# Friday Morning Coffee

European Capital Partners

## Nr. 127 — Duration play back?

Just when we thought the rotation into value was getting traction, the long duration play with a preference for shiny growth stocks appears to be back. The current investor narrative of this phenomenon is linked to the US presidential elections. A so-called blue wave, a landslide win of the Democrats of the Senate and the Presidency, would have ebbed the way to higher infrastructure spending leading ultimately reflation. It could also lead to more regulation of Big Tech and to healthcare reforms, clear negatives for the FANG+ and the healthcare stocks.

As I write this morning coffee on Thursday afternoon, the probability of a blue wave has substantially diminished. While it still looks plausible Biden will become the next President of the United States the Republicans may well keep the majority the of Senate. Markets were quick to adjust to this new scenario by reversing the blue wave trade as Big Tech stocks rallied, and healthcare rebounded.

The below graph from Bloomberg compares the performance this year of Big Tech, or Fang+, and long-term US bonds against the equities of the rest of the world. Big Tech and ultralong govies massively outperformed equities outside the US. The explanation is simple. On the one hand, in a world of ultra-low interest rates, you are well off holding long-duration assets as your discount factor of the future cash flows, being its future earnings or coupons of a bond, approaches 0. Growth and far away coupons of bonds have relatively more worth in such an environment. On the other hand, equities outside of Big Tech and the US represented below in pink by MSCI World excluding the US, are representative of the underperforming value stocks.

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So, is the long duration play back with value selling off as the anticipated blue wave failed to arrive? We should not jump to this conclusion to easily for 3 reasons:

1) As in real life, on the stock markets everything has a price and many growth companies are, in our humble opinion, currently priced for perfection. There will be disappointments ahead as these companies will not always be able to meet the inflated expectations. The gap between growth and value is now at a historic level and a mean reversion is more and more probable. Investors will question their "must have" status in their portfolios sooner or later.

2) In the three months following the last 2 US presidential elections, value as a factor outperformed other factors like momentum or quality by a significant margin.

3) A Biden win would certainly lead to less aggressive behaviour on tariffs and for example be beneficial for certain value sectors, like the European car industry and European industrials.

**At ECP, we are keeping the course and stay true to our value roots. During the pandemic, we increased our focus on the fundamental quality of the businesses we invest in and solidly integrated sustainability into our investment process. Therefore, we believe our current portfolio is well equipped to weather any short-term political turbulences. At the same time, we continue to identify new quality investment ideas at substantial discounts, or margins of safety, to their fair values.**

Have a nice weekend,

**Léon Kirch, CFA**
*Partner & Chief Investment Officer*
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