THE **CAMBRIDGE** WEEKLY

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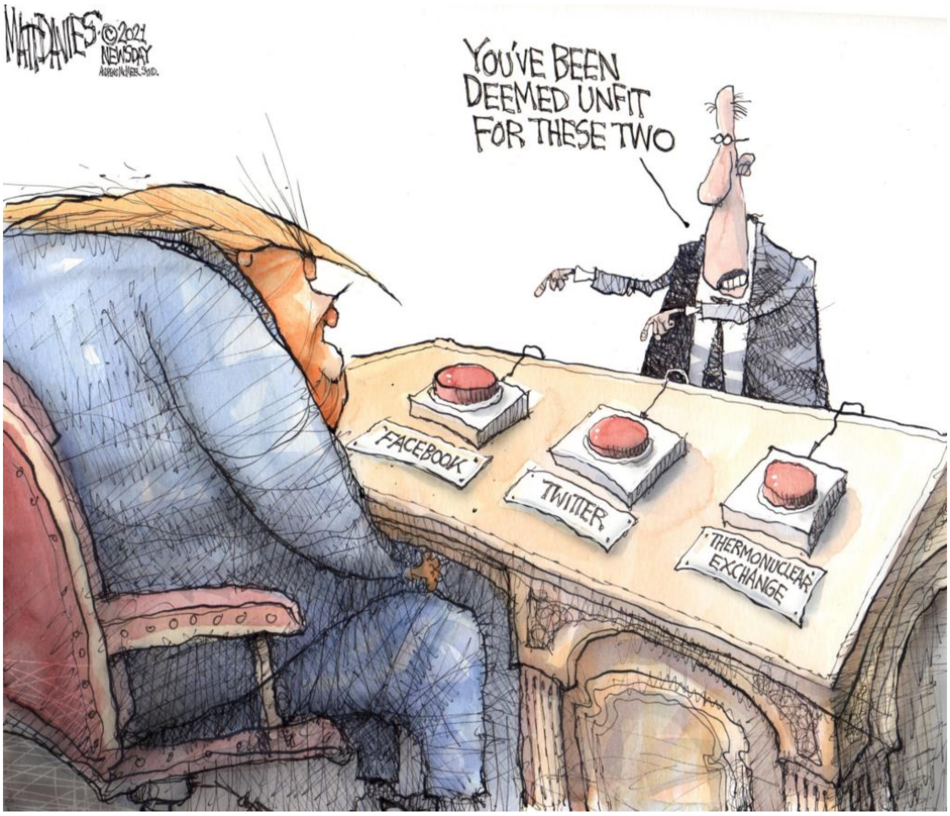


Absurdities of Trump's world, Matt Davies, 8 January 2021

Fiscal turbo replaces lame duck Trump

As we wrote last week, there is a broad consensus that this year will see a strong economic rebound as mass vaccinations finally put an end to the pandemic – even if we have to wait until the second half of the year to see it. Ahead of Wednesday's inauguration of Joe Biden as the 46th President of the United States, there is also a widespread expectation that the new administration will usher in a more sustained recovery than the faltering US growth displayed over the last quarter of 2020. The hope is that Biden will be able to deliver on his campaign promises of substantial but also structurally beneficial fiscal stimulus. If he can, it would amount to a rebuilding of US crumbling infrastructure towards a better, greener future. Some even see this as the opportunity for a re-run of Franklin D Roosevelt's New Deal, credited with having put an end to the crippling depression of the 1930s.

The Biden administration's announcement on Thursday of an immediate fiscal support programme worth an additional $1.9 trillion confirmed these expectations. This explains why US and global stocks saw another week of positive returns, despite the fight against the COVID pandemic increasingly hampering economic activity everywhere. The $1.9 trillion programme does not contain any notable elements of fiscal investment into sustainable infrastructure, focusing instead on overcoming the household and business income gap that lockdowns are inflicting, and on ramping up vaccination to a huge scale. The (potentially more contentious) investment plan will only come in February. While the markets might want to see that right away, the deal on the table allows for rapid bipartisan approval now, and consensus-building later.

The step-change compared to last quarter is that US policy is no longer paralysed by Donald Trump's erratic and divisive leadership, and there is a palpable sense of urgency for immediate action from the incoming administration. And, compared to what we expected they could deliver last year, the events of last week have increased such action significantly. The surprise attainment of a majority in the Senate by the Democratic Party, together with Trump's behaviours making him (and the Republican Party's operational leadership to some extent) unpalatable for much of the centre-right US electorate, have vastly increased the Biden administration's policy power and ability to execute.

From a UK perspective, this change is comparable to the improvement in political momentum between Theresa May's and Boris Johnson's governments following the Conservative Party's landslide election win in December 2019. Except that there is one crucial difference – Biden knows how to 'be president', having played an integral role in President Obama's administration. The first 100 days of the incoming president promise to be more dynamic than previous changeovers of US government. It should make a welcome change to the stifling inertia and lack of effective policy response that marred US policy since the pandemic landed last March, which made Trump increasingly insecure about his unpopularity amid the looming economic downturn.

From this angle there is further upside potential to come from Biden's medium-term policy portfolio, and last week's announcements mean that his administration is off to a good start. Unfortunately, elsewhere the near-term picture is not quite as unanimously positive.

The UK is grappling with the worst second wave public health pressures of anywhere in Europe, at the same time as attempting to bed down the post-Brexit trade framework. We suggested before Christmas that both sides would be well advised to delay implementation of the trade deal's measures for long enough to allow businesses to prepare, given the last-minute agreement had left no time to do this in an orderly fashion. Not surprisingly, the UK stock market lagged its global peers once again. However, with a strong rebound of growth, and potentially a green infrastructure rebuilding effort around the world firmly on the 2021 horizon, UK stocks may still come good in the near term. The UK market's domination of distinctly cyclical sectors and global companies, together with having been unloved because of Brexit uncertainties, is making investments in UK large caps (FTSE100) still one of the more promising likely sources of portfolio returns during 2021.

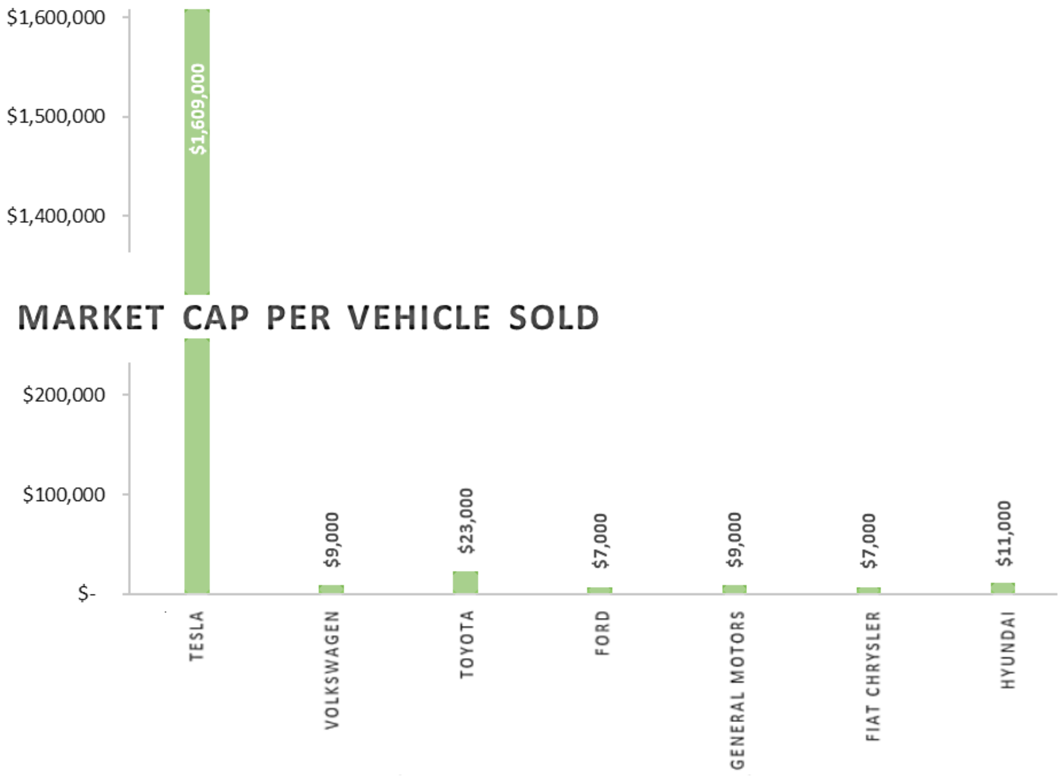
Tesla: Tech, green investment, carmaker or just another bubble?

While Donald Trump won the title of America's most impeached President, the prize for strangest news story of the week went to his eldest son. Donald Trump Jr took to Instagram (well, it couldn't be Twitter, could it) to make a plea to billionaire Elon Musk: set up a Trump-friendly social media platform to "blow Twitter away". The sight of Trump the younger asking the world's richest man to help him make a website is certainly extraordinary, but then 'extraordinary' is how Musk has made his name – and his fortune.

The recently anointed richest person alive may be the boss of Tesla and SpaceX, but his image is more rock-star than executive. It is safe to assume most people could not name the current CEO of Ford, Toyota or Volkswagen. But Elon Musk, the owner of a car company that makes just 1% of the number of cars its rivals make a year, is a household name. A multi-billionaire that declares he does not care about money, Musk has helped – and at times hindered – the press and investment exposure of his companies massively over the years.

This certainly has not hurt Tesla's market performance recently. Investment flow data show that Tesla has been the darling of retail and selected institutional investors over the last year. This, rather than an explosion in earnings, has been the main driver of its meteoric price performance. Last year, as the global economy fell into its deepest recession on record, Tesla's stock climbed 800% and now has a market capitalisation of around $820 billion, making it by that measure 50% of the entire global car industry. Despite only being admitted to the S&P 500 weeks ago, Tesla has already overtaken Facebook to become the fifth largest company in the index.

This incredible performance both excites and scares, depending on whether one is a true believer in Tesla or a sceptic. At its lofty price, Tesla dwarfs all its major competitors combined, despite producing a fraction of the cars they do. Having shipped just under 500,000 units last year – Tesla's highest-ever sales figure – in 2020 the market valued the company at around £1.6 million per every car it sold. Given its Model S sells for $70,000, that is quite some ground to make up.



Source: Bloomberg, Tatton IM, 13 January 2021

None of this is to denigrate Tesla as a company, of course. When talking about Tesla's massive valuation, there are leagues of 'Teslanaires' standing by to tell you why the electric carmaker is the real deal. Tesla has leading technology in both the design and mass manufacturing of electric vehicles, as well as a big foot in the door of the self-driving market. Analysts estimate that the Tesla Model 3 sells at a profit margin of around 30%, which is a matter of factors higher than the average of its combustion engine competitors.

The old brands are keen to join the electric market – and many have devoted vast resources to developing and rolling out new electric models. But there is no guarantee that established carmakers have an advantage in the new market. Indeed, history shows that when new technologies arrive, newer companies often have the edge, being unburdened by the legacy of the old tech. With governments, businesses and the investing public all striving towards sustainable alternatives, it is not unreasonable to think a company without a gas-guzzling history might end up winning out.

The long-term argument is fine, but no matter how you look at it, $820 billion for a company that makes relatively little compared to its competitors is expensive. There are some extenuating circumstances. Tesla has received a big helping hand from its S&P inclusion and its recognition for environmentally-friendly investments – which have forced rebalances toward it. But the problem is not that Tesla may one day fail to lead in sales as it does in stock price, the problem is that it is trading as though its future domination is already in the bag.

That is dangerous to assume. Even if Tesla can fight off more experienced manufacturers, it may not be able to do the same to new entrants. Apple and Google have already announced intentions to launch into the electric and self-driving car markets (Google's self-driving car company Waymo is indeed perceived as one of the leaders in the sector), and with their immense resources and technological know-how, they are well placed to make a sizable dent in an already crowded space. Essentially, while Tesla's justification may not be wrong, it is nonetheless speculative.

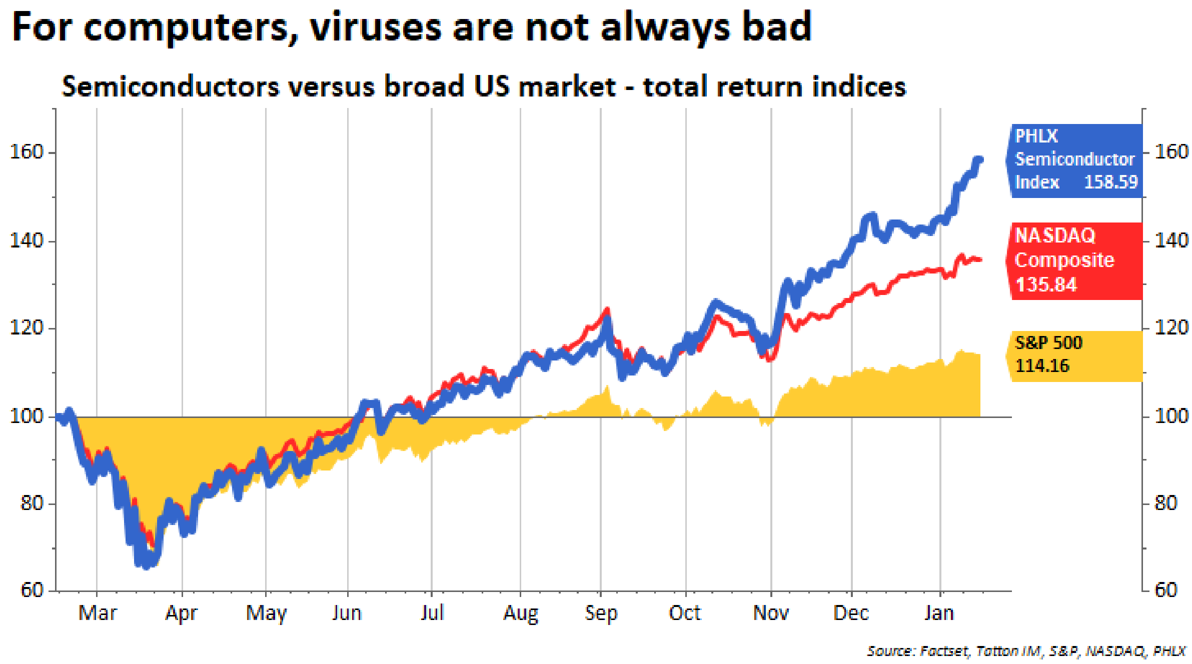
However, saying Tesla is expensive is not the same thing as saying we expect its stock price to come down soon. For one, many of the factors underlying its massive expansion – an extremely accommodative financial environment, a supportive political and social backdrop (with an emphasis on green technologies) – are still present.

Also, by virtue of its popularity, Tesla now has an advantage that none of its traditional competitors have – an enormous market value. This gives it the financial firepower to expand and reinvest, including even buying out some of its competitors. Whether Elon Musk would sanction such a move is doubtful, but the point is that with exorbitant price comes exorbitant privilege, and it is a privilege Musk and his board will want to use to their advantage.

All of this is to say, Tesla is certainly no sure thing, but its valuation is based on more than just faith in an impulsive billionaire. The company has a lot going for it, but if an industrial carmaker is to remain the darling of the stock market, it has to start selling more cars and make more profit soon. Putting it another way, in 1999, during the height of the Dotcom bubble, search engine companies Google and Yahoo! traded at similarly fantastic valuations. In the case of Google, investor faith was eventually richly rewarded, whereas Yahoo! has all but disappeared.

Bull in a chip shop

With most of the developed world stuck at home, it has been a good year for chipmakers (no, not those kind of chips). Developers and manufacturers of semiconductors saw a massive bump in demand in 2020, buoyed by the "stay at home" orders issued by governments and the consequent increased computer usage. TSMC, the world's biggest supplier of computer chips, saw its profits climb 23% in the last three months of the year, up to $5.1 billion.



The launch of Apple's new iPhone – with chips provided by TSMC – helped the Taiwanese company into the year-end. But even when that bump-up is accounted for, the underlying trend is undoubtedly strong. Consumption of just about everything digital shot up last year – from remote working and learning to servers and gaming. TSMC, as with others in the semiconductor business, had a part to play in all of it.

Before the pandemic, there were worries that TSMC would be hit by rising US-China tensions, after the Trump administration banned sales to Huawei, one of its best customers. But demand for semiconductors during the pandemic has been so strong suppliers cannot keep up. Talk now is of a global shortage of microchips, affecting the automotive industry in particular.

More advanced cars need more (standard) chips, but manufacturers have been reserving capacity for their bigger tech customers and their needs for more sophisticated, higher profit chips. The shortage has left car manufacturing crippled, with Volkswagen, Nissan and Honda all forced to cut production. Problems are so pronounced that TSMC called it their "top priority" to solve shortages for carmakers.

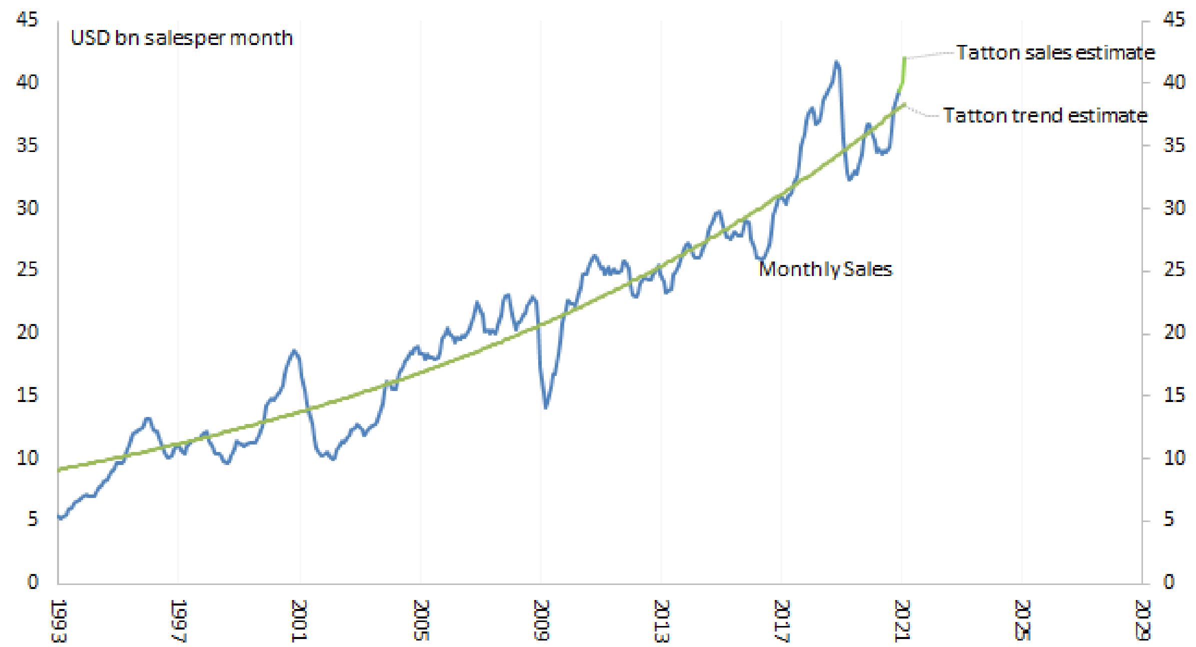
Solving it will be a tall order. The chip industry at large is seeing shortages in every area, with analysts expecting supply gaps to last into 2022. Underlying these shortages are many technical issues. For example, scaling up chip production is slow and expensive, and access to the raw materials is limited. With demand for 5G phones and high-tech gear sky-rocketing, chipmakers have invested in equipment to make newer and better chips which they can sell at higher margins.

But demand for older chips is still growing, and since making older models is less lucrative, producers have not kept pace. Indeed, supply disruptions are being most acutely felt are in older technologies using standard chips.

Some big industry players were already beset by difficulties. Intel, the star of the first tech boom, last week fired CEO Bob Swan after product delays and deep-seated issues that have knocked the company off its perch. Intel is one of the few chip companies to do both design and production in house, using techniques pioneered while incoming chief Pat Gelsinger was the company's technology officer. Its "Tick Tock" method of production – which allowed for faster and faster technical upgrades – was thought of as cutting edge ten years ago. But the company has now fallen so far behind other players like TSMC that there are suggestions it should cease its manufacturing arm altogether.

If Intel were to focus just on design ("fabless" as it's known among the cognoscenti), it would hardly help the global chip shortage. While there are multiple chip designers in the global market – ARM in the UK, NVIDIA and AMD in the US – manufacturers are comparatively few. TSMC and Samsung are the largest in this area and the most technically able, but 2020 has highlighted the dangers of overly concentrated global supply lines. And with a lasting global shortage, there is an even greater incentive to branch out.

Global semiconductor sales



Source: Bloomberg, Semiconductor Industry Association, Tatton IM estimates

For governments, the chip supply issue is now a national security issue. Over the last four years we have seen private technological superiority become an explicit point of national security in the context of US-China tensions. China, it should be said, is some way behind in chip production technologies, and has to rely on TSMC for most of its supply. But even in the US, there are serious concerns that it may be left without a leading chip manufacturer to count on.

With governments around the world investing heavily in the wake of COVID, technological infrastructure is one area likely to see a big boost. With chip design and production now also a cause for national security concern, we could well see chipmakers receiving subsidies in the post-pandemic recovery. In addition, the coming 'green revolution' in tech needs plentiful supply of chips – for everything from electric cars to newer, less energy-intensive servers. ARM is currently developing in this direction, and its past association with Apple has shown it can compete with the likes of Intel and AMD.

Even without fiscal expansion, chipmaking is sure to see more investment. There have been concerns throughout the pandemic and ensuing recession that businesses would be reluctant to increase capital expenditure (capex) toward boosting productivity. TSMC's latest results show a huge increase in capex – with the company clearly using this period of strength to expand its production.

However, it would be misleading to focus entirely on the end production of chips. European tech companies like ASML and Infineon, for example, are not directly producers or designers but still sit on top of the chip pyramid. ASML makes the equipment that TSMC and Samsung use to produce their chips, meaning it has done extremely well from the growing global chip demand.

What we are seeing in the chip industry is a confluence of many underlying trends. There are technological changes on the supply side, which are slow moving and are currently limiting production. Then there is a longer-term demand story, including environmental and technical factors, which are pushing demand structurally higher. And finally, there is the pandemic, providing a sudden sharp boost. All of these factors point to chip demand outpacing supply for the foreseeable future. So, while the pandemic has become a welcome catalyst for ever-more digital capability and convenience, we cannot expect the past decade's trend of technology improvements without price increases to persist. With global chip-making industry operating at full capacity, and still demand outstripping supply, producer pricing power is as strong as it has ever been.

CAMBRIDGE INVESTMENTS LIMITED

18th January 2021

Global Equity Markets

Market	Fri 15:39	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6695.0	-2.6	-181.9	↗	↗
FTSE 250	20522	-2.6	-545.8	↗	↗
FTSE AS	3782.4	-2.6	-99.8	↗	↗
FTSE Small	6323.2	-0.6	-40.1	↗	↗
CAC	5578.4	-2.3	-132.2	→	↗
DAX	13715.0	-2.5	-349.4	⬀	↗
Dow	30761	-1.1	-342.6	⬀	↗
S&P 500	3760.6	-1.8	-67.8	⬀	↗
Nasdaq	13011.5	-1.4	-186.2	↗	↗
Nikkei	28519.2	+3.7	+1029.0	↗	↗
MSCI World	2738.1	-0.6	-15.2	↗	↗
MSCI EM	1370.8	+1.3	+17.2	↗	↗

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.2	19.7	15.3	13.9
FTSE 250	1.9	19.3	20.9	15.1
FTSE AS	2.9	19.5	16.0	14.0
FTSE Small x Inv_Tsts	1.8	17.6	-	15.0
CAC	2.0	22.5	17.9	14.4
DAX	2.6	23.5	15.8	13.1
Dow	2.0	22.7	20.9	15.9
S&P 500	1.6	27.5	22.8	16.9
Nasdaq	0.8	37.7	29.9	19.3
Nikkei	1.4	29.6	25.2	17.3
MSCI World	1.8	26.3	21.7	16.0
MSCI EM	1.7	21.8	16.5	12.3

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
easyJet	+5.3	Fresnillo	-11.2
TUI	+4.1	Burberry	-8.1
Next	+3.9	Experian	-8.1
DCC	+3.0	Smiths	-7.0
Whitbread	+3.0	Persimmon	-7.0

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.359	+0.1	Oil	55.04	-1.8
GBP/EUR	0.890	+1.2	Gold	1832.4	-0.6
USD/EUR	1.21	-1.1	Silver	24.79	-0.5
JPY/USD	103.82	+0.2	Copper	360.4	-1.9
CNY/USD	6.48	-0.1	Aluminium	2005.5	-1.5
Bitcoin/$	36,149	-9.7	Soft Cmdties	420.4	+5.4

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.29	+0.00
UK 15-Yr	0.51	+0.01
US 10-Yr	1.10	-0.02
French 10-Yr	-0.32	-0.01
German 10-Yr	-0.55	-0.03
Japanese 10-Yr	0.04	+0.01

UK Mortgage Rates

Mortgage Rates	Jan	Dec
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.79	1.81
3-yr Fixed Rate	2.05	2.05
5-yr Fixed Rate	1.98	2.00
10-yr Fixed Rate	2.55	2.55
Standard Variable	3.62	3.62

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

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