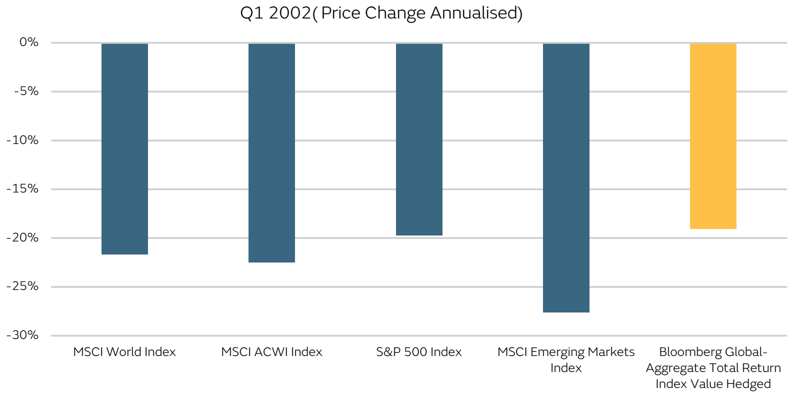
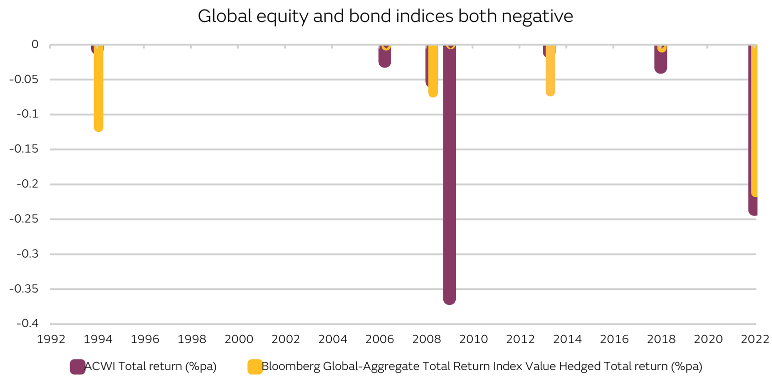
April 2022: turmoil

Last December we wrote “we don’t know where we are headed in 2022”. Indeed we didn’t, but the tendency of unforeseen outcomes to cause a focus on the short term requires us to remember long term investment objectives.

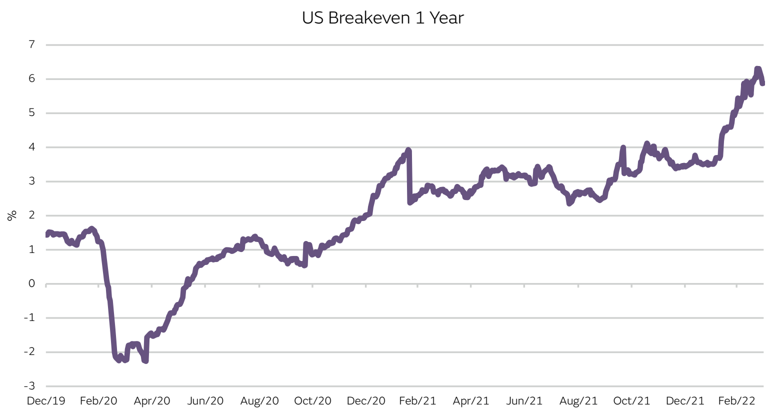
All markets were down in the first quarter, and down sharply.



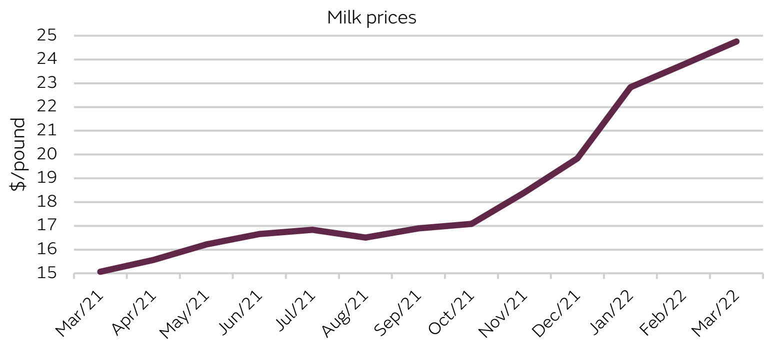
For all markets to be down is very rare. In the last thirty years, global equity and bond indices have had coincident negative quarterly total returns only 7 times.



Of those 7 times, 2 stand out: the 2008 financial crisis and the first quarter of 2022. Both were unforeseen and for both, multiple factors were at play. In Q1 2022 these factors include war, rising rates, policy responses (or lack thereof), a lingering global pandemic, supply chain disorder, depreciating cash, and inflation. The inflation story is playing out in financial markets where the 1 year Treasury breakeven rate is just shy of 6%, up sharply from negative levels at the beginning of the pandemic.

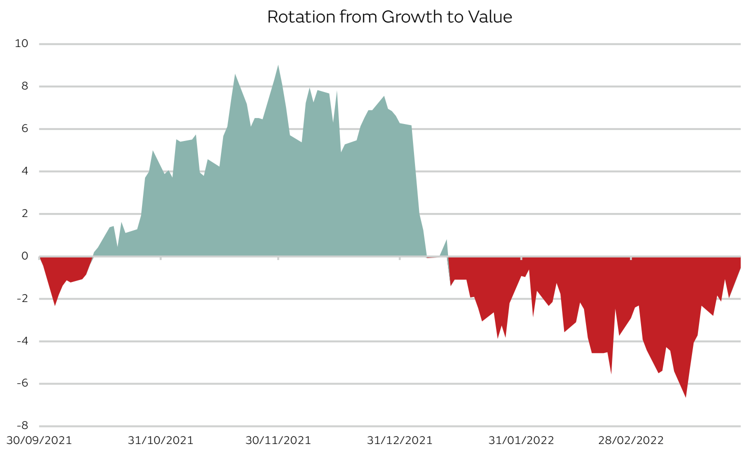


Meanwhile (in the real world) prices seen by consumers look out of control. Milk prices are up 64% since this time last year.



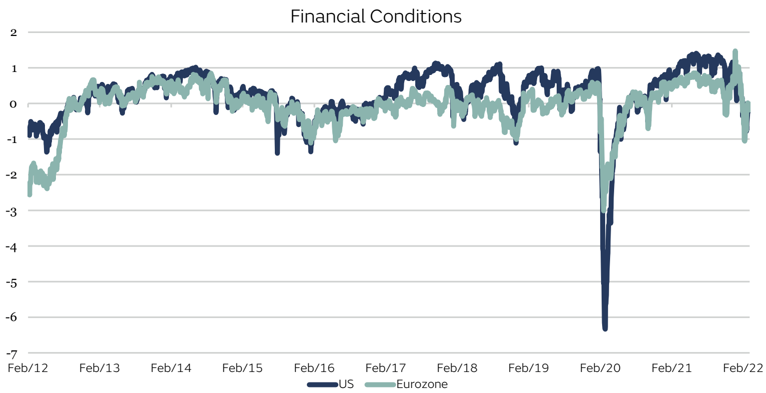
Source: United States Department of Agriculture

Market reaction to all these adverse factors has not just been downward but, as to be expected, we have seen significant rotation during this quarter away from favored growth sectors and to the safer harbour of value.



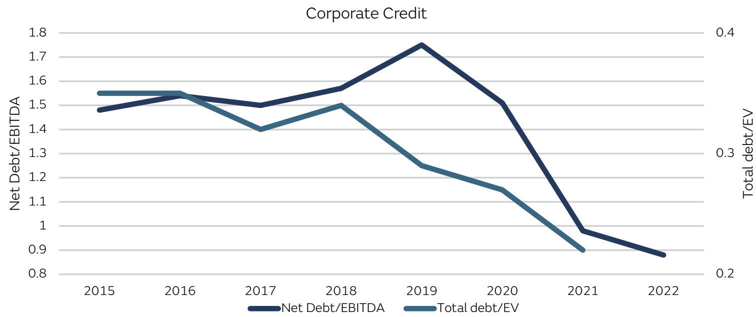
Source: Spread of iShares Factors US Growth over iShares Factors Value, via Bloomberg

The turmoil has not yet hit corporate performance but as financial conditions move negative (i.e. tighter) in the US and Europe, the corporate earnings season will be a key factor for the balance of the year.



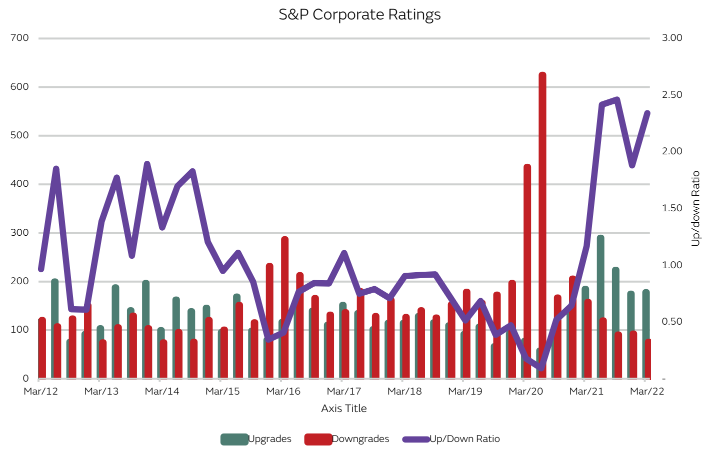
Source: Bloomberg Financial Conditions Index

Of comfort to investors is the fact that credit quality is generally in the ascendant and represents a significant potential offset to adversity. S&P 500 corporate leverage (net debt to EBITDA and total debt to EV) is at its lowest for several years.



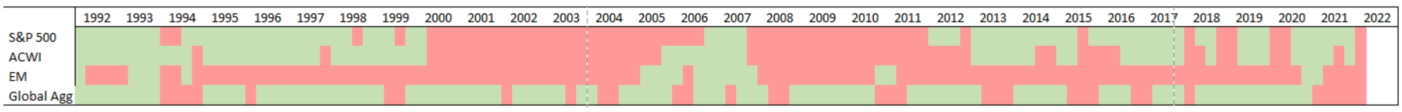
Source: Bloomberg

These credit metrics are reflected in the Standard & Poor's up/down ratio for US corporate credit ratings at its highest in 10 years.



Source: S&P Global Ratings via Bloomberg

We don't know how long the turmoil will last but we do know that time to recover from turmoil has been longer for equity markets than bond markets over the last 30 years.



Source: GIBAM analysis, (red is period of time to recover to prior levels)

All of this suggests looking across all markets (equities and fixed income) and finding resilient and well-run companies exposed to long term themes in which to invest. Happy hunting!

Feel free to contact us at info@gibam.com.