Monthly Commentary 3rd January 2023

December was a difficult month as world equities fell almost 5%, with the US and Japanese indices down even more. Bonds were also hit, especially in Europe and the UK. Commodities were largely flat except for precious metals, which rallied as the USD index gave back more than 2% - a large move by forex standards. Bitcoin fell "only" 3% but a not insignificant 64% for the year.

2022 was not a good year

The world witnessed a blatant war of aggression and brutality by Russia, the return of double-digit inflation in the west after many decades, and a worsening global economy. Financial markets fell hard, knocking a typical 60-40 equity-bond portfolio by almost a fifth. There were not many places to hide. Even commodities that, on aggregate, were up about 15% for the year had all that gain occurring in only the first two months of 2022.

What will markets do in 2023?

We'll start with quoting Bloomberg:

"To kickstart the new year, Bloomberg News has gathered more than 500 calls from Wall Street's army of strategists to paint the investing landscape ahead. And upbeat forecasts are hard to find, threatening fresh pain for investors who've just endured the great crash of 2022.

It may be one of the most anticipated recessions of all time, but that doesn't mean it won't hurt.

Barclays Capital Inc. says 2023 will go down as one of the worst for the world economy in four decades. Ned Davis Research Inc. puts the odds of a severe global downturn at 65%. Fidelity International reckons a hard landing looks unavoidable..."

And they go on to list 131 pages of forecasts on everything from global growth to inflation to valuations to interest rates to earnings growth etc. Ironically most firms did not even bother prognosticating the fate of Crypto (is this yet another contrarian call?).

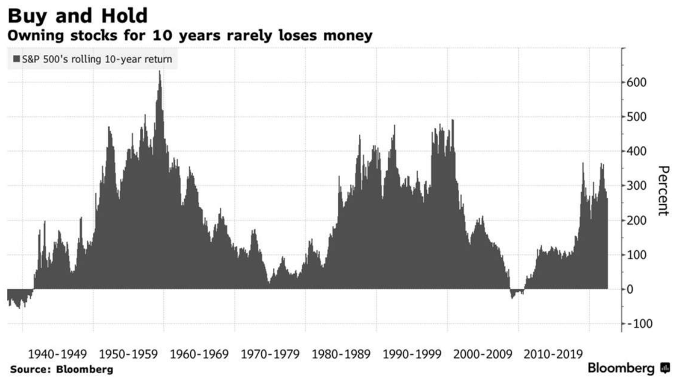
So, there is a prevailing consensus on Wall Street that the first half of the year will be "bad for markets and the second half much better", with broad indices largely ending up where they started.

The main argument in favour of such a scenario is that major central banks will keep tightening and thus drive the global economy into a recession. Most economists expect a deep or shallow recession, but almost none of them are expecting a soft landing. Though not often, sometimes consensus is correct, and we would not be surprised if this scenario plays out. On the other hand, markets almost never care about the logical arguments made by strategists and tend to do the unexpected, as if they want to confound most expectations.

What we do know is that equity valuations have come down considerably and it would be a fool's errand to wait for them to bottom before one starts buying. As Jim Fullerton, the ex-chairman of Capital Group said in 1974, in the midst of a bear market:

"Some people say they want to wait for a clearer view of the future. But when the future is again clear, the present bargains will have vanished. In fact, does anyone think that today's prices will prevail once full confidence has been restored?"

In making investment decisions, one should keep in mind the below graphic from Bloomberg that shows that owning US stocks for a decade is almost always a winning strategy.



We believe that a well-diversified portfolio that invests in high quality securities should do well over the years, and the above chart corroborates this. On the other hand, speculating or choosing narrow themes has almost always ended badly. One such recent example is Cathie Wood's Ark funds that became an investing sensation because of her strong convictions that innovative growth companies were poised to deliver 20% annual returns for years to come. It seemed not to matter if these companies were not necessarily profitable. The chart below from the FT and Morningstar shows that Ark's assets under management fell from a peak of $60 billion in early 2021 to just over 10 billion last week.

What is striking is that much of this loss in assets was due to market movements and not so much to investor flows. That hurts and is a good reminder not to bet too much on fads. Of course, Ark's funds might come back in a big way, but for anyone who invested near the top, it might take many years to recoup their capital.

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