
The Next Bear Market Has Just Begun

10 October 2018 | Marcel von Pfyffer, Arminius Capital

For the last six months we have been warning our investors that the end was nigh for the US bull market which has appreciated by a colossal +423% for the S&P500 TR index from 6 March 2009 to 21 September 2018. Arminius Capital ALPS fund investors have benefitted from this since the fund's inception in 2014, until we became very concerned at the end of the first quarter 2018 and began to materially add to (increasingly expensive) hedges. The recent rises in US 10-year bond yields and falls in global equities have signalled that the long bull market is over.

The coming global bear market will not be like the GFC. It wasn't caused by a US housing bubble, it won't cause a US and European banking crisis, and it won't be limited to developed economies. But the US and other share markets will fall by 20% or more, many companies will go bust, and a recession will follow.

We can't yet predict how long this bear market will last. It may be over in three months (like the 1987 crash), or it may drag out for eighteen months (like the GFC). No two crises' manifestation or duration is ever the same. In Australia it will be complicated by the housing downturn and the retreat of commodity prices. Oil and gas producers, however, will do well. It will certainly damage all portfolios (individual investors, superannuation & pension funds, speculators & traders) which don't have short positions or derivative protection.

The Trump Administration has made the bear market worse by its foolish policies. The trade war with China is already increasing US costs and causing hardships to some US industries. Further retaliation by both sides will make matters worse and most likely not remedy the one fact the US, EU & Japan all have openly acknowledged and agree upon: that the global trade playing field is not level – in China's favour.

In particular, The Donald's decision to re-impose sanctions on Iran have propelled oil prices upward. The effect of sanctions will be to cut Iran's oil production from 2.5 million barrels per day to between 1.0-1.5 million barrels per day. China will continue to import Iranian oil, carried in Chinese ships, and Iran has four decades of experience in evading US sanctions. But there is not enough spare production capacity in the

world to make up the lost Iranian production, so oil prices are rising, and may soon reach USD\$100 per barrel again. US and Australian motorists are going to be paying more!

One of the reasons we are confident that the next bear market is under way is the behaviour of the technology sector. Tech stocks have led the way down in the US, and most of them do not have the earnings or dividends to justify a price floor. Over the last eight years, the tech sector has grown to make up 25% of the S&P500 index, so the sector and the index have a long way to fall. The big tech stocks – such as Facebook, Apple, Amazon, Netflix, and Google will still be in business, but they will be a lot smaller, just as they were after the dotcom boom and the GFC.

The Arminius Capital ALPS Fund is short several US tech stocks, as well as many other US, European, Japanese, and Australian stocks. We expect that our fund will perform significantly better than the market and adhere to our ethos of long term capital preservation.

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