



ABALONE[®]

Italian on holiday

ABALONE'S MONTHLY REPORT

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During a sultry spring afternoon, an Italian gentleman enters a bank in New York and asks to speak with the employee in charge of the loans. He explains to the official that he has to go to Italy for two weeks to find his family of origin and needs a loan of 5,000 dollars. The employee explains that the bank is willing to grant the loan but requires some form of guarantee. At this point, the gentleman takes the keys of a Ferrari out of his pocket and puts them on the table; he also delivers the car registration certificate, all the insurance documents and points out that the car is brand new, parked in the street just in front of the bank. The official gladly accepted the car as collateral for the loan and immediately ordered a delivery man to take the car to the underground garage of the bank. For a few days the president of the institution and the officials make jokes about this Italian who uses a Ferrari of 250,000 dollars as a guarantee for a loan of 5,000 dollars. Two weeks later, the Italian returns, returns the 5,000 dollars and pays interest of 16 dollars and 44 cents. At this point the curious official asked him: *"Dear Sir, we are really happy to have you as a customer and this operation went very well. But you have to excuse us: we are a little confused. We looked for some information about you and saw that you are a multimillionaire. We wondered why you needed a loan of \$5,000 to go on holiday"*. Then the Italian answers: *"Where do you think I can find a place in New York where I can park a Ferrari for two weeks for just \$16.44 and hope to find it when I get back?"*

STRATEGY AND DESIGN TO MANAGE THE COMPLEXITY OF REALITY

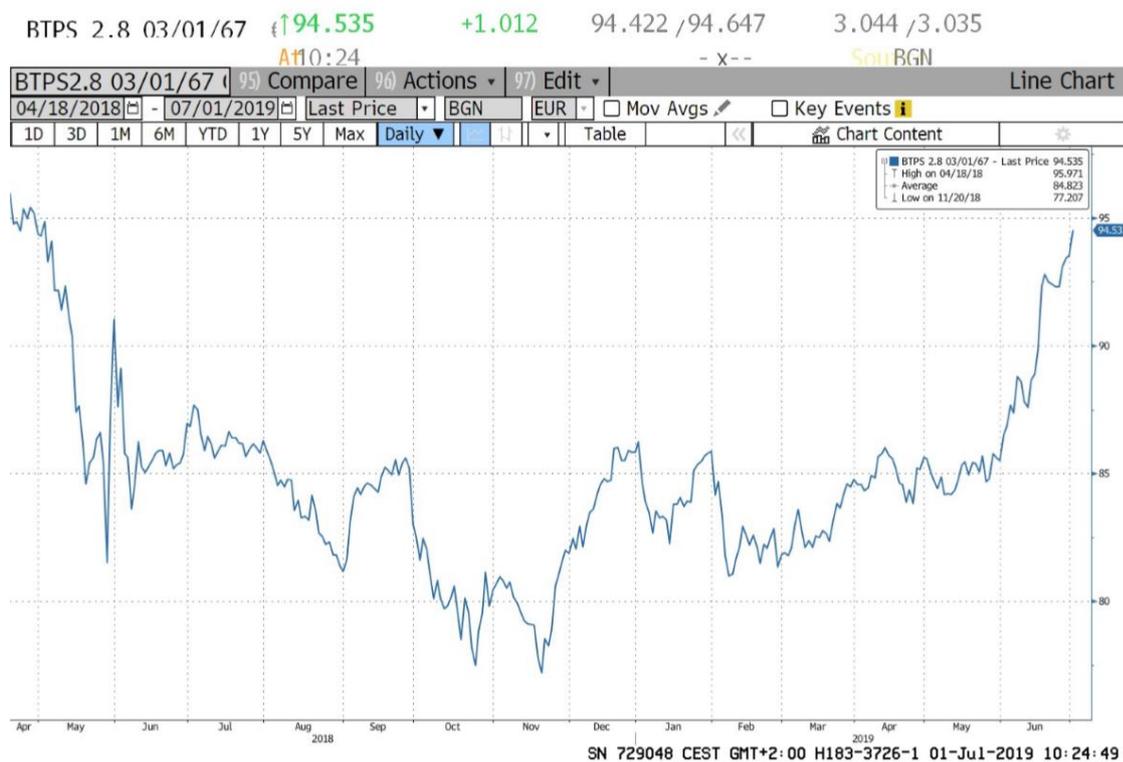
Very often in life appearances deceive and the financial sector is no exception: portfolio managers know well that price movements often do not follow dynamics in line with market logic, news and data. The causes of these apparent irrationality are to be found in the fact that the reality is too complex to be understood as a whole and the information we have are limited and incomplete. When you design a management strategy it is very important to have a clear understanding of this concept otherwise it is easy to make gross errors that irreparably compromise the performance of the portfolio.

THE CASE OF BONDS AND THE U-INVERSION OF INTEREST RATE EXPECTATIONS

To figure out what we are talking about let's take a very current example and consider what is happening in the bond industry: many investors in 2018 closed or reduced long positions imagining that the compression of yields after a few years was over, excessive and unsustainable. Those who have reduced these positions have obviously not thoroughly evaluated the main dynamics that impact on bond pricing and have acted

instinctively, being misled by partial data and incomplete analysis. For example, many analysts did not consider that the population ageing trend and technological deflation have become persistent factors and counteract inflationary pressures in a structural way. As if that were not enough, the world economic growth, even if good, is distributed like a leopard, in some areas it is not satisfactory and on a global scale there is a lot of geopolitical uncertainty. In such a context it is really difficult to think that the central banks can undertake long and lasting paths to raise interest rates, if anything the opposite.

Moreover, the enormous amount of liquidity put on the market in recent years by central banks must be allocated and must be invested regardless of the levels of return rates offered by bonds: all major investment funds (UCITS funds and pension funds) are forced by regulations to allocate liquidity and this detail is often overlooked but in reality is very important. Currently many investors do not buy debt to benefit in terms of return but they do because, like the Italian tourist who went to the New York bank, they have an absolute need to park the liquidity. So all those who in recent months on the emotional thrusts have reduced bond exposures behaved a bit like the bank employee who ironized about his customer without considering that the reality is often more complex than it looks. The conclusion is that for good management it is very important to rigorously design precise and resilient strategies that allow you to manage the feelings, panic and fears that are almost always a source of error.



Source: Bloomberg. Price of the Italian government bond maturing in 2067: on high durations, the U-turn effect of monetary expectations is clearly visible.

QUANTITATIVE EASING ALSO AFFECTS THE EQUITY SECTOR

For a reason similar to the one we have just seen, I think we should be very cautious about saying that there is a good chance that the stock market will collapse if there is a recession. As we have seen in the reports of the past months, if it is true that stock market prices are close to the highest is also true that the valuations are far from the highest and we should remember that "*Beati monoculi in terra caecorum*": at a time of rates close to zero or negative even dividend yields of 3% or 4% may seem extraordinary and irresistible (especially if associated with corporate businesses that appear extremely resilient and sustainable). Twenty-two centuries ago, Archimedes understood the importance of the principle of communicating vases: since it is one of the main drivers for determining the prices of financial assets, we must be careful not to forget it right now.

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Founded in 2015 by CEO Roberto Colapinto, Abalone Group comprises 3 investment companies that, thanks to their widespread presence in Europe, offer cross jurisdictional services in Italy, Luxembourg, the United Kingdom, Ireland and Malta. Abalone Asset Management specialises in the management and distribution of investment funds, Abalone Suisse SA in wealth management services and quantitative strategy development, Abalone Service in legal and structuring services, with a focus on European investment funds and securitisation vehicles.