Insights

Inflation Murmuration

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Sort-term bursts of volatility in financial markets continued into the beginning of last week, as markets remained concerned about higher inflation expectations. What started as an unexpected spike in yields in the bond market a few weeks back soon spread to equity markets, especially impacting technology stocks and other sectors that had performed especially well in 2020.

After a wild ride last year, markets are still primed for sudden and violent moves. It did not take much this time (a move up in treasury yields) for the financial press to start talking about bubbles bursting and the end times coming.

While we do see some parts of financial markets exhibiting bubble-like symptoms (not mentioning any names… *cough*… Tesla… *cough*), many other sectors, including high growth businesses, remain reasonably valued and many of those companies are also exposed to the upside from a strong economic recovery in 2021. Earnings growth of +20% to +30% in 2021 and 2022 will not be uncommon for many of these firms, many of which are trading on free-cashflow yields of 4% or higher (half of global debt markets trade on negative yields).

Worries about inflation, and any one of a dozen other worries (anyone remember North Korea spooking markets?), will come and go. Investors must always remain vigilant, and this is certainly not a message encouraging complacency. What this latest dance in equity markets teaches us is that remaining focused on valuations of the stocks you buy is critical. Inflation spikes would worry us if we were invested in stocks trading at 1,000x earnings (guess who!), but we are not.

Valuation is the foundation from which real investment, as opposed to speculation, takes place. And in our view, there remain many exciting long-term investment opportunities in equity markets from here. They may be harder to come by, but that makes the winners even more exciting to invest in when you find them!

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