Monthly Commentary 2nd of August 2022

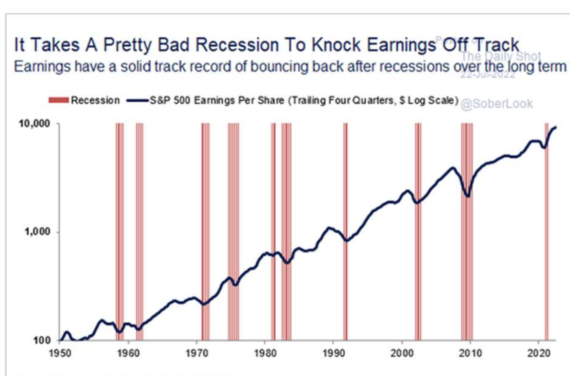
It was a very good month in financial markets as both equities and bonds rallied. The US market was especially strong with a gain of more than 9%, while Europe was not far behind. Only emerging market equities fell, perhaps weighed down by the strong dollar, which rose 1.1% to a 20-yr high. Bonds were also very strong, with the global index rising 2.55%, while credit was even stronger with 4-7% gains! Commodities were flat, mainly due to the 6.75% drop in oil prices. Bitcoin roared back with a gain of more than 27%, confirming its correlation with risk.

Can the rally continue?

Perhaps. Sentiment has been very weak and many sentiment indicators like Bank of America's reliable "Sell Side Indicator" point to 14% returns over the next 12 months. Investor positioning, with historically high levels of cash also point to a rebound in markets. Others, like JP Morgan strategists are looking at valuations, that have come down a lot, to justify more optimism. They say that they look "better than fairly valued". For example, in the US, the Price-to-Earnings (P/E) ratio has fallen from 27 to 18, and in Europe, the drop has been even more dramatic, falling from almost 24 to 12.5.

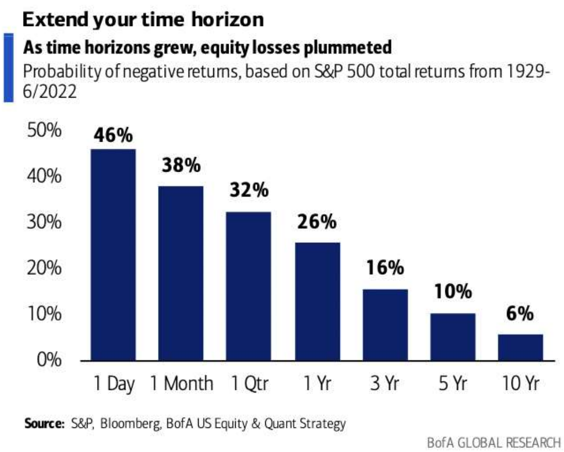
On the other hand, there are multiple reasons to believe that July was just a reprieve in an ongoing bear market. After all, inflation is still very high and Central Banks have pledged all that it takes to defeat it. This means they will likely continue their aggressive rate hikes, and most pundits see this as a sure route to recession. And we all know that recessions are not good for markets. They cause corporate earnings to decrease, which would make the "E" in the P/E ratios higher, so the low ratios we mentioned above would not look as flattering anymore.

Almost all the financial news we read is negative and most financial commentators are expecting further drops in the markets. We are certainly aware of the dangers. At the same time, we are sticking to our belief that we cannot time the markets and that in the long term, rising corporate earnings lead to higher stock prices. See chart below from LPL:



At today's valuations, Merrill Lynch have revised their expected 10-yr annualized total returns (price plus dividends) from close to zero, last December, to 6-7% for the next 10 years. Not that bad!

Also from Merrill, one should remember that it's "time IN the markets". The two charts below show quite clearly that not only should investors have patience by being invested over long periods of time, but that trying to time the markets would result in huge opportunity costs.



Avoid panic-selling

Market timing can lead to missing out on the best days

S&P 500 returns by decade excluding the 10 best and 10 worst days, as of 7/12/2022

Decade	Price return	Excluding best 10d per decade	Excluding worst 10d per decade	Excluding best/worst 10d per decade
1930	-42%	-79%	39%	-50%
1940	35%	-14%	136%	51%
1950	257%	167%	425%	293%
1960	54%	14%	107%	54%
1970	17%	-20%	59%	8%
1980	227%	108%	572%	328%
1990	316%	186%	526%	330%
2000	-24%	-62%	57%	-21%
2010	190%	95%	351%	203%
2020	18%	-33%	126%	28%
Since 1930	**17,703%**	**28%**	**3,811,434%**	**27,340%**

Source: S&P, BofA US Equity & Quant Strategy

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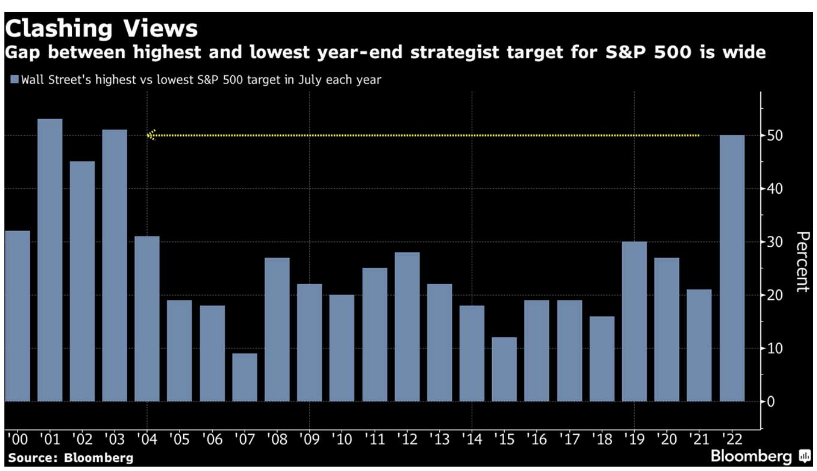
If anything, last month was a reminder that we should stay invested. Had we sold everything and held cash on June 30th, we would have missed the massive rally in July. Yes, portfolios have a way to go to recover their year-to-date losses, but we are confident that long-term quality holdings will eventually come back and start making money. After all, as per the chart on the left (above), the probability of negative returns falls dramatically the longer you are invested.

What is impossible to predict is the market's short-term direction. There has not been a larger discrepancy in forecasts since 2002. See below.



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