Monthly Commentary 1st of November 2022

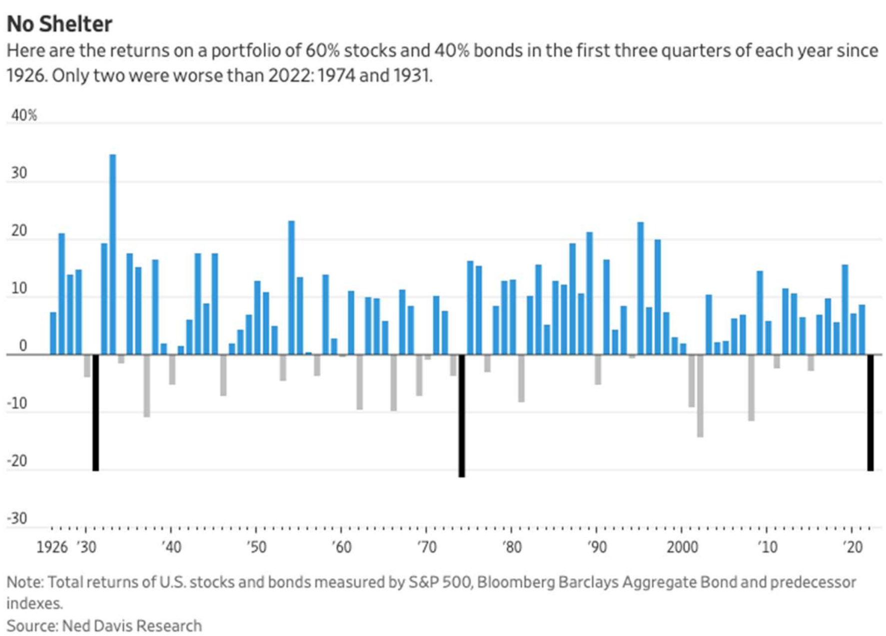
October was a good month as markets bounced back from deeply oversold conditions. Global equities, led by the US were up 6%. Ironically EM equities bucked the trend and fell almost 3%. Bonds were mixed with US Treasuries falling and Gilts rising. The USD gave back some of its incredible YTD gains. Commodities bounced back, with crude oil up almost 9%. Bitcoin was up 5%.

Is this the beginning of the end?

If one was to read most market commentaries and expert opinion, this bounce is yet another fake that draws in investors only to punish them down the road. The thinking is that *as the bad macro and geopolitical news keeps getting worse, we cannot possibly have a market that will move in any other direction than down*. There is certainly a lot of bad news. What we do not know is how much of it is priced in the markets. We can argue that the news this month is even worse than last month. So we could have bailed out last month. But had we sold, we would have missed considerable upside and basically crystallized the losses. We still maintain that being in the market will pay off, even if it takes a bit longer to reach and then exceed the previous highs.

How bad has it been?

The graphic below from Ned David says it all. A basic 60% equity and 40% bond portfolio has had torrid returns in the first 9 months of this year. In fact, it's been among the worst returns of the last 100 years.



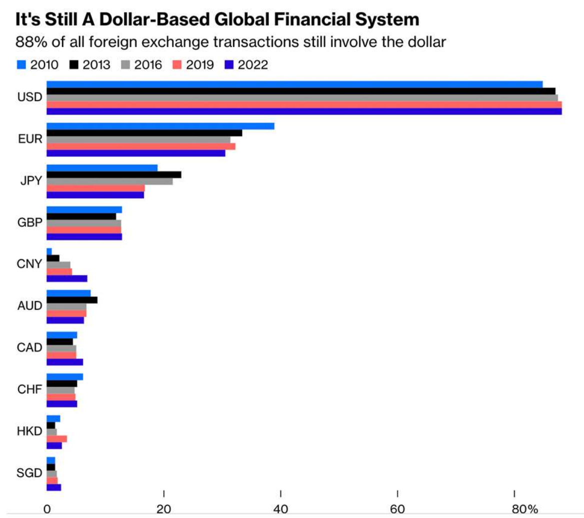
What gives us comfort? That the blue lines are far more plentiful than the grey or black ones. So the odds are with those investors that stick to being invested…

A small Forex primer

We are often asked where different currencies might go and we always reply by saying we really have no idea. There is a lot of data available but while it is possible to make reasonable arguments that point to one level or another, in practice it is all but impossible to make heads or tails.

Below are some tidbits about this market

1. It is by far the biggest trading market in the world, with almost $2,000 trillion being traded every year. To put things in perspective, the World's GDP is "only" $100 trillion.
2. The USD dominates, with almost 90% of the volume (source John Authers, Bloomberg):



3. London is by far the most important financial center for forex trading, with about 40% of total volume, with the US a distant second with half of that.
4. We have access to the forecasts of dozens of foreign exchange strategist at major banks. As of today their forecasts for major currency pairs are the following:

Contributor: Bloomberg Composite | Region: G10 | As of 11/01/22

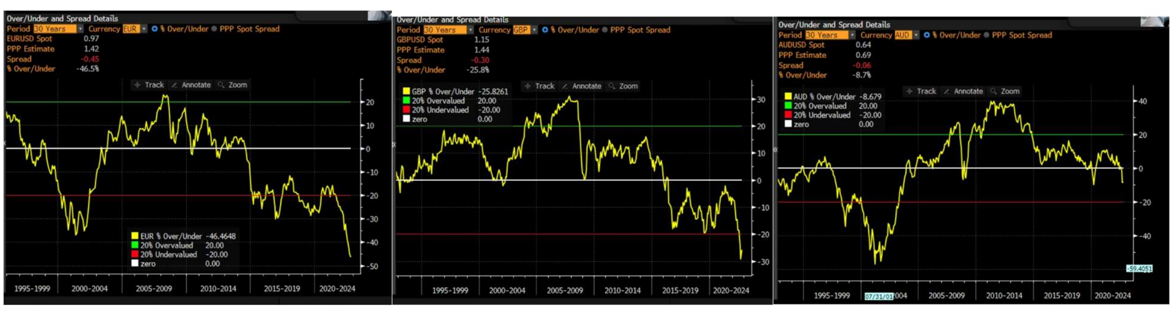
	Spot	Q4 22	Q1 23	Q2 23	Q3 23	2023	2024	2025	2026
11) Euro	EURUSD								
Forecast		.97	.98	1.00	1.03	1.05	1.09	1.12	1.10
Forward	.99	.99	1.00	1.01	1.01	1.02	1.04	1.05	1.06
12) Japanese Yen	USDJPY								
Forecast		145	142	139	135	135	123	119	120
Forward	149	147	146	144	142	140	133	128	122
13) Japanese Yen	EURJPY								
Forecast		141	140	140	141	140	132	132	131
Forward	147	147	146	145	143	142	138	134	130
14) British Pound	GBPUSD								
Forecast		1.10	1.10	1.12	1.15	1.17	1.22	1.25	1.28
Forward	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.15	1.15
15) British Pound	EURGBP								
Forecast		.88	.89	.88	.88	.88	.89	.94	.91
Forward	.86	.86	.86	.87	.87	.88	.90	.91	.92
16) Swiss Franc	USDCHF								
Forecast		.99	.99	.98	.97	.96	.95	.93	.95
Forward	1.00	.99	.98	.97	.96	.95	.92	.90	.88
17) Swiss Franc	EURCHF								
Forecast		.96	.97	.98	.99	1.00	1.05	1.03	1.04
Forward	.99	.99	.98	.98	.97	.97	.96	.95	.94

We can look back a year to see what these same strategists were forecasting a year ago. As you can see, it's a much different picture. For example, on November 1st, 2021 they predicted that EURUSD would be at 1.17 at the end of September of 2022, but the actual level was 0.98. A rather huge miss. Even the biggest euro pessimists predicted 1.10…

Contributor Bloomberg Composite | Region G10 | As of 11/01/21

		Spot	Q4 21	Q1 22	Q2 22	Q3 22	2022	2023	2024	2025
11)	Euro	EURUSD								
	Forecast		1.16	1.16	1.17	1.17	1.17	1.18	1.20	1.21
	Forward	1.16	1.16	1.16	1.17	1.17	1.17	1.19	1.21	1.23
12)	Japanese Yen	USDJPY								
	Forecast		112	112	112	113	112	113	114	115
	Forward	114	114	114	114	114	113	112	109	107
13)	Japanese Yen	EURJPY								
	Forecast		130	131	132	132	132	133	131	131
	Forward	132	132	133	133	133	133	133	132	131
14)	British Pound	GBPUSD								
	Forecast		1.37	1.37	1.39	1.40	1.40	1.42	1.40	1.40
	Forward	1.37	1.37	1.37	1.36	1.36	1.36	1.36	1.36	1.37
15)	British Pound	EURGBP								
	Forecast		.85	.85	.85	.85	.84	.83	.85	.85
	Forward	.85	.85	.85	.85	.86	.86	.88	.89	.90
16)	Swiss Franc	USDCHF								
	Forecast		.93	.94	.94	.94	.94	.94	.93	.96
	Forward	.91	.91	.91	.90	.90	.90	.89	.87	.86
17)	Swiss Franc	EURCHF								
	Forecast		1.08	1.09	1.10	1.10	1.12	1.11	1.10	1.08
	Forward	1.06	1.06	1.05	1.05	1.05	1.05	1.05	1.05	1.05

5. One way of judging if a currency is overvalued or undervalued is to look at its Purchasing Power Parity (PPP), which is published by the OECD. The PPP is supposed to be the "real" value of a currency when one considers the purchasing power of various goods and services around the world. Below are three currencies (EUR, GBP, AUD) versus the USD, and what their actual value has been vs their PPP's over the last 30 years.



Currently all three are undervalued by various amounts (EUR by 46%, GBP by 26% and AUD by 9%). So one could conclude that over a 2-3 year horizon, one could do worse than selling USD and buying EUR and GBP.

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