Global Matters Weekly

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Upside Down

by Gary Moglione

One of my favourite TV shows is Stanger Things and this week marks the release of the much anticipate fourth season. For those who are unfamiliar with the show, it follows the adventures of a group of young friends as they battle with various creatures that enter our world through a portal into an alternate dimension, which they call the "upside down". Looking at markets right now feels like we may have slipped into some sort of alternative dimension...

If we review the market environment over the past ten years there is a very consistent backdrop in the form of:

- Falling interest rates
- Deflation concerns
- Bull market in risk assets
- Growth stocks outperforming value stocks
- Technology sector driving markets upwards
- Huge expansion in valuation multiples, particularly amongst the highest growth stocks
- High levels of speculation resulting in prices for assets such as cryptocurrency and non-fungible tokens (NFT) reaching extreme levels

It seems we entered the "upside down" sometime around the end of October 2021, the current environment is vastly different:

- Rising interest rates
- Inflation concerns
- Bear markets (NASDAQ is down 24% from peak, S&P 500 teetering on the edge of one)
- Value outperforming growth
- Technology sector pulling markets downwards
- Valuation discipline is increasing as multiples contract, particularly amongst the most expensive stocks
- Lower levels of speculative Investments causing a crash in value of assets such as cryptocurrency and NFT's

Effectively, the market environment we are now operating in is some sort of mirror image of the preceding ten years. Investors become conditioned by the environment they operate in, particularly when it has had such success and longevity. Many market participants under the age of 35 have only really witnessed one cycle.

Behaviourally we all take comfort from investing with the herd and find it much more palatable to make investments in assets that historically have performed well. As a result, many portfolios have become more and more skewed to assets supported by a falling interest rate environment. This has resulted in a massive allocation to growth and technology stocks with many portfolios ill-prepared for what has been a pretty sharp inflection point.

If you have not already reviewed your portfolio, then I suggest you do and continue to do so periodically. Ensure your investments have not become overly skewed towards the old environment. Many are not aware of bias in their portfolio when it is performing strongly and then are tempted to "buy the dip" when prices start to fall, compounding their losses. Check that you have plenty of diversification across asset classes, regions, market caps, sectors and styles. You are more likely to be light on value stocks and investments with inflation linkage. Liken it to packing your suitcase for a holiday: you will pack some swimsuits for the beach but you may need a raincoat if the weather turns. The same thought process should apply when constructing your portfolio. Looking through history these style cycles can last anything from 2 to 12 years so there is still time to acclimatise your portfolio.

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Important notes