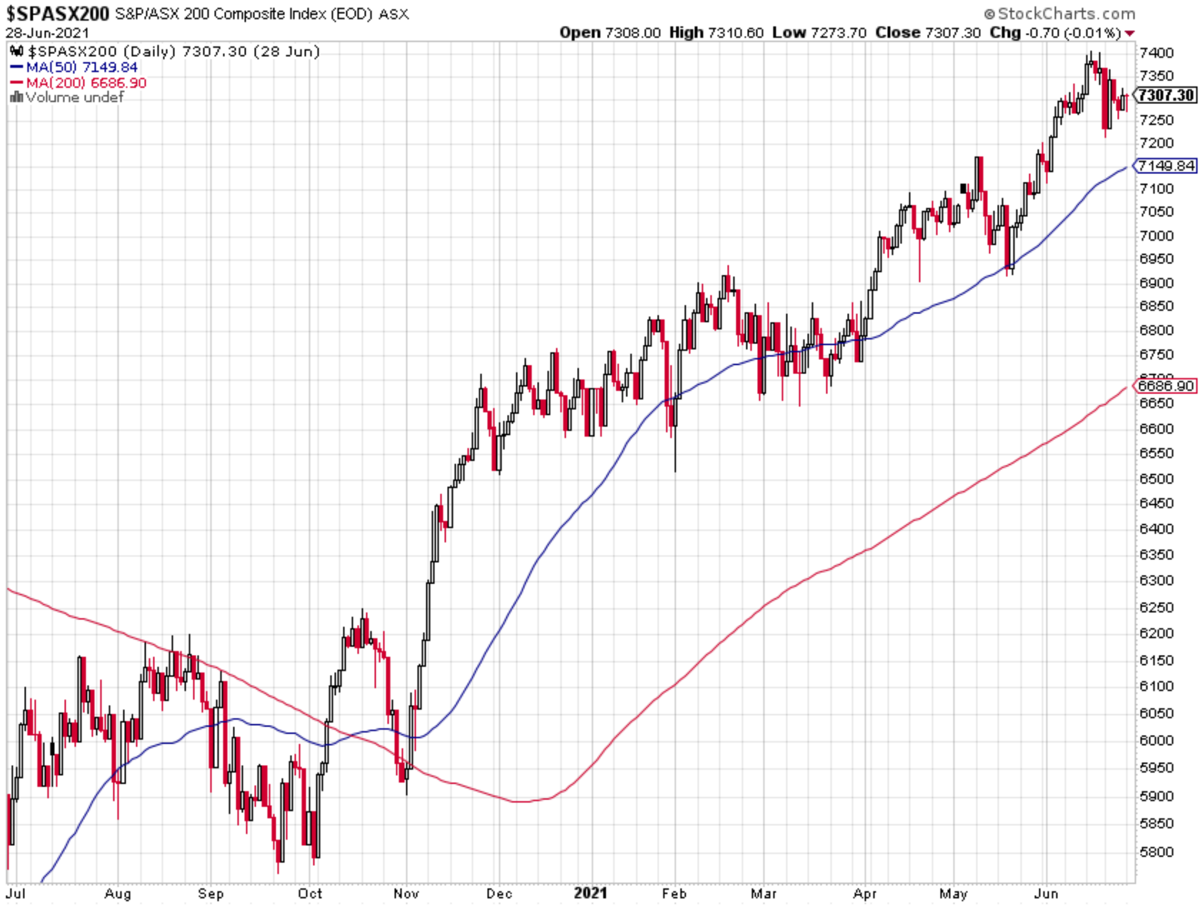
It's been a rather eventful 6 months in finance-land. Epic short-squeezes seemingly triggered by online bloggers, bitcoin bubbles and busts. Oh, and a big winner in a cryptocurrency with a dog logo that was created some years ago as a joke! What a world…

Meanwhile, most global share markets continue to exhibit remarkable strength and resilience.

Here's 12 months' worth of the S&P 500:

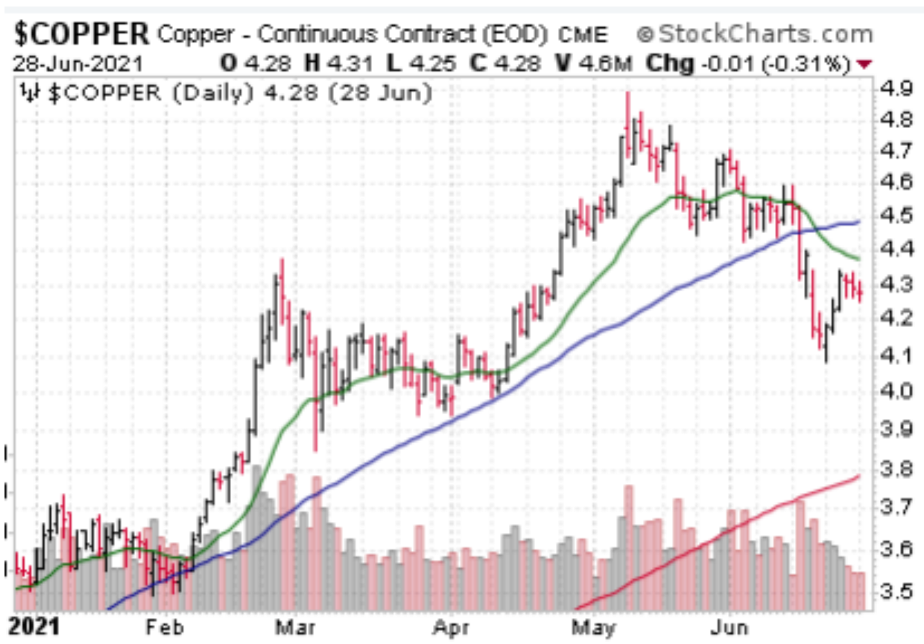


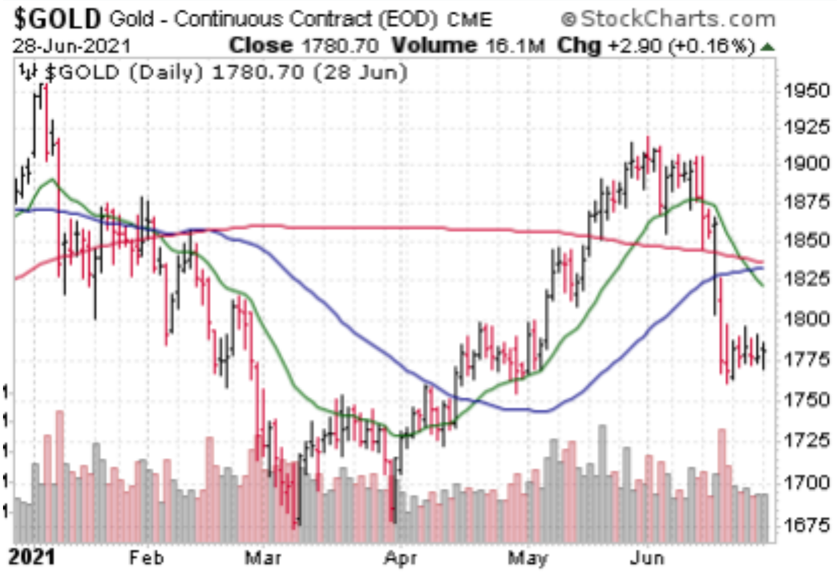
Our ASX 200 has been nearly as impressive:



Some impressive gains for the first half of the year – around 15% for the US and around 10% for us. Superannuation funds will be delighted with the returns they are able to report to customers for the financial year.

Zoning in on the last six months, it's been a rather wild ride for a lot of markets.




$GOLD Gold - Continuous Contract (EOD) CME
© StockCharts.com
28-Jun-2021 Close 1780.70 Volume 16.1M Chg +2.90 (+0.16%)
$GOLD (Daily) 1780.70 (28 Jun)
1950
1925
1900
1875
1850
1825
1800
1775
1750
1725
1700
1675
2021
Feb
Mar
Apr
May
Jun


$USD US Dollar - Cash Settle (EOD) ICE
© StockCharts.com
28-Jun-2021 Op 91.82 Hi 92.01 Lo 91.68 Cl 91.88 Chg +0.03 (+0.03%)
$USD (Daily) 91.88 (28 Jun)
93.5
93.0
92.5
92.0
91.5
91.0
90.5
90.0
89.5
2021
Feb
Mar
Apr
May
Jun


$BTCUSD Bitcoin to US Dollar CRYPT
© StockCharts.com
29-Jun-2021 7:55pm Last 36379.53 Vol 38.2K Chg +1892.42 (+5.49%)
$BTCUSD (Daily) 36379.53
65000
62500
60000
57500
55000
52500
50000
47500
45000
42500
40000
37500
35000
32500
30000
27500
2021
Feb
Mar
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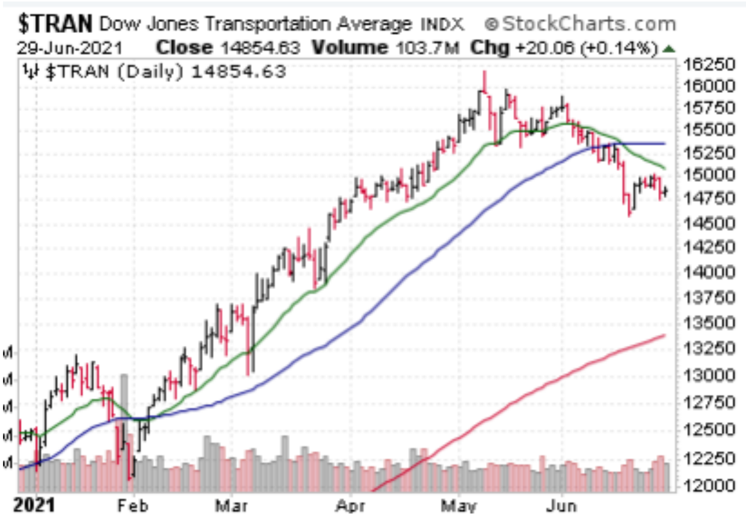
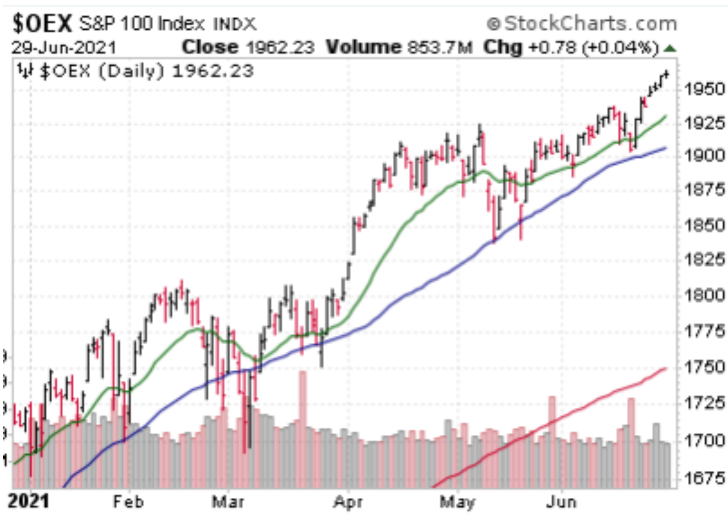
Interestingly, share markets are one of the few major markets not to experience a meaningful pullback during the first half. This sort of divergence is observable in different share market segments.

Here’s the Dow Transports – in pretty much a bona-fide downtrend:



Whilst mega-cap (aka “big tech”) pushes ever higher:



And small-caps have basically been range-bound since February:

Look at all these charts through to about March/April – all in strong uptrends. This "uniformity" is testament to a strong market environment where investors speculate indiscriminately. This current market current environment isn't that.

"Great – thanks Lindsey… thanks for telling us what's happened in the past - very insightful… how about giving us something useful? How do we make money over the rest of the year?"

Yep – that's fair. It is typical for us finance commentators to focus on telling you what you probably already know followed by some vague comments about the "near-term" and "medium-term". A popular phrase when describing the future is "cautiously optimistic".

One of my favourite sayings about financial markets is a quote often attributed to New York Yankees baseball legend, Yogi Berra;

"It's tough to make predictions. Especially about the future."

I've bravely (foolishly) made a few fairly blunt predictions over the past 6 months. I've been taking stock of where we're at and revisiting what I've said. Back in March I had the following to say:

"I believe we're nearing the end of this long bull market that began after the Global Financial Crisis of 2008. My reasoning for this is because I'm a student of the markets. There are certain hallmarks observable throughout market history during each "phase" of the market. We are witnessing basically all the hallmarks that have preceded major tops."

"Valuations are extreme yet there's a sense that the markets can't fall. An ingrained view that whilst central banks continue to engage in "QE", the market simply can't fall. Nonsense. As I've noted repeatedly, QE is nothing more than an "asset-swap" where the central bank swaps zero-yielding cash for negligible-yielding government bonds. Creating a sea of excess liquidity is surely "market-positive" but the asset market levitation effect is mostly a confidence trick – there's no physical mechanism whereby the newly-created bank reserves are automatically routed to asset markets."

"There's also a perception that there's no plausible catalyst to trigger a fall – "why would the market roll over?" But history shows that there need not be a triggering event – hugely overvalued markets have tended to roll over when the economic outlook remains excellent… but not quite as excellent as it did the week before. In other historical cases, it's the market rolling over that has exposed the economic fragility lurking under the surface – the "cause" is assigned after the fact."

"A major hallmark of historical market peaks has been silly behaviour on the part of investors."

“Major blow-ups, frauds and scandals are also a feature you tend to see towards the end of bull markets – the culmination of years of “risk-on” behaviour. A huge surge in IPO’s is also a hallmark. A good dose of hubris and invincibility on the part of investors is a feature.”

“Investors are currently heavily leveraged and trades frequently overlap.”

“The only question is when.”

“I don’t think we’re there just yet. I sense the markets can continue to find dip-buyers for a little longer. We’re overdue a “correction” – the typical 8 to 12% retracement, which will “feel real”. But I sense it will once again be met with a solid bid, just like every other dip for the past 10 years. Maybe even some new highs afterwards. But my guess is that the markets won’t properly “recover” – won’t revert to the same uniform, indiscriminate , frenzied buying we’ve seen.”

“Building on this timeline, my guess is that the second half of this year might mark “the top”.”

I remain very comfortable with these comments. What has surprised me is the resilience of the markets – or at least those major indices. We’re still waiting on that “correction”. It will come as sure as night follows day.

What needs to happen for that to occur is simply an uptick in “risk aversion”. That’s all.

Regarding the economy, last month I had this to say:

“There’s much excitement and enthusiasm about a boom on the horizon in major economies including the USA. But let’s be a bit more specific and put some context around this.”

“Yes, predictably there will be a boom in the private sectors of the US economy – “C” and “I” (in our GDP calculation formula). We sure better hope so because with the pending collapse in government stimulus, if the private sector doesn’t grab the baton from the government, we’re in for a rough ride.”

“For what it’s worth, I believe the private sector will bounce back strongly in the US and other places, just like it seems to be in Australia. But the point is this will substitute for the decline in government spending. Data points will probably remain a bit more volatile than normal for a little while longer but what I don’t see is a durable uptick in the GDP growth rate for most major economies compared to where it’s been in recent years which, for most developed countries, has been on the decline for some time now.”

Nothing has changed in the last month for me to change this view. I believe the economic outlook remains “fair” – not “good”, but I’m not forecasting an imminent recession. A return to the slow growth pre-Covid world is probable.

But the economy isn't the capital markets. I will be very surprised if the markets make it to Christmas without a solid correction – at least in the 10 to 15% range.

If you poke around under the bonnet, you will see that positioning is heavily skewed to the upside – margin debt at record levels, Call option open interest very high, particularly small positions (indicating retail order flow). It's true there's no upside limits on these sorts of things (thus they don't offer a reliable "sell" signal). But what they represent is selling pressure.

As the charts above highlight, the market has become reliant increasingly on a small number of mega-cap stocks to post gains on the major indices, whilst the broader market already exhibits weakness. This is not good.

Back in December, I had this to say when surveying the financial landscape and pondering what 2021 might have in store:

"I predict 2021 to be a tough year. Let me explain what I mean…"

"Warren Buffet famously said "be fearful when others are greedy". It's time to be fearful. We're beginning to see some of the hallmarks that historically have only been seen towards market peaks… at a time when valuations are as elevated as they ever have been."

"There's no limit to how high valuations can go. There's no reason why markets can't go up 15% in 2021. If they do, it will likely be a difficult year for us (and every other value-conscious investor). We'll do what we can and hopefully generate some return here and there. But we sense no pressure to chase the market higher and will probably under-perform a rising market."

"Conversely, if the market goes down 30% we are hopeful of delivering substantial outperformance. In this scenario, 2021 will be considered a difficult year for most investors, but hopefully not us!"

"This brings me to our core portfolio management focus during 2021. Here it is – highly insightful… highly analytical…"

"Don't lose a heap of money."

So far I was prescient in my statement "there's no reason why markets can't go up 15% in 2021"! But overall I remain very comfortable with these comments also.

With the markets as richly valued as they have ever been, understand that the gains of the past 6 months come at the expense of future gains. Poor returns in the medium-term are practically guaranteed.

Ultimately, I'm afraid I don't have any money-making ideas to offer you at this point. As we round the bend into the home straight for the year, what I want to reiterate is some of the comments I've made in the past six months;

Be fearful when others are greedy.

Be patient – I know it's hard, but good opportunities to deploy capital lie ahead

…But you need to have capital to deploy…

There's another old saying I encourage everyone to heed at this point;

Opportunities are far easier to make up than losses.