Global Matters Weekly

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Belvest 研富

Divine inspiration

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The month of January takes its name from the Roman god Janus, whose two opposing faces depict duality and transition, endings, and new beginnings. This god of gateways looks both backward and forward, and if ever there was a January to excite him (he is generally depicted with a beard), then this is surely it. As he looks backward, then by any measure 2022 was a horror show for most investors, as it was in the real world for the many oppressed people around the world. The Great Rate Reset led to a sharp repricing for most financial assets, leaving few places to hide. Cash was king, and only really pockets of less directional alternative strategies and some commodities made any meaningful gains. Anyone wanting a quick lesson on how interest rate 'duration'[1] affects bond prices needs to look no further than the Austria 100 year 'century' bond (issued in June 2020) which fell 55%[2] in 2022. It would take 65 years collecting the €0.85 annual coupon to recoup that loss! In fact, since its €139.3 peak price in December 2020 it has fallen by a full €100, ending 2022 at €39.3[2]. That's a 72% decline in two years, not far off Tesla's 2022 calendar year performance I might add, demonstrating somewhat simplistically how growth stocks are long duration assets.

On a brighter and less Tyrolean note, and with Janus looking forward, 2023 presents us with a fuller palette of investment opportunities than we've seen for some years. Within fixed income, yields have risen so much that for the first time in a while, there is something of a buzz around the asset class. Of course, inflation is the root of all bond evils and inflation-adjusted yields are still firmly negative and real returns will only be forthcoming if inflation does fall back. Importantly though, higher yielding investment grade bonds once again provide some ballast in portfolios with scope for capital upside, something only possible in the negative yielding world when there was a 'greater fool' to sell to (who could usually be found, to be fair). On that point, last week we saw the stock of negative yielding debt fall back to zero for the first time since 2014 and whilst it's possible we flirt back into negative territory in the year ahead, the slow drain of liquidity from the financial system resulting from quantitative tightening will continue to exert an upward pressure on yields. A slam dunk year for bonds is far from guaranteed, but fixed income is just that and a very bad year like 2022 mathematically improves the following years' prospects.

Equities offer an attractive entry point after the pain of last year. In the UK, the main market trades on less than 10x next year's earnings (or greater than 10% earnings yield)[2]. The more discerning active buyer can pick up high-quality, dividend growing companies for even less. The growthier small-cap names trade at a similar valuation in aggregate and only twice in the last 30 years have they underperformed the blue-chip UK index by more than the 22% they trailed by last year. Other regions now offer similar value. US equities remain optically the most expensive market, although valuations have reverted considerably over the last year, and paying up a little for the quality and resilience of that market doesn't seem unreasonable. The question Janus needs to consider when assessing 2023 is whether the current implied earnings are fair, or risk falling short as the global economy slows, as is now widely expected. If the latter eventuates then the true (and trailing) earnings multiple will be higher, the earnings yield lower, and the relative attractiveness over now higher yielding corporate bonds – the equity risk premium – will be eroded. With corporate margins being squeezed, that is a valid concern and one reason why equities are not being hoovered up today, but the uncertainty is reflected in the price.

It is quite possible that the market lows are retested at some point this year, but as long-term investors we, like Janus, have to look further ahead than what lies immediately before us. If policy rates do top out in the summer this year, as is currently priced, then we could see risk appetite returning more quickly than one might otherwise expect. Equities typically bottom out before the real economic pain ends and the end of the hiking cycle is often a precursor to this. Having been positioned through most of 2022 with low bond exposure and higher allocations to real assets, alternatives, and cash, 2023 will hopefully present opportunities to recycle last year's relative winners into cheaper equities, credit, and more esoteric discounted investments that will lay the foundations for real compounded capital growth and income into the future. When Janus looks back on 2023 let's hope his face is smiling.

Sources
[1] Duration is the measure of a bond's price sensitivity to changes in interst rates
[2] Source: Bloomberg Finance L.P.

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