Monthly Commentary 4th January 2022

December was a banner month that ended a banner year for the world's developed equity markets. The US, Europe and the UK were all up more than 4% in December and closed the year with impressive performances. Bonds were weaker across the board and had a year to forget. This was especially true for both UK government and corporate bonds that fell more than 5% in 2021. Commodities were strong, with crude oil and base metals having particularly good years. The USD was up more than 6% for the year (on a trade-weighted basis). Bitcoin had a weak month, down almost 20% but a strong year, up almost 60%.

What does 2022 hold for investors and how is Elgin positioned?

If one wants a good summary of what to expect, there's few better than Bloomberg's compilation of forecasts from no less than 50 financial institutions. Just click on https://www.bloomberg.com/graphics/2022-investment-outlooks/?srnd=premium-europe

Admittedly, even though there are only summaries, one can get completely confused when trying to navigate their way through so much information (more than 100 pages of it). If anything, the varying, yet considered views of a lot of smart people highlights that it is impossible to predict what the future holds in financial markets.

To summarize (from the first paragraph of the article):

As 2022 begins, the overriding message from almost 50 financial institutions across Wall Street and beyond is that conditions still look good, but the rip-roaring rallies powered by the reopening are history. Growth will ease. Returns will moderate. Risks abound—but so do opportunities.

While there are some consensus views (like inflation being higher than average in the first half of 2022), there are also many differing ones, and that is what makes markets exciting and unpredictable. Most of these forecasts will have proven to be wrong when we look back a year from now, no matter how clear the logic is.

So how does one formulate an investment strategy? At Elgin, we believe that diversifying and sticking to quality are a good basis on which to build such a strategy, so we will continue to keep using the same philosophy.

Admittedly it has become difficult lately with interest rates so low and poised to rise. While this is a consensus call, and might not necessarily come to be, we are questioning why we should invest one's full allocation to fixed income at a time when rates are so low. What are the outcomes for fixed income?

1. Rates stay the same, in which case the yield is paltry or negative.
2. Rates rise, in which case there will be a loss in the value of bonds.
3. Rates fall, in which case the value bonds rise. Assessing the probabilities, especially in lieu of even modest inflation, this eventuality is the least likely.

This conundrum has led us to hold some extra cash instead of being fully invested in bonds. Naturally, clients will ask why we are holding cash instead of making that money work? The reason is risk profile. If an investor is not comfortable with being 100% in equities, theory suggests that the balance of their portfolio should be in fixed income, which is considered less risky. As explained above, this might probabilistically lead to losses at the current juncture of low interest rates.

How about alternatives such as hedge funds, basic commodities, gold, private equity, venture capital, Crypto etc? Fair enough, but these investments are not without their own risks. Hedge funds have been all over the place in the last 10 years and have by and large proven that they do not necessarily "hedge" effectively. Commodities are not only extremely volatile but accessing them is not that straightforward as in most cases it involves being exposed to short-term futures contracts that need to be rolled over on a regular basis at a considerable cost. Gold has had too many false dawns and we do not see why it should not continue to disappoint. Private equity and venture capital is both illiquid and largely inaccessible to the retail investor. As for Crypto, the mainstream platforms that we use are still reluctant to accept almost all crypto-related investments whether due to regulatory, liquidity or risk-related concerns.

Which brings us back to equities. While they carry risk, one has to weigh their potential based on historical analysis and assess how much to allocate to them in a portfolio. In this case, as can be seen below, with some statistics from the Dow Jones Industrial Average (a US stock market index) going back to 1896, as well as the same index and the S&P 500 (the other major US index) going back 41 years. The probability of making money in equities is not bad:

Overall History		
	Average Return:	12.0%
	Percent Up Yrs:	74.6%
	Percent Down Yrs:	25.4%
	Average Up Yr:	21.3%
	Average Down Yr:	-15.2%

Since 1980	Dow	S&P 500
Average Annual Total Return	13.7%	13.6%
Up Years	35	35
Down Years	7	7
Average Up Year	18.3%	19.0%
Average Down Year	-9.2%	-13.2%

Still, there is risk, and unless one is willing to take this risk and be 100% exposed to equities, then one can mitigate this risk by holding cash rather than some bonds or alternatives, and hence our allocation to cash.

Bits and pieces

On a lighter note, three graphics got our attention this week.

The first (from Statista) shows that having a strong password is actually much safer and not that difficult to do. Keep in mind that it has to be reasonably long (11-12 characters), and include a capital letter, a number and a symbol. Simple as that.

How Safe Is Your Password?

@SoberLook

Time it would take a computer to crack a password with the following parameters

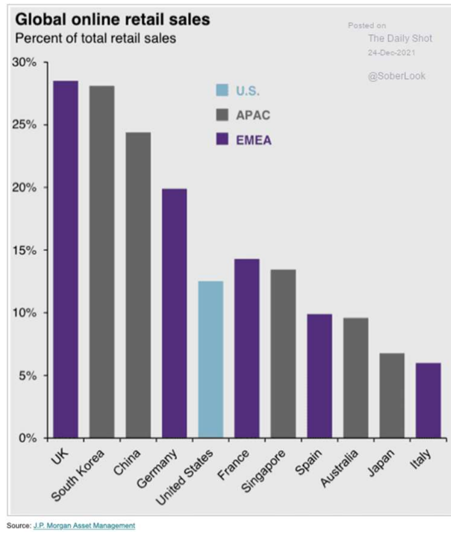
Number of characters	Lowercase letters only	At least one uppercase letter	At least one uppercase letter +number	At least one uppercase letter +number+symbol
1	Instantly	Instantly	-	-
2	Instantly	Instantly	Instantly	-
3	Instantly	Instantly	Instantly	Instantly
4	Instantly	Instantly	Instantly	Instantly
5	Instantly	Instantly	Instantly	Instantly
6	Instantly	Instantly	Instantly	Instantly
7	Instantly	Instantly	1 min	6 min
8	Instantly	22 min	1 hrs	8 hrs
9	2 min	19 hrs	3 days	3 wks
10	1 hrs	1 mths	7 mths	5 yrs
11	1 day	5 yrs	41 yrs	400 yrs
12	3 wks	300 yrs	2,000 yrs	34,000 yrs

Source: Security.org

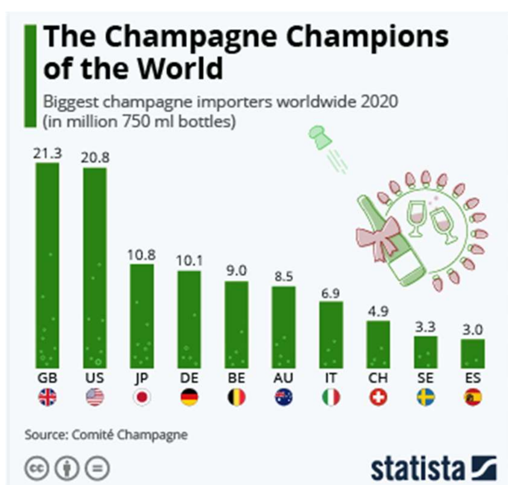
statista

The second (from JP Morgan) shows the percentage of retail sales that are online. We were surprised at the low(ish) levels in some countries. So there is a lot of upside potential.

Time to buy more Amazon stock?



The third (also from Statista) shows that Belgians not only have a good taste in chocolate and beer, but they love Champagne. Go Belgium! Only the French drink more Champagne per capita than Belgium…



We wish you all a happy and healty 2022!

The Elgin Team

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