LHV Portfolio Management

Monthly Investment Report

January 2021

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Vaccinations against corona virus is slow, but with positive results.

As the consumption grows again more widespread, we expect the inflation rate to go higher.

Contrary to the often-popular view, higher inflation environment is usually negative for the equity markets

Growth and inflation are coming back

Globally the vaccination against the corona virus has been slower than expected, but the initial results are still positive and suggest that we will surpass the worst part of corona virus soon. In Iisreal, where COVID-19 vaccine has been received by the largest share of population (37% of the population), COVID-19 infection among people over 60 years of age has fallen by 40% in the last two weeks and the number of hospitalized patients decreased by 32% compared to two weeks ago.

If the world economic growth recovers with increased vaccination, the most important change in the investment landscape for us is the change in inflation. As the consumption grows more widespread, we expect the inflation rate to go higher. In the long-term, inflation has always finally increased in an environment of central bank money printing and government deficit spending. We think this time will be no exeption.

Market index movements	January 2021
Eurozone bond index	-0.5%
World stock markets	0.3%
North America	-0.3%
Europe	-0.7%
Emerging markets	3.8%

** Total return of MSCI indices, in euros*

Rising inflation will cause a storm

Contrary to the often-popular view, higher inflation environment is usually negative for the equity markets. If inflation is 0%, a equity investment with 2-3% dividend yield seems reasonable. However, if inflation is 2-3%, we should expect 4-6% yield to get a similar real return to the previous example. To achieve this, companies must either significantly increase the dividend payout or the share price should materially fall. We believe that if actually inflation will increase to 2-3%, this will be enough to shake substantially popular dividend and growth stocks.

Long-term opportunities in commodities

For us, in a higher inflation environment, the most interesting investment opportunities lie in the commodities and materials sector, from where we have acquired most equity positions in portfolios. We have diversified our commodity sector investments between different topics, of which our core positions include copper / silver as the biggest winners in the electrification trend, forest as a renewable raw material, Nordic mining automation technology companies and gold as an asset that perserves capital.

In the past year, commodity sector has initally rallied with the gereral market boom. But if the economic growth recovers and inflation gathers pace, there is still plenty of upside left in the commodity prices.

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In a higher inflation environment, the most interesting long-term investment opportunities lie in the commodity sector.

At the moment, we have not yet seen real inflation in the economy, only inflation expectations have risen. Market participants expect that inflation will in the future be exactly close to 2%, where the central banks want it to be.

In Europe, inflation has been below the central bank 2% target for more than a decade. We see no reason why to anchor ourselves to 2% inflation target, when central banks themselves say that they are prepared to allow inflation to rise higher in the short-term so that economies can grow out of debt more easily?

In any case, we are critical of the ability of central banks to control inflation if it grows high than 2%. Just as central banks were not able to increase inflation for years when it was too low, it is doubtful whether they will be able to slow it down if prices rise too fast.

Investment strategy

For us, in a higher inflation environment, the most interesting long-term investment opportunities lie in the commodity and material sector, from where we have currently acquired most equity positions in portfolios.

In addition to commodity sector, we also look at value stocks from Nordic and other European markets, of which some we have added to the portfolio. We believe that there are still some opportunities in the industries that have been in the epicenter of the corona crisis, although in most cases equity prices already have high expectations priced into the shares.

We have also mapped the fastest growing industries from other sectors, especially from the Nordic stock markets. But in general, we have to pay an extremely high price on the stock exchanges for any growth companies, which is why we have put most of our buying ideas on the shelf to expect cheaper price levels.

We can see that bond markets are an asset class with very few opportunities as the interest rates are artificially kept close to zero by central banks. If interest rates remain artificially low, we believe some part of global fixed income investors will look for alternative assets to preserve the capital purchasing power, of which gold could be the biggest winner in the long-run.

Best regards,
Mikk Taras and Kaius Kiivramees