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Leaping over leap days

by Lorenzo La Posta, CFA

I joined the financial industry on 29 February 2016, precisely 8 years ago at the time of writing, and on a leap day! When you are a fresh financial engineering graduate like I was, you think everything moves according to formulas and all you need to beat financial markets is a bit of stochastic calculus and a couple of MATLAB libraries. I guess ingenuity and overconfidence are some of the things that make youth so much fun.

Back in 2016, global economies were recovering from the 2008 financial crisis, experiencing moderate growth and low inflation. Most central banks around the world were continuing the accommodative monetary policies that were established in the aftermath of the crisis (ECB and BoJ in particular, with their ultra-low rates and asset purchase programs) and the US Fed had only just started raising rates. Inflation was subdued in many advanced economies, despite efforts to stimulate inflationary pressures, and oil prices were relatively low compared to pre-2014 levels due to oversupply concerns. Overall, I would call it an unspectacular year from a financial perspective.

Instead, it was a year of political surprises, with the UK voting to leave the EU (remember when Brexit felt like something major?) and the US voting (unexpectedly) for Donald Trump as their new president. The first led to a significant market crash and doomed the British Pound to a new normal around multi-decade lows, whilst the second ended up being market friendly; with optimism about potential fiscal stimulus measures, deregulation, and tax reforms.

Rolling forward to the next leap day, 29 February 2020, we were at the start of the COVID-19 pandemic, hopefully a once-in-a-lifetime event that froze the world for a few months and forced a drastic and, in some instances, permanent change to the way we go about our lives. In the space of four weeks, global equity markets fell by about 34% and governments and central banks stepped in with a bout of monetary and fiscal interventions to help global economies out of the crisis, effectively nullifying (and more) all efforts at lowering public debt levels and increasing interest rates that had been done over the previous few years.

Certainly, that did help asset prices, but it set the basis for the inflationary wave and subsequent monetary tightening cycle of 2022-23, the sharpest and strongest that the world has seen since the late 70s and early 80s. This, at least, was in fact a spectacular time for financial markets.

As of today, markets have normalised, inflation is falling back to long-term averages, interest rates are expected to come down to more comfortable levels, most economies are in decent conditions and consumer sentiment is good. We do have our good share of questions: the future of China; the durability of this equity rally we're witnessing; the impact of artificial intelligence on earnings; the maturity of the credit cycle; the path of multi-asset investing etc… but as much as the world is always throwing (financial) curveballs at you, I do feel more relaxed than four years ago. At least, now I can again hug my friends without a face mask!

So, what have I learnt over the past eight years you may ask? That the less you know, the more you think you know. That sometimes things can take a U-turn without you even realising, and other times things won't change, no matter how much you expect them to. That technology can both be an enabler and an obstacle to business practices. That central bankers have behavioural biases as much as everybody else. That Brownian motions are better suited at modelling physics than equity returns, and that MATLAB is unnecessarily expensive, R or Python are better value for money. And that at the next leap day I will probably be writing about some new market dynamic that at the same time has echoes of the past.

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