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BAOBAB INVESTMENT MANAGEMENT
AFRICAN ROOTS | GLOBAL PERSPECTIVE

The Friday Filter

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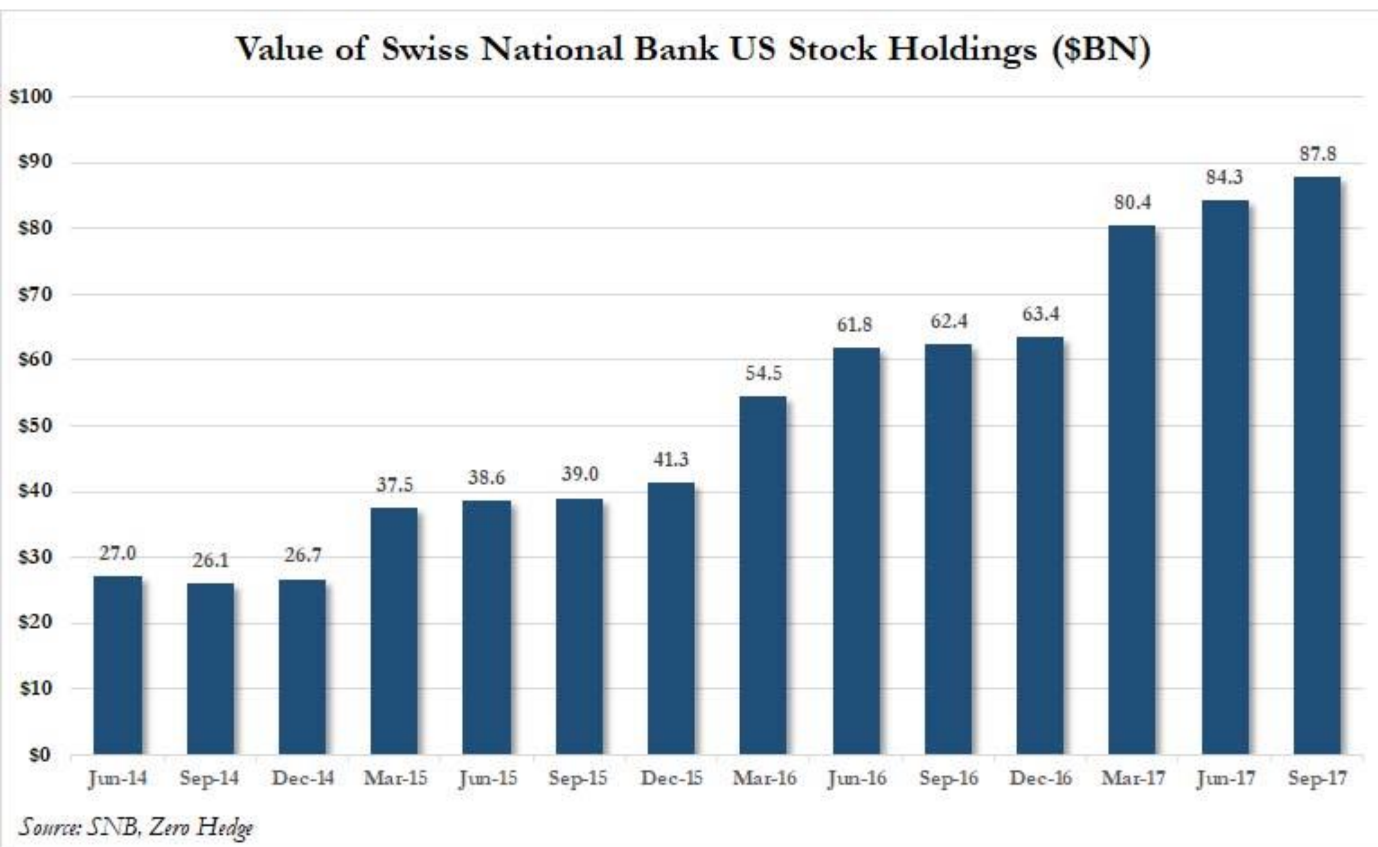
A bear market in fear

Warren Buffett has always told us to "buy when others are fearful, and sell when others are greedy". Looking around the world today it is difficult to find fear as most markets hit new highs every day. Despite the fragile nature of the world, it really does feel like we are in a bear market for fear! It is little wonder that the likes of Buffett are sitting on an increasing cash pile as they wait for attractive pricing of desirable assets.

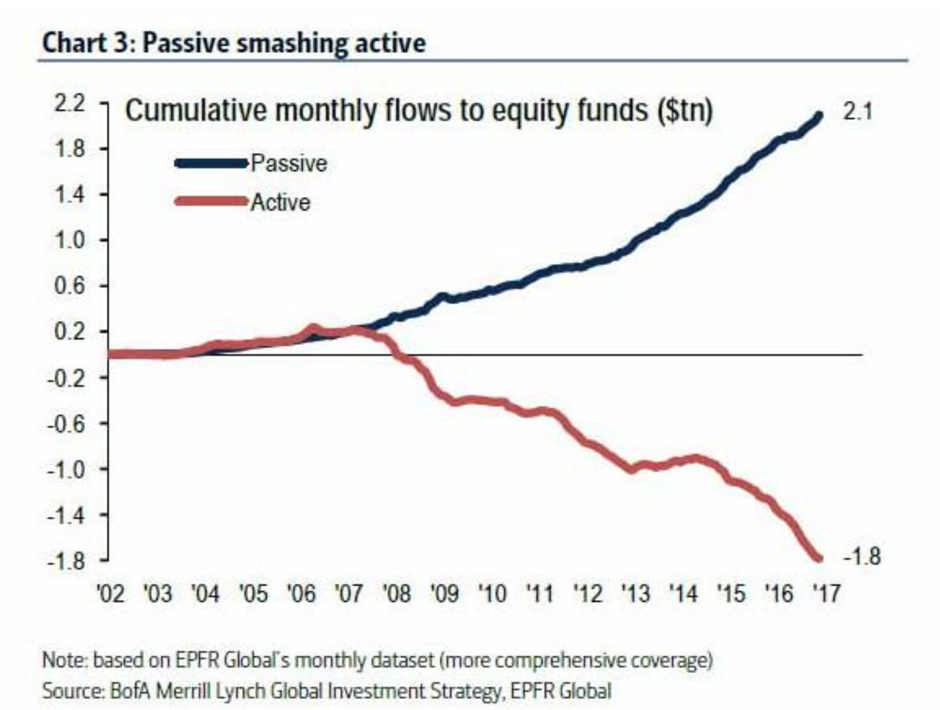
Unlike Buffett, the marginal investor today has become very price insensitive and, if anything, is encouraged by increasing prices and the lack of fear. Whether you are a central bank, an Exchange Traded Fund (ETF) or a company buying back shares to boost anemic earnings growth, the price you pay has little or no influence on your investment decision.

Swiss National Bank – ongoing buyer of US equities



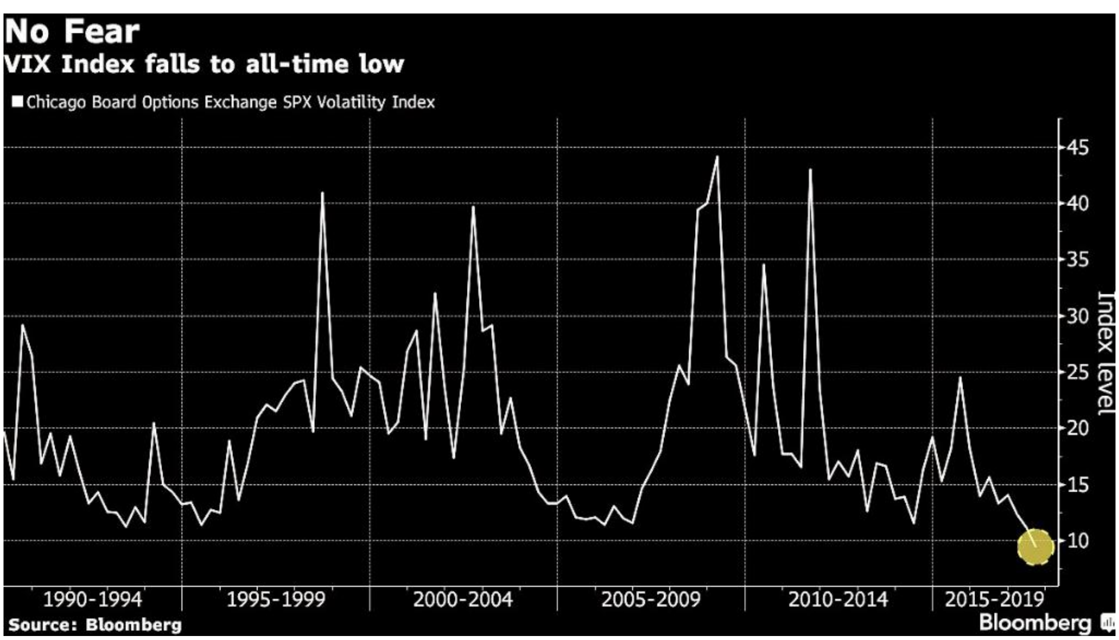
The top 5 holdings in the Swiss National Bank's portfolio are unsurprisingly Apple, Google, Microsoft, Facebook and Amazon, positions which they continue to add to at higher prices.

The move to passive investing has been well publicized and a key driver of market indices and suppressed volatility. The merits of the passive approach that provides market exposure at lower fees are clear. What is not as clear is the risk attached to the approach and what happens when the buyers become sellers.



Given this ongoing bid in the market, regardless of price, it is little surprise that market levels are elevated, and valuations stretched. Despite a seemingly challenging macro-environment and investors that appear cautious in their tone, this is not reflected in asset prices and market volatility is lower than at any time in history. The US stockmarket, as an example, has not had a 3% correction in the past year.

VIX – Market expectation of volatility



Because price is such an important part of our investment process, market complacency does pose challenges for us, especially when constructing new portfolios. While the environment may be challenging, we continue to do what we have always done, which is to patiently seek investment opportunities where we can buy a stake in a good business at a material discount to what we think it is worth. When we find such opportunities, we invest, and if we don't find them, we don't invest.

Despite the poor opportunity set at an index level, both here and abroad, beneath the surface there remain pockets of fear for patient stock pickers to take advantage of. Because our approach is flexible and focused (we run concentrated portfolios of our best ideas), we only need to find a few very good ideas each year and we remain confident that the market will continue to present them to us.

Despite this very benign market environment, we have still been presented with some exceptional buying opportunities in recent times that have contributed to solid portfolio returns. It wasn't long ago that Anglos and Glencore were seemingly going out of business as commodity prices tanked due to concerns around Chinese demand, creating an exceptional buying opportunity in these companies. The fear created by Samsung smartphones exploding made investors forget about the far more important chip business that has just produced record operating profit. Emission issues, Elon Musk, Brexit and other challenges facing the automobile industry led to investors offering Fiat Chrysler shares at really depressed prices despite a clearly articulated plan to further improve profitability. Domestic issues (most notably the firing of the odd Finance Minister) has resulted in periodic bouts of fear that marked down solid local companies like Discovery, Imperial and bank shares. Continued domestic uncertainty continues to create select opportunities, particularly in small and mid-cap shares where there has been indiscriminate selling and many shares are now trading at crisis levels. We will delve into some of these opportunities in a future note.

Buying fear is one of our strengths, thus a lack of fear can be frustrating. The challenge for us is to not let expensive markets force us into lowering our hurdle for investment. This might mean fewer new ideas and larger cash balances, particularly for global portfolios. **This may also mean sacrificing some short-term gains, but is consistent with our approach that we believe leads to a safer, more robust, and over a full market cycle, a more profitable portfolio.**