Eleon Capital Management Ltd.

- MARKET OUTLOOK -

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*I*n an interview with Charlie Munger, the moderator asked him what a good investment opportunity looks like and he responded: *"A sure thing!"*

*R*eflecting on my investment decisions, the most obvious one I made was in late 2008 following the Great Financial Crisis (GFC) in September of that year. Between October 2007 and March 2009, the S&P 500 index had fallen approximately from peak to trough 56%, whilst corporate free cash flows were nowhere near as volatile. As per Howard Marks, the market was characterised by: a dearth of optimism, high levels of fear, poor recent market performance and widespread losses, excessive risk aversion and the reluctance to supply capital. Even though the capital markets and the economy were in complete disarray at the time, and notwithstanding the bleak macroeconomic environment, the odds were significantly in favour of equities returning favourable results over a reasonable period even though I had no way of knowing nor predicting the market movements of equities over any time period. What characterised that period in formulating the odds of market outcomes was just how extreme things had become and thus creating such a comprehensive 'margin of safety' for investment opportunities that with the right temperament and patience, it was inevitable that a satisfactory result would have been achieved.

*W*hen the next big crisis confronted the world in 2020, specifically the Covid pandemic, I felt that, much like the previous crisis, it would present very favourable odds for investment, given the severity and tragic nature of the pandemic and the resultant impact on the world's economies and by and large investor psychology. Between February 2020 and March 2020 (literally, a month), the S&P 500 fell 33% from peak to trough and progressively marched upwards. However, I did not take advantage of that brief opportunity because I felt the markets had further to fall. My conciliation was that, at least in theory, my assessment at the time was correct – but was it?

*E*ven though the equity markets bounced back quickly, I felt uneasy that my analysis was wrong. Warren Buffett, a huge proponent of "be greedy when others are fearful and fearful when others are greedy", was a net seller of equities in that period despite Berkshire Hathaway's fortress balance sheet and colossal cash potion.

Why, was Warren Buffett – the most successful and rational investor of all time – who in the previous crisis advocated buying equities, not doing so in this crisis? While he explained that while the net selling position was not as extreme as the figures implied, they felt they needed to sell their entire airline holdings as it would have been immoral to accept government support when one of their principal shareholders had such a strong balance sheet. But upon further reflection, I felt that Buffett correctly assessed that this crisis had presented risks which were both unknown and unquantifiable; thus,

"the margin of safety was illusionary."

In this instance, battening down the hatches, irrespective of the outcome, may have been more sensible. Therefore, I concluded that my initial assessment was wrong, even though the outcome would have been in my favour.

*A*fter both crises, three factors drove equity markets to such highs. Two are directly related to valuations and the other is an enabler of investor psychology. After both crises, interest rates were driven to extreme lows, pushing up valuations and 'forcing investors' to search for yield. After both crises corporations posted good earnings following their recessionary slumps. And finally, governments across the world injected massive amounts of liquidity into the financial system. Thus, as animal spirits began to take hold and credit availability loosened, equity prices increased.

*T*oday those supportive measures no longer apply, given that central bankers worldwide are tackling the inflationary issues that have arisen post the Covid pandemic. Of course, while the two examples noted above were extreme events and whilst we have no way of predicting either the trajectory of the impact of the complex macroeconomic environment or the effects of inflation on equity markets,

"it is critical that when we make investment decisions, the odds and margin of safety are correctly assessed"

and are of such magnitude that even if mistakes are made, they allow for a satisfactory result.

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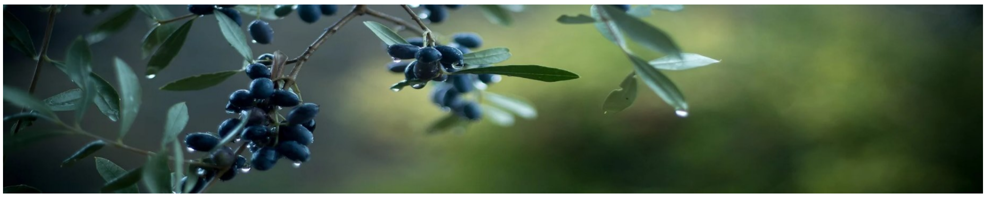

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Strong Roots, Sustainable Growth

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