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The U.S. versus the World

This article is excerpted from a letter by Zeke Ashton, managing partner of Centaur Capital Partners, based in Southlake, Texas.

One interesting feature of the global investing landscape so far in 2018 is the nature to which the positive returns have been dominated by the U.S. stock market while the rest of the world markets are struggling and in many cases are down substantially. Below are various MSCI index returns year-to-date through September 14, 2018 across broad classifications (U.S., world, then the developed markets of Asia and Europe, and finally emerging and "frontier" markets) as well as some countries of interest.

MSCI Index	YTD Return
USA	+8.82%
World	+3.00%
Asia Pacific	-6.81%
Europe	-5.93%
Emerging Markets	-11.22%
Frontier Markets	-16.40%
Australia	-7.01%
Korea	-11.56%
China	-12.83%
Brazil	-22.13%
South Africa	-25.72%

Source: MSCI YTD returns through 9/14/2018

The China return noted above is for the MSCI China index, but the local market indices are showing much worse returns (the Shanghai market is down 18% and the Shenzhen market is down 26%). There are other areas of distress in global markets as well, particularly in certain commodities and in precious metals (the U.S. listed "Gold Bugs" index is down 28.5% year-to-date and down 33% over the past year). Even Canada's major index was showing a negative return on the year through mid-September despite being boosted by the ongoing cannabis investing boom.

The strong outperformance of U.S. stocks versus most of the rest of the world is starting to create a meaningful valuation differential between comparable companies listed on non-US exchanges and their U.S. listed counterparts. We are starting to see some intriguing valuations for high quality businesses outside the U.S. and particularly in Asian markets. Though we have historically been extremely North America-centric with regards to our holdings in the Fund, we do think that some of the best investing value available today is likely to be found outside the U.S. markets. If this trend of divergence in valuation persists or intensifies, you may begin to see a modest tilt in favor of non-U.S. stocks in the Fund portfolio over time.

Bear Market Math Strikes Again

Back in the September 2017 letter I discussed the wide variance in perception between how the financial media have in recent years come to describe a bear market (i.e., a quick 20% sell off followed by a recovery) and my own experiences of true bear markets (i.e., the 40/50/80 rule). In that letter I provided three examples of bear markets since I'd been investing in which the bear market math held true – the highest quality securities fell 40%, the median security fell 50%, and the worst stuff sold off by 80% with a lot of zeros mixed in. Well, it looks like we can add a fourth, as the crypto-currency boom that reached a fever pitch in early 2018 has now experienced a true bear market. This one has actually been quite a bit more spectacular than your average bear, in part because the craze reached such extreme levels on the way up and in part because it is so hard to know what any of these crypto-assets are worth (and, in many cases, whether there is any true intrinsic value at all) which has likely limited the conviction for buyers to step in on the way down. As of this writing bitcoin is down almost 70% from its early 2018 highs and the median or average decline in the crypto index is probably 80%. Many of the most egregious of the "crypto-crap" has already gone to zero or likely will be there shortly. It will be interesting to see if anything emerges from this particular mania that ultimately proves to be of unique or lasting value. My guess is that something probably will, though it may take awhile for the cleansing process to run its course.

Financial Crisis Retrospective and Lessons Learned

This month will mark the 10th anniversary of the fall of Lehman Brothers and the onset of the darkest period of the financial crisis of 2008. There has already been a lot of digital ink spilled on "what have we learned?" media pieces covering how the great financial crisis happened, how it might have been prevented, and speculation about what future crisis may or may not befall us or how potential future cases of financial destruction might be prevented.

My take-away from having read similar pieces after the dot-com bust and many historical articles and books describing other crises is that any lessons learned in the immediate aftermath of financial catastrophe are quickly forgotten during the next boom. In his classic 1994 book titled *A Short History of Financial Euphoria*, financial scholar John Kenneth Galbraith wryly noted the "extreme brevity of the financial memory." Here is a representative excerpt from that book:

In consequence, financial disaster is quickly forgotten. In further consequence, when the same or closely similar circumstances occur again, sometimes in only a few years, they are hailed by an always supremely self-confident generation as a brilliantly innovative discovery in the financial and larger economic world. There can be few fields of human endeavor in which history counts for so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present.

Whether one studies the tulip bulb mania or the crypto-currency craze, the same patterns emerge but always with just enough of a twist to make it feel like "this time it's different." Of course we will have bear markets and financial crises in the future, but we won't likely see a perfect sequel to the global financial crisis of 2008 or the 2000-2002 bursting of the tech bubble or even the 2018 crypto-crash. The seeds of future crises will be slightly different from those that have come before, and the events that trigger the avalanche will as always seem to be fairly random and unpredictable in real time. The underlying cause of financial booms and busts – humans taking risk-seeking and speculative behavior to extreme levels

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after a period of prolonged recent success – has probably been around as long as there have been humans and markets.

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