Monthly Commentary 3rd of October 2022

September was a HORRIBLE month for financial markets across the board. World equities fell about 9%, with the US and emerging markets leading the way down. We wouldn't be exaggerating to say that bonds crashed, falling between 3.5% (US Treasuries) and 8.9% (UK Gilts and corporates). These are monumental moves. Commodities, as a whole, fell 7.6%, with crude oil down 11%. Major currencies such as the euro, pound sterling, yen and yuan tumbled versus the US dollar which soared more than 3%. Surprisingly, bitcoin was the cleanest dirty shirt, falling only 3.9%.

Nowhere to hide

As much as it hurts, we shall repeat this heading. There was nowhere to hide as all asset classes tumbled. To say this has been a challenging year in the financial markets would be a gross understatement. Unfortunately, while every manager preaches its merits, there have been few benefits from diversification this year. Even commodities are down 30% from their March highs.

Below we address three major questions in order to preempt our clients from asking them.

1. Why has this happened?

It's very hard, if not impossible, to identify THE cause but some combination of the US central bank, (the Fed) misreading the stickiness of inflation, China's policies around Zero Covid and the effect that has had on the supply chain, and the war between Russia and the Ukraine all seem to have a hand in this downturn. These issues have contributed to the rapid rise in inflation over the past year. Inflation brings fear that the Fed keeps raising rates and to that end, the market has become obsessed with the path and level of these rates.

2. Why had we not sold everything before the drops at the turn of the year?

This is the question we have answered the most times over the years in these newsletters. Let's start by saying that not selling everything is based on the collective experience of past market cycles. It is coupled with the knowledge that trying to time the markets by attempting to sell on the way down and attempting to buy on the way up is a sure recipe for poorer long-term returns. Markets have always had risk and volatility and that is why we always ask clients what their tolerance for risk is – both at onset and once a year thereafter. Also, unless a client specifically asks us to lower or increase their tolerance to risk, we shall not sell or buy just because we think the markets will fall or rise. If there is no tolerance for risk, then one would not invest in markets at all.

Below are some facts that corroborate why we did not sell everything, knowing full well that most serious managers worldwide have not either:

- The next time the market goes down and doesn't recover **will be the first time**.
- The market falls 20% every 2-3 years and has always recovered.
- The market is up 70% of the time – so odds are on the investor's side.
- There have been 19 bear markets in the last 140 years and the average lasts 290 days.

- Buying assets at a lower price is better than at a higher price.

So the market has always found a way to recover. We see no reason this time will be different.

Note that pension funds, that account for almost 2/3rds of the market know this. That is why they are not selling, unlike many individual investors who tend to sell during crises. This is the main reason individual investors' have much poorer returns than pension funds over time.

The graph below shows the multiple crises that have occurred in the last 35 years, and yet, world equities somehow managed to overcome each one. So we suggest zooming out and seeing the markets with the right perspective and not with one-year blinkers.

3. What do we do now?

Markets don't trade on "good" or "bad" but they react to "better" or "worse". It might be helpful to start thinking about *what happens to the market if*:

- Inflation numbers surprise lower
- The Federal Reserve indicates it won't raise rates as high as the public currently believes
- The consumer is better prepared for a recession than in past occurrences
- The war takes an unexpected positive turn

We certainly aren't predicting these but if one or some were to happen, it seems the market would have to reverse course to account for these positive outcomes. And if it's not any of these that will mark the beginning of the rebound, it will be something else. But as night follows day, this too shall pass, and it's better to be invested when the markets have bottomed, otherwise one would never participate. So while we have made or are making small changes (like buying short term bonds, not being overweight equities and being underweight fixed income), we have confidence that portfolios are well placed to partake in the rebound when it comes.

We are pleased to say that many clients have been adding cash to their portfolios as they know it will benefit them to buy while assets are hit.

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