

Investment Outlook  
From Bill Gross  
September 2020



**Tattooed**

If my mother were still alive it would send her to her grave, but then she's there already and oblivious to the fact that her 31-year-old grandson has lots of tattoos. She swore that when I went into the Navy that if I came back with "Mom" plastered on either arm, that she'd disown me, but I wasn't into it – my mom or the tattoo.

Anyway, my son – her grandson – Nick, who's 31, now has one. As a matter of fact he has plenty. He's got a "sleeve" on his left arm, a term that basically implies there's no more room left in the inn, or the arm -- no vacancy – full up.

I haven't inspected them closely but I know at least they don't say "Dad" -- thank goodness -- because we're estranged for some odd reason and he'd want to have it removed now. But since his "sleeve", he has gone on to implant significant life philosophies on the other arm, ankles, back, and parts unknown. He even has the name "Gross" tattooed on the inside of his lip which drives my ex-wife Sue mad and was and is now the only tattoo that I truly enjoy, if only for that reason. Revenge by tattoo I suppose. I wonder though how anyone sees it and if it's supposed to be romantic.

I cynically envision the locking of lips, whenever it occurs, involving a mirror image, sort of like the one a dental assistant would use to discover cavities on his left molar. Kind of a weird makeout would be the result I suppose, but then millennials are a strange group and prior to the lip locking when connected on Tinder, the prospective young lady would swipe right on her phone in eager anticipation of locking on to that rather "Gross" thing on the inside of his lip.

So Nick would be quite a disappointment to Grandma and now is, as the reader can tell – to me. My two older kids Jeff and Jenn are relatively tattoo free. Jennifer has one on her leg and probably elsewhere – a

Dad can't know these things -- and Jeff...Well as his mom and my first wife says at birthday parties, "he's perfect".

Guess there is always one tattooed (black) sheep in every family. Nick is mine.

Well the global economy has been tattooed in 2020 by an invisible virus – like the one on the inside of Nick's lip I suppose. No hidden lip tattoo here, the virus' effects are clearly visible. And life for more than 7.5 billion people has been changed in unbelievable ways. For the lucky ones who have managed to escape "six feet under", there are quarantines aplenty, leading to significant breaks in work habits, leisure, education, and most importantly, college and professional sports! The looming question of course is will things ever be the same, and when answered with a "probably not", the race has been on in financial markets to identify winners and losers. "Stay at home" stocks have soared while cyclical and "value" oriented issued have stagnated or in many cases gone down.

In my previous Investment Outlook I identified interest rates or more specifically "real interest rates" as a contributing factor because of the discounting mechanism of declining yields on stocks' forward cash flows and the fact that growth stocks were much more sensitive and upward price responsive to Treasury Inflation-Protected Securities (TIPS) yields as they decline. Investors comparing returns on European stocks might be shocked to learn that 5-year, government-linked yields in Germany are a mere minus 115 basis points while in the U.S. they are even more negative at a minus 130. Since crisis levels in March of this year, U.S. 5-year real yields have declined by an astounding 180 basis points or 1.8%, while in Germany, to use an example, they are down a mere 60 basis points. All else equal, that differential explains a lot about the performance of individual global indices including the weakness in the dollar over the same time period.

But for stocks, according to archaic but commonsensical earnings or dividend discount models, that difference could help explain – all else equal – at least a 20% to 30% performance disparity in European vs U.S. stocks. Lo and behold the FTSE, DAX, and CAC 40 indexes are down an average 5% to 15% while U.S. averages such as the Nasdaq and S&P 500 are up 5% to 25%. Like the caveat in my July Outlook, the real rate rally in the U.S. is not the only answer – the U.S. economy has received significantly larger fiscal stimulus than elsewhere. Disposable personal income in the U.S. never declined and as of the last reading is up at about a 12% annual rate. Germany and other European economies decided to inject lighter stimulus straight to corporations while the Treasury and Fed gave "helicopter" handouts straight to individuals via unemployment benefits and other guarantees to put money right into workers pocketbooks.

But now, an investor comparing real yields and the future of fiscal stimulus efforts in both European and U.S. economies must grapple with whether this U.S. advantage will continue in future years – the election notwithstanding.

My opinion is that much – if not all of the U.S. fiscal stimulus is over. To continue to pump the economy in future years would require not just a 4 trillion dollar deficit but a 5 or 6 trillion dollar one. And to reduce the deficit to 3 or 2 trillion would actually be known in economist speak as "fiscal drag" and would have to be made up by at least 6% to 7% real annual growth for years and years in the private sector – a Trumpian or a Bidenian dream I suppose but not realistic.

In addition real interest rates would have to move continually lower. The 5-year TIPS might have to go to minus 180 and then minus 230 which would require quantitative easing of unacceptable proportions.

An investor, not day trading on Robinhood, therefore should begin to play defense via heretofore shunned sectors such as tobacco, banks and even – yes, foreign companies listed on European bourses that have not skyrocketed on dreams of back-to-normal economic prosperity followed by even lower artificial real interest rates. There is little money to be made almost anywhere in the world – Covid 19 vaccine or no.

Our global economy's tattoo cannot easily be removed for years to come.