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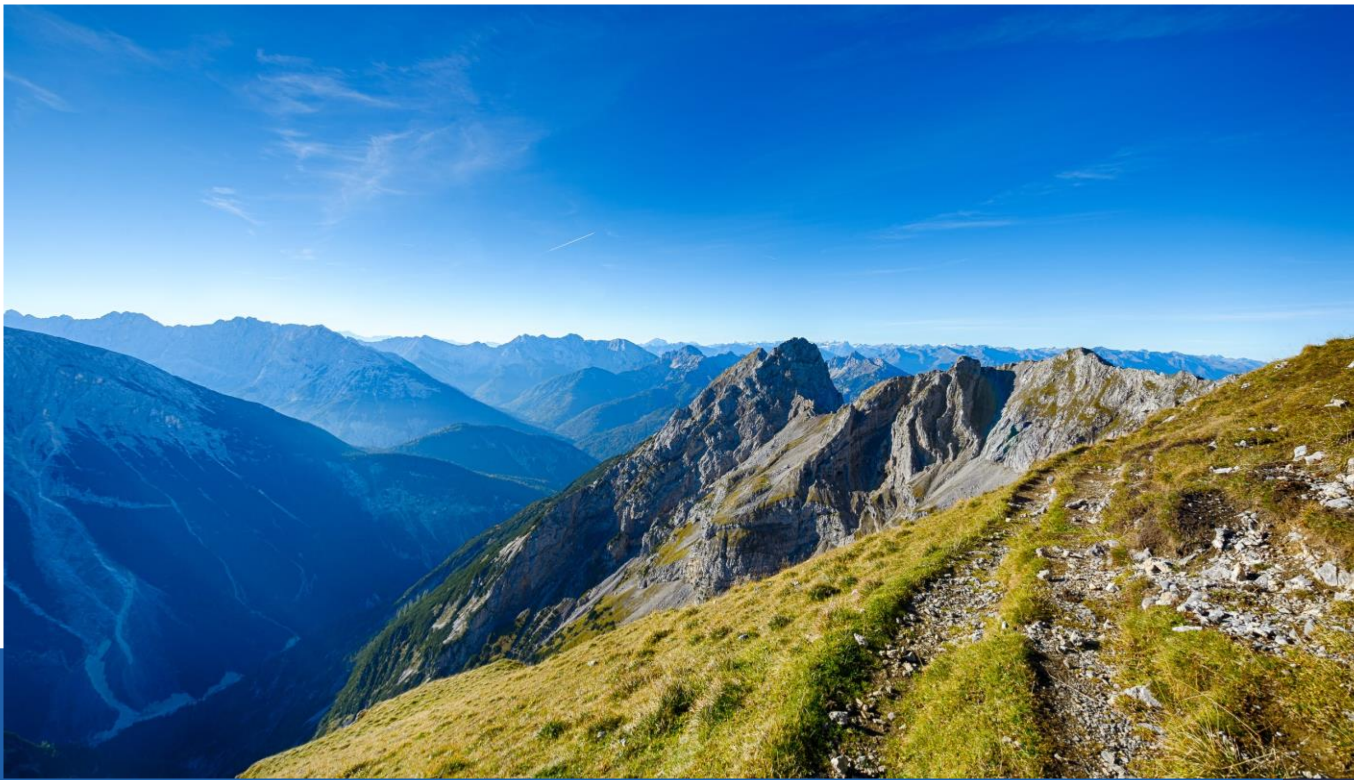
Binary Capital Investment Management



Chief Investment Officer Note

The triple effect

Long-termism shapes our relationships and our investments.

January 2022

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The triple effect.

Investment and portfolio management invariably involved big choices and hard decision making. Often being patient and seeing through the wild gyrations of markets is hard, but it has to be done. At Binary Capital Investment Management we seek long terms returns for clients. This is our core focus. We do this irrespective of how the investment markets are behaving in the short-term. 2022 is shaping up to be a year of potential change.

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The year has certainly started off with much news, investment noise and speculation. There has been a considerable market sell off in January – one of the worst in the last 20 years. In summary, there has been rotational movement away from *growth to value* throughout the month. At the start of the year, as we have been since inception of the strategies, we have been positioned with a growth focus running through all our portfolios.

Looking into this a bit deeper. Why has there been such a growth sell-off? Since the great financial crisis there has been systematic government effort to revive global economies, this has consisted of central bank quantitative easing: injecting money into the financial system, uniquely low interest rates and western inflation remaining relatively steady, all a benign scenario for investment markets, especially equity markets.

All of the above had resulted in a bull market for equities, earnings have grown and price earnings multiples have expanded to record levels. This bull market has been particularly noticeable in the technology sector where technology stocks (in the main) have had exceptional returns, the high growth US market has benefitted from such.

Late last year the narrative shifted: post pandemic inflation is appearing, and appearing significantly, we have inflation in some countries at 40yr highs, this together with a change in the interest rate cycle and a slowdown on central bank monetary easing has resulted in investment markets entering 2022 with negative sentiment and such issues overhanging them. This has reflected in some severe price corrections in January as investors adjust their portfolios to these factors and reassess the continuation of the bull market in equities especially around price valuations. In addition to this, geopolitics is becoming newsworthy, with a weak west giving Putin and Russia grounds to ramp up rhetoric along its border with Ukraine. This is also concerning. This seems posturing and more to do with economics and political concessions, but one never knows. We monitor events with interest. Furthermore, it does appear that the inflation concern could be overdone, with inflation in the US and UK expected to peak in the coming months, and thereafter gradually moving to more normalised levels.

So overall, a very eventful start to 2022. We always expect market corrections to occur, the timing we do not know, but they are expected. Indeed, I wrote about it in my end of year narrative and outlook for 2022 [written in late December 2021]. I quote that again here:

" Every year is different, 2022 will not follow what happened in 2021 nor 2020. One dominant narrative we keep hearing about is the possibility of a market correction, a correction of the so called 'market bubble', a correction which for many market participants is long overdue, and the year 2022 seems right for such a change. Let's address this issue. Firstly, no one knows when such a correction, if it does happen, will occur. We have already witnessed significant drawdowns over the past two years with subsequent market upturns. Secondly, even if such a correction occurs, we will not know until after the event the extent of the correction, the bursting of the 'bubble' – if one calls it that. Most likely as long-term investors we will manage through the downturn and indeed see it as a buying opportunity as assets are priced more cheaply. We will be brave and forceful in our actions here. We are mindful of these issues at all times, but it does not cloud our judgement in what we see as the right investment opportunities, at the right time with the right strategies for clients."

Right now, we are doing nothing. We are assessing what is going on and what changes, if any, we will make in the coming weeks as we gain more credibility on what is happening, could happen and what re-allocations will work best into a forward-looking scenario that is different from the pandemic years with more volatile markets

Investment markets regularly move in volatile directions. We do not get carried away when markets are positively upwards, so we do not do the opposite when we see market downturns. Resilience is needed. We are long-term investors for a reason: so that such market volatility can be managed, and corporate earnings and prospects are therefore more aligned and realised, therefore share prices reflect better the investments held. History judges that by being long-term with an investment outlook with quality investment solutions that are non-index like is a winning strategy. Being resilient and emotionally stable is a good character trait in investment portfolio management and most importantly in these challenging times.

Owning the index in itself is also a *risk*. In any market scenario the index manager cannot change sectors, themes or stocks to reflect the new evolving market reality before them. Any drawdown in the index will itself be reflect similarly in the index fund which could be markedly different in more actively managed, quality funds. The index fund remains fully invested and holds many losing positions in market downturns. In such market scenarios quality, credible active management should be able to create value. Whilst indexation investing did well last year, it does not necessarily hold it will do well this year.

We ourselves are genuine high conviction investors and such a market scenario whilst not been beneficial so far for us just now, could be more so as the year progresses. It is difficult to get a precise read across from historical market actions, every year has its own developments, but we have seen markets often rise up as quickly as they fall. It is often at the very apex of the news, for example, interest rate actually rise, that markets starts recovering again. As I write this in late January 2022, the market outlook is mixed, as we are not short-term traders we do not pay significant attention to this outlook, it is five years plus out we think and plan around. Taking such a view, such reactions now will inevitably will just be 'blips' in different long-term price movements and investment journeys: just like we saw in the dotcom bubble, the great financial crash as well as other investment crisis cycles.

Looking at actual corporate fundamentals, real numbers. The recent corporate earnings season has been relatively positive. Some high profile examples: Apple had an excellent earnings quarter driven by its macbook product range, Apple seems to have navigated supply bottlenecks well. Another technology giant, Alphabet also had great earnings, above expectations with record profits and a positive outlook. Microsoft also had a good earnings quarter. These technology giant's earnings numbers highlights the powerful nature of their businesses, and the opportunities for them in *any* economic scenario. We own these big technology stocks in our investment positions and will continue to do so.

As we look towards the future, we believe one thing is very clear, technology will increasingly play a large part in all our lives. Technology will continue to affect all sectors: retail, healthcare, manufacturing, transportation, pharmaceuticals and so on. Technological innovation is not going away, indeed it is increasing significantly. As a result, the opportunity for the future to be more disruptive in traditional sectors and corporates is clear. We believe some of our investments are well placed to take advantage of such future trends for the benefit of investors. The questions needs to be asked: why would you not want to own exposure to such exciting sectors and themes for a long duration? Is it worth buying more in such market downturns?

In remaining steady does not mean we are not reacting. We are watching events very closely and if opportunities present themselves in the coming weeks that makes sense for us for inclusion in clients' portfolios, we will not hesitate to act in the interest of our clients and investment returns.

The performance of the investment strategies in January 2022 should be seen in the broader context of what we are trying to achieve, for it is without such volatility and genuine active asset allocation, portfolio management and such a forward looking approach, we would not be able to create such broader long-term returns for clients.

Our now annualised 2019 – 2021 three year track record is worth noting, it remains very compelling, and gives a sense of the possibilities going forward for investors. It is around these rolling terms that investment performance, strategy and style we should be judged around.

We always remain focused around the work to do.

Saftar Sarwar
Chief Investment Officer
Binary Capital Investment Management

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