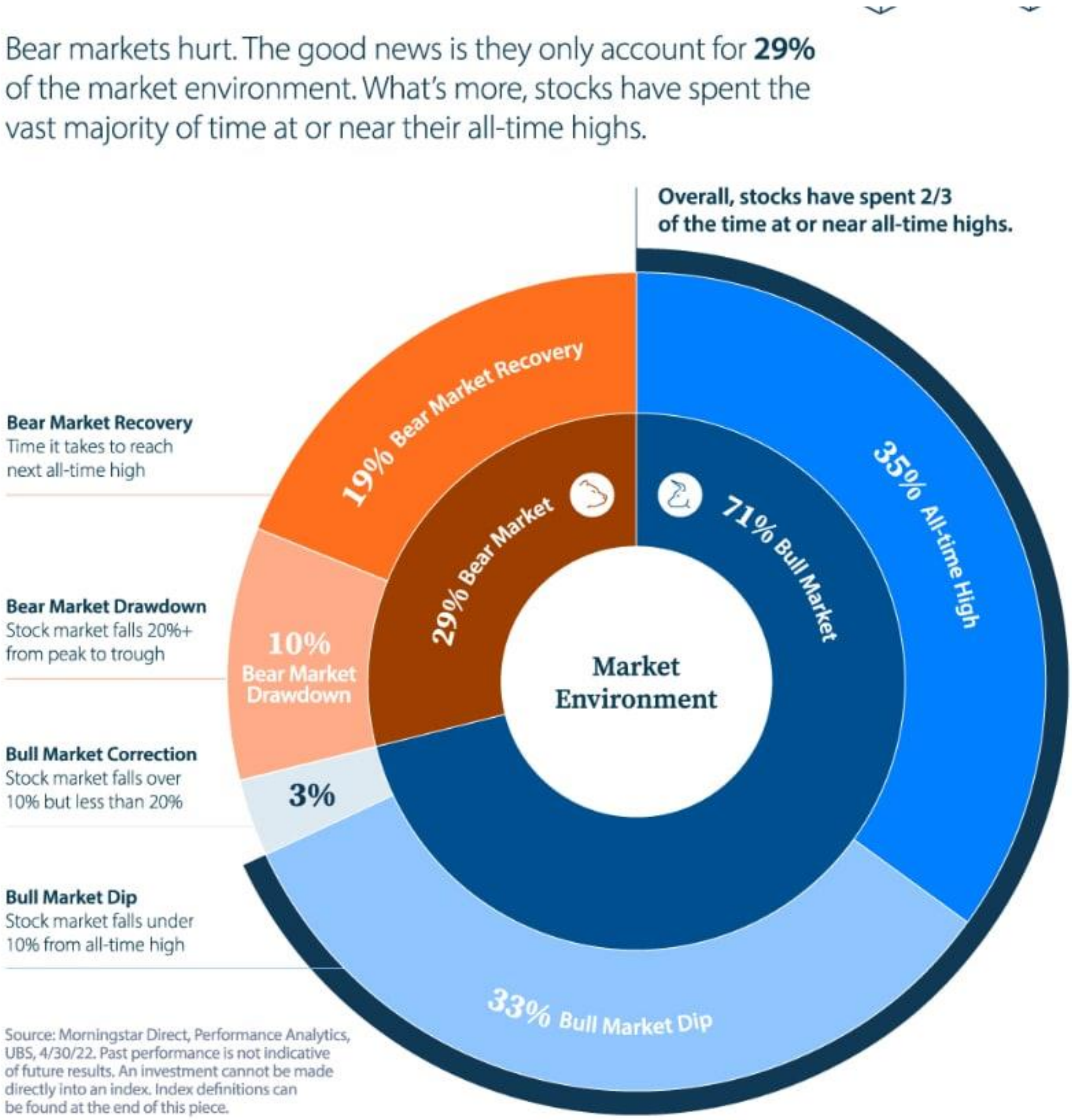
19 October 2022

Overview

Phew – I may be smiling in the picture but how annoying that so many people will see their mortgages shoot up.

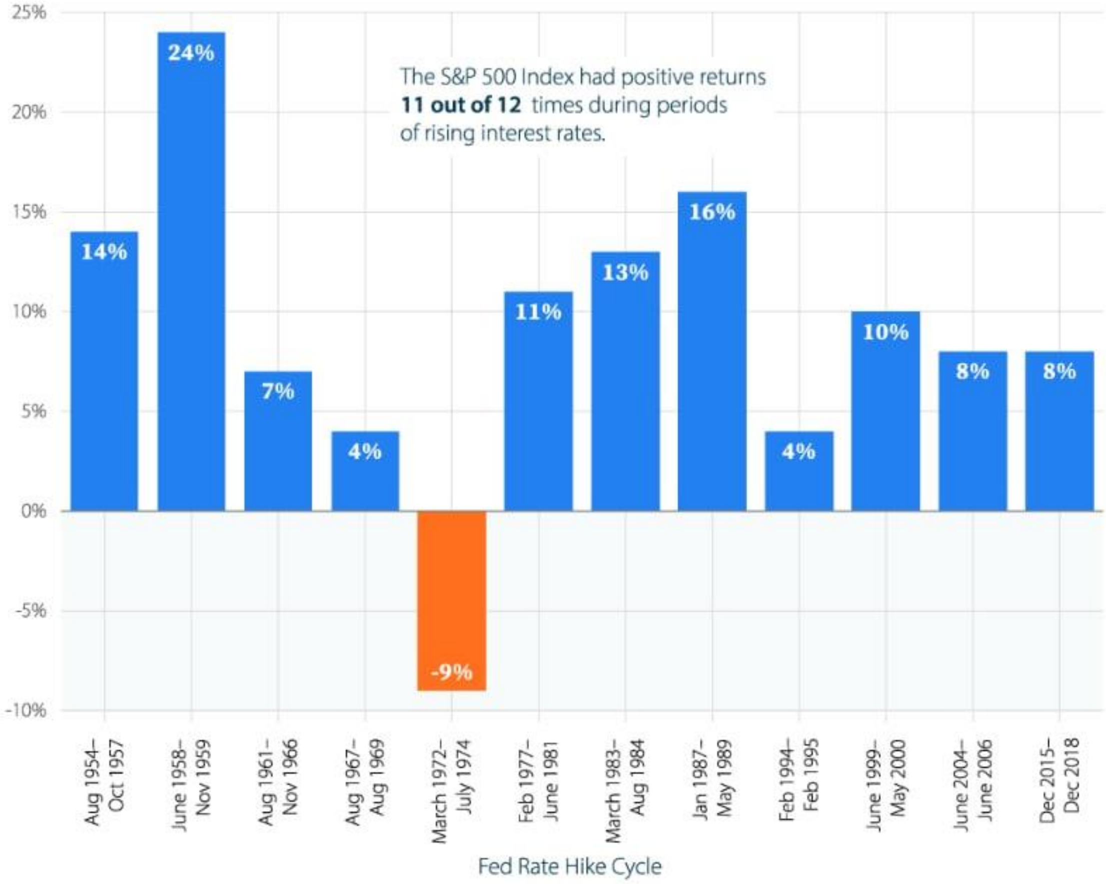
In this newsletter I will both explain in simple terms what is going on and where the opportunities lie in stocks, commodities and ETFs.

First the good news. Bear markets do not last very long as you can see from the image below. Also, they are generally infrequent. Well, we care more about now than what happened in the past. But that is good to know.



And here is some more important good news. The markets tend to do well even in rising rate environments. It's why you will read more about why those holding a lot of cash will be getting ready to take out the odd stock here and there. I'll investigate these below too.

S&P 500 Index Annualized Total Return



Sources: Morningstar, Haver Analytics, March 2022.
Past performance is not indicative of future results.
An investment cannot be made directly into an index.
Index definitions can be found at the end of this piece.

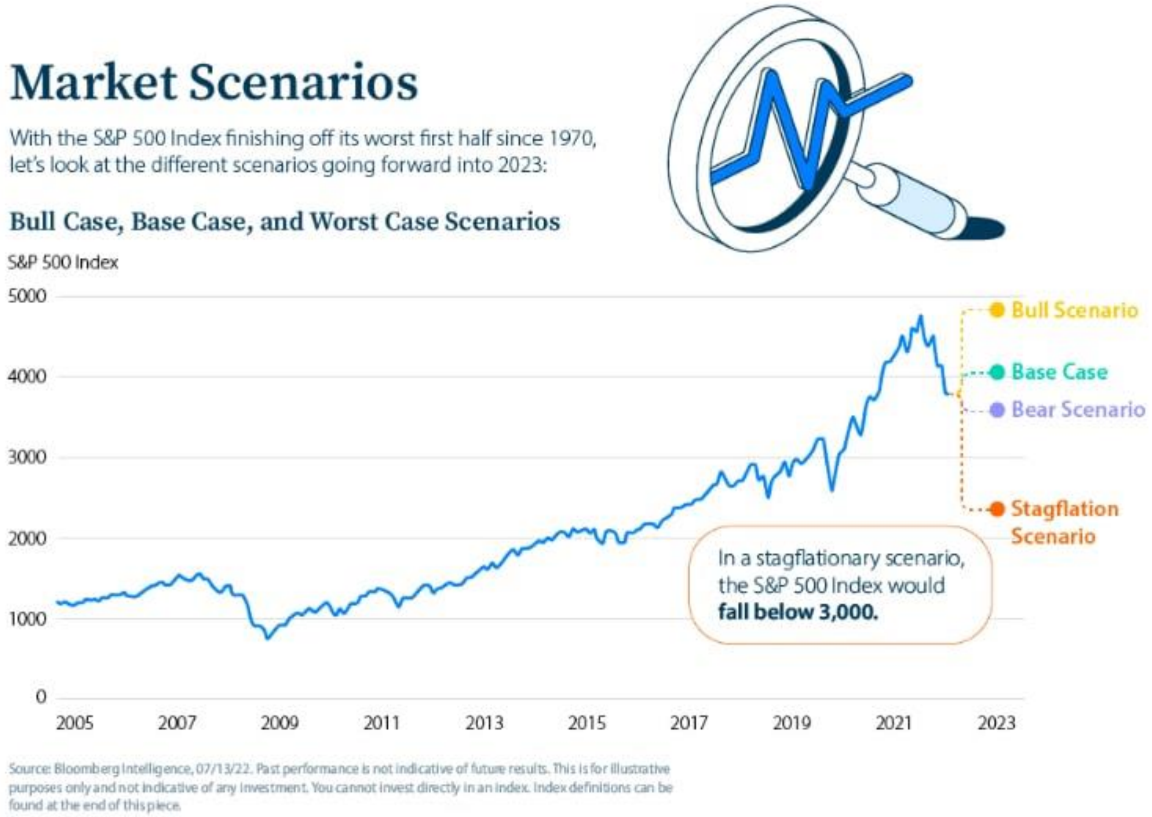
Market Environment	Description	% of Time in Market Environment
All-Time High	Stock market hits all-time high	35%
Bull Market Dip	Stock market falls under 10% from all-time high	33%
Bull Market Correction	Stock market falls over 10% but less than 20% from all-time high	3%
Bear Market Drawdown	Stock market falls over 20% from peak to trough	10%
Bear Market Recovery	Time it takes to reach next all-time high	19%

Source: Morningstar Direct, PerformanceAnalytics, UBS 4/30/2022. Based on monthly returns from 1945.

Fed Rate Hike Cycle	S&P 500 Index Annualized Total Return
Aug 1954 - Oct 1957	14%
Jun 1958 - Nov 1959	24%
Aug 1961 - Nov 1966	7%
Aug 1967 - Aug 1969	4%
Mar 1972 - Jul 1974	-9%
Feb 1977 - Jun 1981	11%
Mar 1983 - Aug 1984	13%
Jan 1987 - May 1989	16%
Feb 1994 - Feb 1995	4%
Jun 1999 - May 2000	10%
Jun 2004 - Jun 2006	8%
Dec 2015 - Dec 2018	8%

Source: Morningstar, Haver Analytics, March 2022

Analysts have a clever ‘out’ albeit an honest one. They will give a variety of scenarios and ask you to pick. Below is one such example. So, you have to pick. We don’t want to gamble unless it’s asymmetric. At the moment I cannot see any cause for a bull scenario. But it’s not a one way bet to the downside. You see asymmetric trades are worth it e.g. long GBPUSD (more on that shortly). Anything else is too much of a gamble.



Whilst I will keep an eye on consumer discretionary, I will pick based not just on momentum but as always value, growth, income, cashflow, sortino etc.

Consumer discretionary stocks cover non-essential items such as restaurants, hotels, and automobiles.

Consumer Sentiment Index Level	Historical Odds of Consumer Discretionary Outperformance (12-Month)
< 55	100%
< 65	74%
< 75	76%
> 95	50%

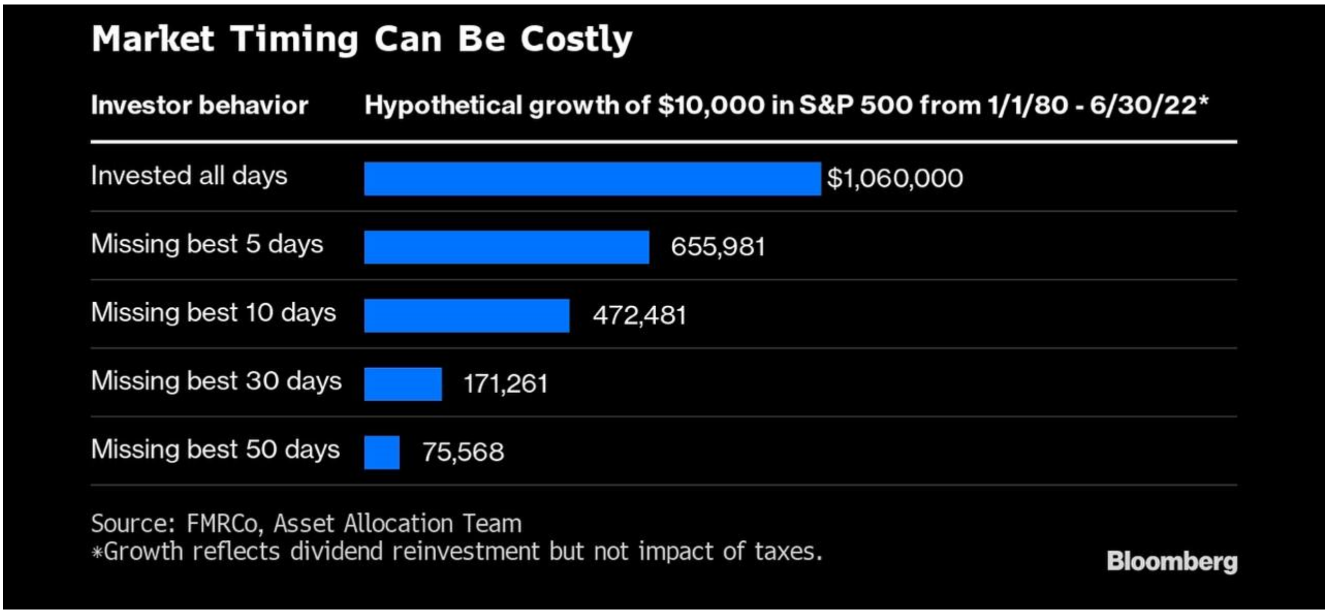
Given historical patterns, the consumer discretionary sector may be poised to accelerate over the next 12 months.

Are we in a recession yet? There is some talk the US already is. If this is the case then it's good for US stocks because of the data below. This is because the market anticipates and looks ahead.

Market Scenario	S&P 500 Index Cumulative Price Return During a Recession	Year
Worst Case	< -18%	2001
Base Case	16%	Average
Best Case	> 44%	2020

Historical data shows that on average, the S&P 500 Index has returned **16%** one year after the start of a recession.

I love these charts below about timing. The problem is no one ever misses one great day. They miss a bunch of bad ones too. But anyway, they always fascinate me because they also tell me how a few days make a big difference; in life and in the markets.



To perk you up some more I want to show you this image of bouncebacks. So again, it begs the question – are we on the cusp. I am watching closely with money ready to deploy. But still waiting.

S&P 500 returns after falling -20% from record high (since 1950)	6-months later	1-year later	2-years later	3-years later
10/21/57	9%	31%	46%	40%
5/28/62	11%	26%	45%	59%
8/29/66	18%	25%	36%	24%
1/29/70	-9%	11%	20%	38%
11/27/73	-9%	-27%	-6%	7%
2/22/82	1%	32%	40%	62%
10/19/87	15%	23%	48%	31%
3/12/01	-7%	-1%	-27%	-6%
7/9/08	-27%	-29%	-17%	6%
3/12/20	35%	59%	72%	
Average	**4%**	**15%**	**26%**	**29%**
% positive	**60%**	**70%**	**70%**	**89%**

Look what they did to my beautiful pound! I've been buying GBPUSD in small steps. I think it is a no brainer. I am not over-leveraged and have the liquidity to manage a fall to even £ to 60cents! And I am happy to hold my positions for years.

Inflation and Assets

I will examine commodities ETFs going forward in light of the data below. It is also heartening to see that stock dividends outweigh inflation.

Which asset classes have historically tended to perform well across different types of inflationary environments?

Average Real Annual Total Returns 1973-2021

	U.S. Equities	U.S. Treasuries	U.S. T-Bills	Commodities	Gold	REITs
Goldilocks	16.1%	4.3%	0.8%	0.4%	-2.5%	18.1%
Disinflation	8.4%	8.1%	1.7%	-5.6%	1.3%	3.5%
Reflation	14.6%	-2.0%	0.0%	21.0%	-1.1%	14.0%
Stagflation	-1.5%	0.6%	0.4%	15.0%	22.1%	6.5%

Both U.S. equities and Treasuries have shown the strongest real returns in deflationary periods.

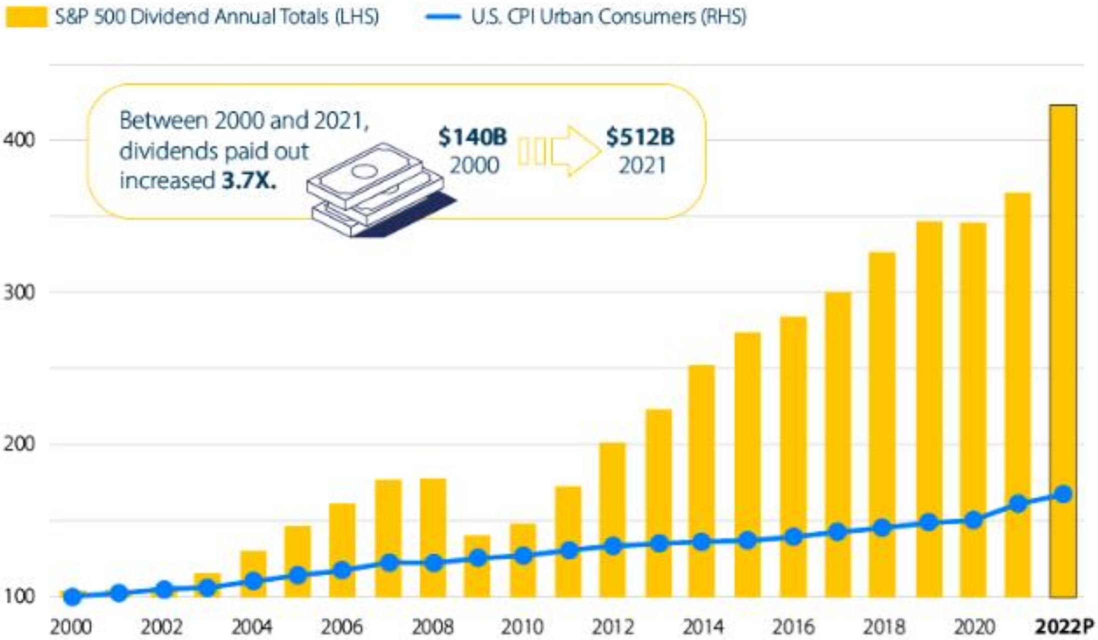
U.S. equities have typically performed well during moderate inflation.

Defensive assets like gold and commodities have historically performed well during stagflationary periods.

Source: Datastream Refinitiv and Schroders, 09/30/21. U.S. Equities are represented by the S&P 500 Index, U.S. Treasuries are represented by the Bloomberg U.S. Treasury Long Index, U.S. T-Bills are represented by the FTSE U.S. Domestic 3-Month T-Bill Index, Commodities are represented by the Bloomberg Commodity Index, Gold is represented by the Dow Jones Commodity Index Gold, REITS are represented by the FTSE Nareit All Equity REITs Index. Past performance is not indicative of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece.

Consider how S&P 500 Index dividends have performed against inflation over the last two decades:

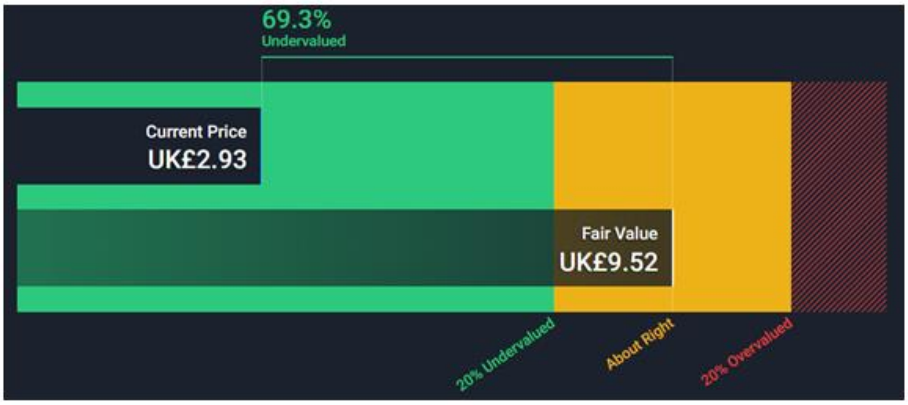
S&P 500 Dividend Growth Outpaces Inflation



Source: S&P Dow Jones Indices LLC, Bureau of Labor Statistics, 05/23/22. Past performance is not indicative of future results. You cannot invest directly in an index. Index definitions can be found at the end of this piece.

One Pick I Especially Like

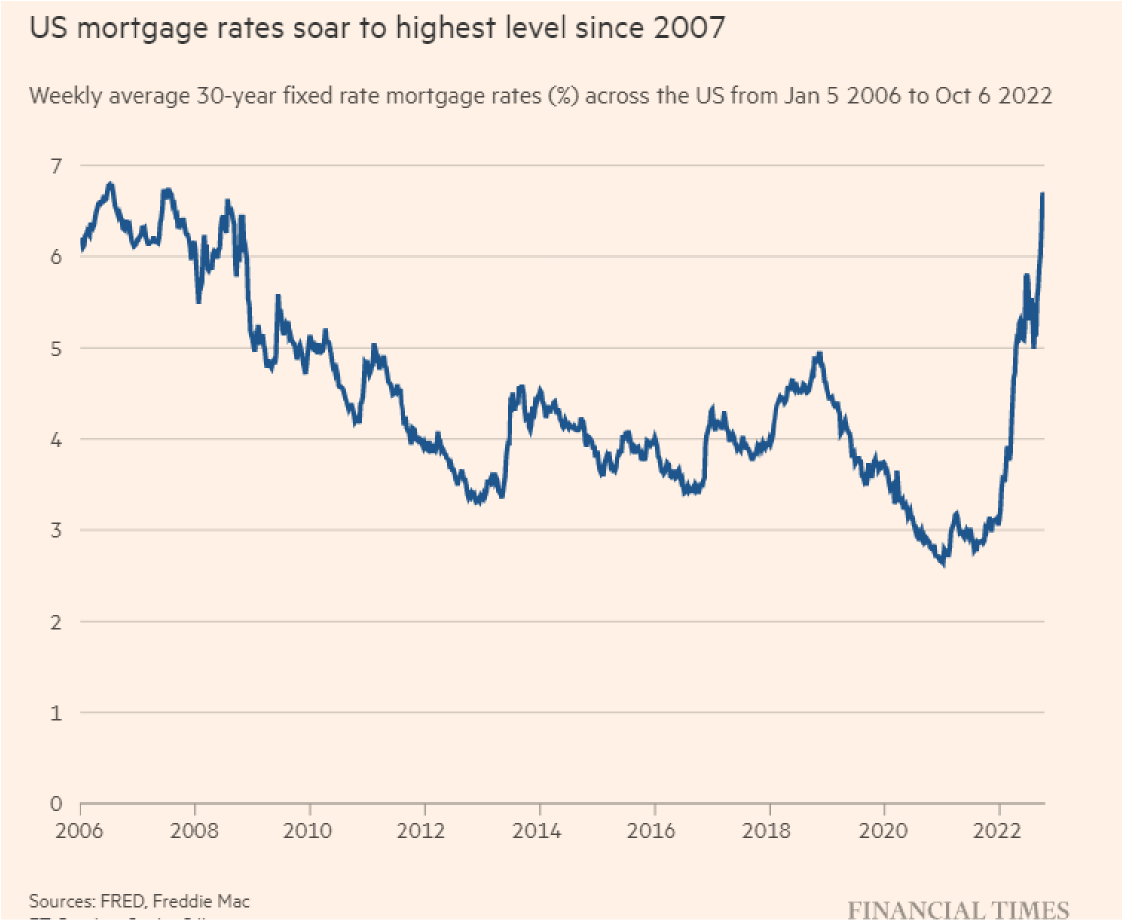
This on hit my Sharescope criteria on valuation, growth, income and more and also on discount cash flow valuation.



Braemar Shipping Services PLC

Misery Loves Company

US mortgage rates highest since 2007 and it’s not because Kwasi visited Washington last week.

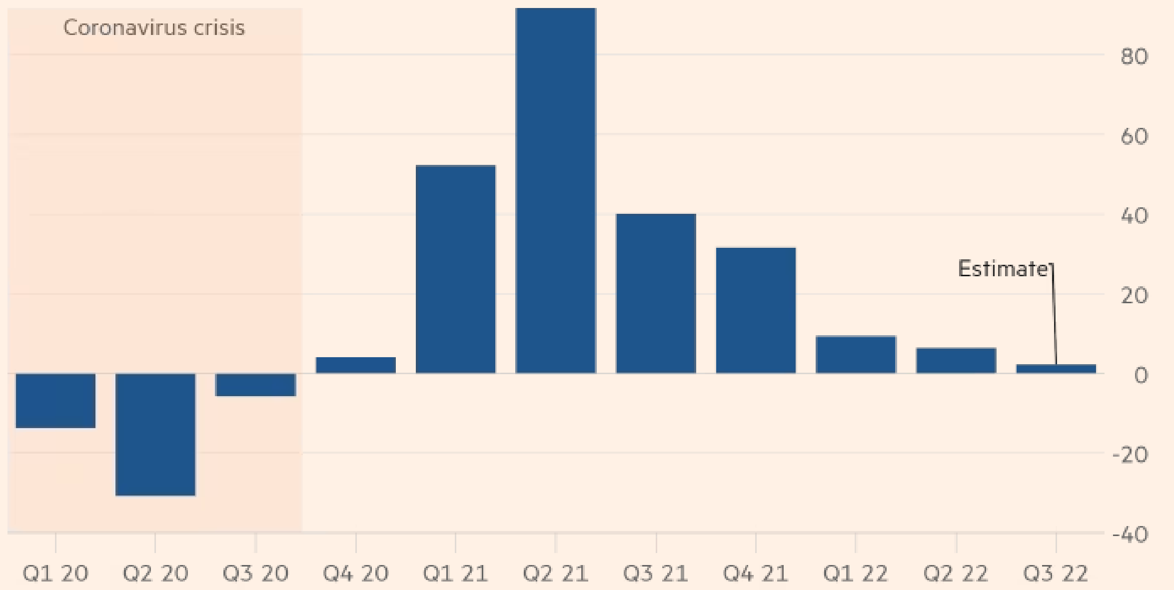


The good part of markets falling is of course they get cheaper. The trick is to remember the price is not alone what dictates when stocks are cheap. They have to be cheap relative to future profits.

And whilst we expect falling profits, if prices fall more than profits, then they are cheap and prices will rise to catch up.

Big US companies expected to post slowdown in profit growth

Year on year change in EPS (%)

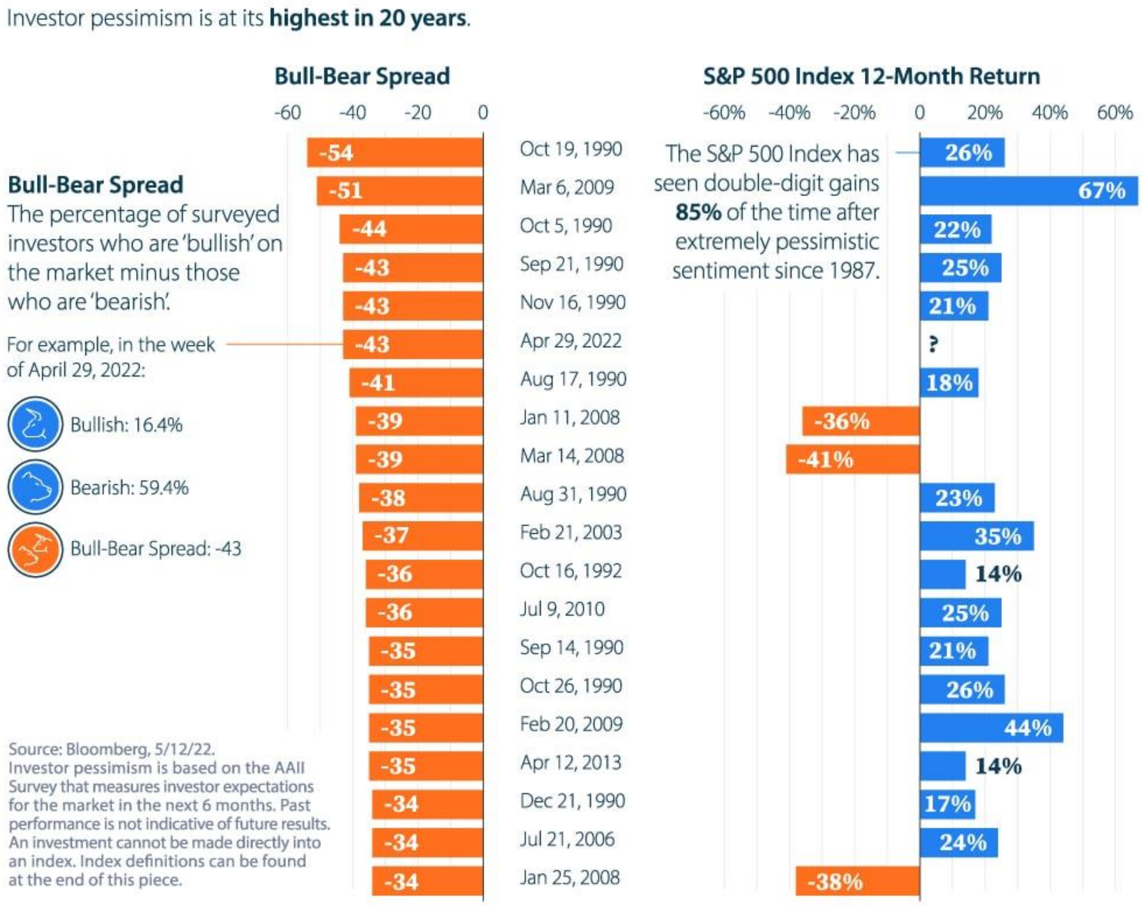


Source: FactSet


MENDON

I've been sharing with you my insights from my US trip which was all market focussed. Again, to give you some good news, the data supports the optimism of the people I met. See the image below. Again points to moves upwards.

This does not mean the same stocks rallying as fast as in the past. We will still need to be very very picky. According to CNBC, “UBS’ chief investment officer Mark Haefele said history suggested the market would only bottom when investors start to expect looser monetary policy over the next six to 12 months or economic activities hit a trough.”

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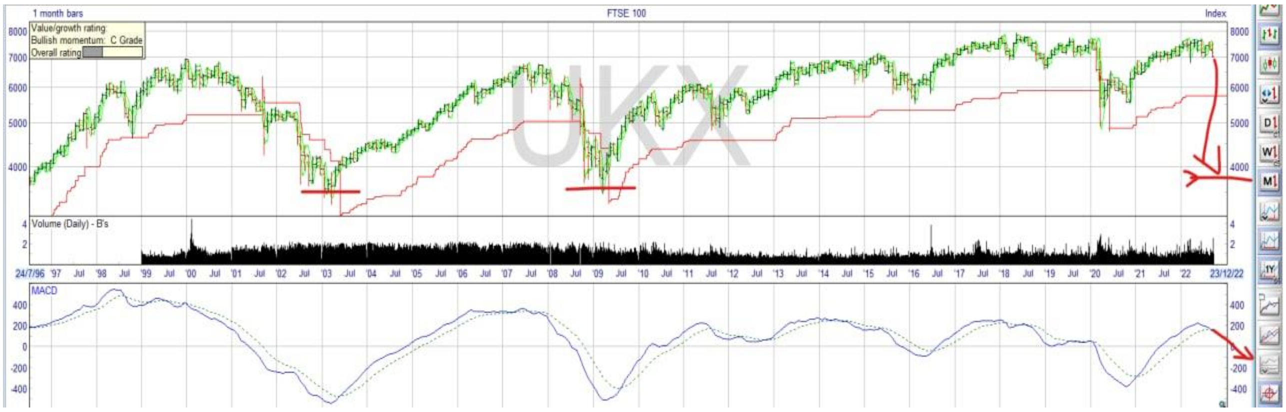
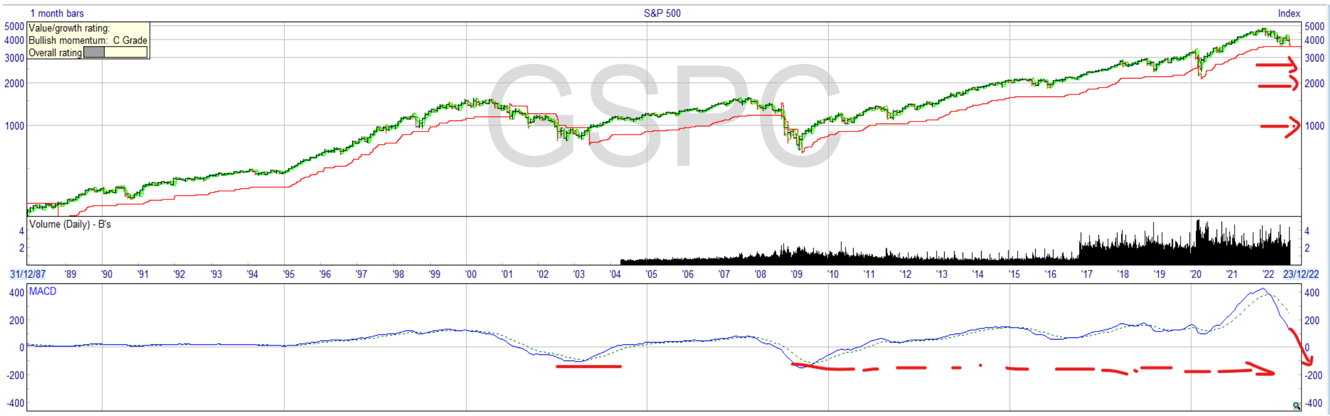
Do I see things being as bad as I have marked? No, but I have shown you just how easy to reach and recent such lows are.





So, what do you think - 2500? 2000? or 1000? (Worst case is 2,500 I think as a worst case.)

Pound Again

As you will know from my Telegram channel, I've been buying GBPUSD and continue to do so with Hunt in the post. The markets do not trust the Government and so give some benefit for the words, but as the finances become reality then the pound will move higher and bond yields drop (a little). Due to quantitative tightening ie Bank of England selling bonds and pushing their prices lower, the yields cannot drop too much. So, your mortgage will not suddenly get cheaper. Why raise interest rates, if you can just raise cost of borrowing by QT? The BoE will indeed consider that.

Trader Who Made Billions in 2008 Buys Pound Near All-Time Low

- Vulpes' Stephen Diggle says British pound is very cheap now
- Diggle says bet wasn't just opportunistic currency trading

By Bei Hu
26 September 2022 at 08:47 BST

A former hedge fund manager who shot to fame for a $2.7 billion volatility trading gain during the global financial crisis is buying the pound on a day when the currency slumped to an all-time low.

GBPUSD - levels I've gone long on the longer term investments. wish I'd picked up 1.04!

Your Pension

This worries me. These headlines worry me. As a young barrister I would advice trustees on pension excesses. Never could I have imagined such headlines. I did not know they were using derivatives to generate returns.

Pension funds would have faced 'mass defaults' today without BoE action

Why the mini-budget threatened to bankrupt pension funds

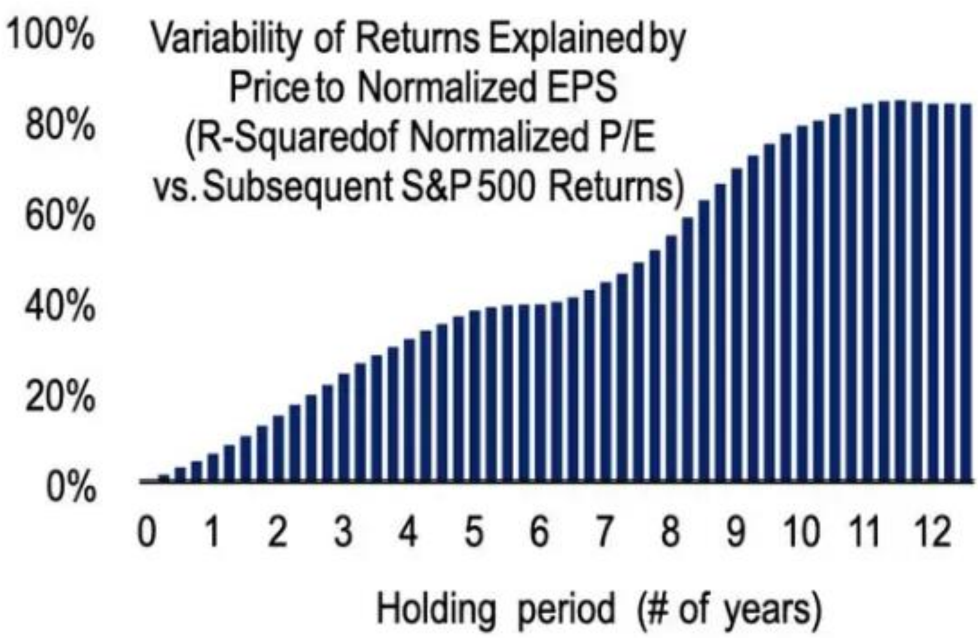
As we all realise in case we had not, that the markets impact our pensions and mortgages. This is so clear from recent events. It underlines why we have to be in control of our SIPP and ISA.

What Moves Stocks & Our Approach

My approach is different to fund managers because whilst I know valuation is important, I know for the time frame I am examining the markets, it is not the only thing. The image below explains this. This is why my stocks have to tick boxes of growth and cash flow and many other factors too.

Exhibit 18: Valuation is almost all that matters for long-term stock returns

Price to normalized earnings predictive power on subsequent holding period returns (since 1987)

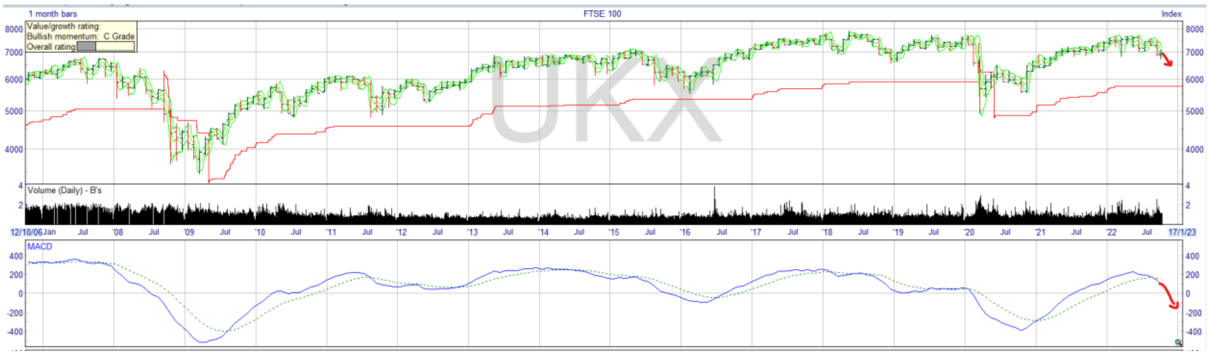


Source: BofA US Equity & US Quant Strategy

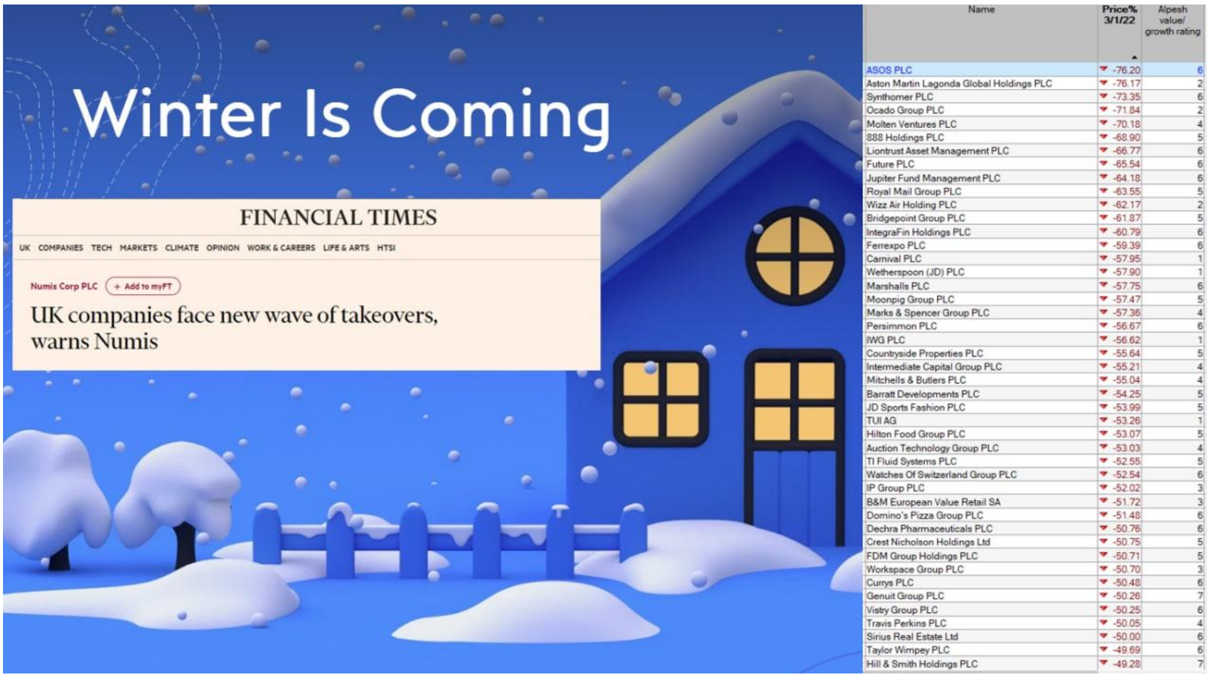
BofA GLOBAL RESEARCH

Yes - BUT don't hold for 10 years!!! Hold 12 months and filter for other factors e.g. growth and income too as we do.

FTSE & S&P500 Bottom?



I fear more falls. Certainly, on momentum but also what the big banks are telling their clients too.



Name	Price% 3/1/22	Alpesh value/ growth rating
ASOS PLC	-76.20	6
Aston Martin Lagonda Global Holdings PLC	-76.17	2
Synthomer PLC	-73.35	6
Ocado Group PLC	-71.84	2
Molten Ventures PLC	-70.18	4
888 Holdings PLC	-68.90	5
Liontrust Asset Management PLC	-66.77	6
Future PLC	-65.54	6
Jupiter Fund Management PLC	-64.18	6
Royal Mail Group PLC	-63.55	5
Wizz Air Holding PLC	-62.17	2
Bridgepoint Group PLC	-61.87	5
IntegraFin Holdings PLC	-60.79	6
Ferrexpo PLC	-59.39	6
Carnival PLC	-57.95	1
Wetherspoon (JD) PLC	-57.90	1
Marshalls PLC	-57.75	6
Moonpig Group PLC	-57.47	5
Marks & Spencer Group PLC	-57.36	4
Persimmon PLC	-56.67	6
IWG PLC	-56.62	1
Countryside Properties PLC	-55.64	5
Intermediate Capital Group PLC	-55.21	4
Mitchells & Butlers PLC	-55.04	4
Barratt Developments PLC	-54.25	5
JD Sports Fashion PLC	-53.99	5
TUI AG	-53.26	1
Hilton Food Group PLC	-53.07	5
Auction Technology Group PLC	-53.03	4
TI Fluid Systems PLC	-52.55	5
Watches Of Switzerland Group PLC	-52.54	6
IP Group PLC	-52.02	3
B&M European Value Retail SA	-51.72	3
Domino's Pizza Group PLC	-51.48	6
Dechra Pharmaceuticals PLC	-50.76	6
Crest Nicholson Holdings Ltd	-50.75	5
FDM Group Holdings PLC	-50.71	5
Workspace Group PLC	-50.70	3
Currys PLC	-50.48	6
Genuit Group PLC	-50.26	7
Vistry Group PLC	-50.25	6
Travis Perkins PLC	-50.05	4
Sirius Real Estate Ltd	-50.00	6
Taylor Wimpey PLC	-49.69	6
Hill & Smith Holdings PLC	-49.28	7

GOLDMAN'S S&P 500 SCENARIOS

S&P 500 LEVEL	SOFT LANDING	HARD LANDING
END OF 2022	3,600	3,400
MID-2023	3,600	3,150
END OF 2023	4,000	3,750

Source: Goldman Sachs

Is It Time to (Keep) Buy Sterling?

The British pound continues to face significant challenges, with the currency seeing significant volatility in recent years. This is likely to continue for some time.

The pandemic was especially hard on the UK economy, which has weighed heavily on the pound. In March 2020, the pound sank to its lowest level against the US dollar in more than 30 years as the pandemic forced the UK into lockdown. Then this year, it got worse.

Two years later, the sterling is still going through a tough time. In fact, things look worse for the currency. In May 2022, the pound fell to around $1.1443, well below its pre-pandemic level. This is the first time in 37 years that UK importers are getting so little for their pound. As I write we are around the same level.

So, what does the future hold for the pound sterling? Is it time to buy the currency, or is a further decline on the cards?

Historical Context

To understand where the pound might be headed, it's worth looking at its recent history. For most of the past decade, the sterling has been in a period of decline.

Before the pandemic struck, the key drivers were the UK's decision to leave the European Union and concerns about the country's economic prospects. These factors weighed heavily on the pound, causing it to fall by around 4.5 percent since 2016.

The pandemic then exacerbated the situation, as the UK was one of the worst-hit countries in Europe. This led to further concerns about the country's economic prospects, and the pound fell to its lowest level against the US dollar since 1985.

The Current Situation

The UK is now recovering from the pandemic, but the outlook for the economy is still uncertain. The country's vaccination program is progressing well, and the government has set out a roadmap for easing lockdown restrictions.

However, there are still risks that the recovery could be derailed by a resurgence of the virus or further lockdown measures. There is still considerable uncertainty about the pound's future prospects.

What Does the Future Hold?

Looking ahead, the key question is how the UK economy will perform in the coming months and years. The pound is likely to recover if the country can avoid a double-dip recession and return to strong growth.

However, if the recovery falters or the UK economy underperforms relative to other countries, then the pound could fall further. This is especially true if interest rates stay low, making it less attractive for investors to hold sterling.

Make the Right Moves

For me, I continue to be a buyer but without over leveraging and with the prospect of holding for a long time. I think GBPUSD 1.2 is when I need to think of selling (even if then).

Who Is Predicting a Stock Market Crash and Why?

Since the onset of the COVID-19 pandemic, there has been much speculation about a potential stock market crash. The fact is the pandemic led to widespread economic uncertainty and instability. And as we enter the final months of 2022, more and more people are beginning to voice their concerns about the stock market.

Many prominent figures in the financial world are warning of an impending crash. While it's impossible to say for sure whether or not they're right, it's essential to understand their reasoning.

In this article, we'll look at some of the most prominent individuals predicting a stock market crash and the evidence they're using to support their claims.

Let's delve right in.

Michael Burry

Michael Burry is an American hedge fund manager who famously predicted the subprime mortgage crisis of 2008. In recent months, he's been warning that another financial crisis is on the horizon. Burry has pointed to several factors that he believes could trigger a market crash.

Firstly, he believes that the Federal Reserve's quantitative easing program is creating an asset bubble. Secondly, he believes that corporate debt levels are too high and that interest rates are bound to rise eventually. And finally, he thinks that the stock market is overvalued and due for a correction.

Burry believes that, within a few years, the S&P 500 could sink to less than 1,900 points. That's a 53 percent decline.

Jeremy Grantham

Veteran investor Jeremy Grantham, co-founder and chief investment strategist at asset management firm GMO, also predicts tough times ahead for the stock market.

Grantham believes that the current bull market is ending and that we're in store for a prolonged bear market. He points to many factors, including high valuations, low-interest rates, and excessive optimism.

Grantham sees the recent stocks' rebound as nothing more than a passing repricing phase. He believes the market will soon enter a period of mean reversion, where prices revert to their long-term averages. He expects the S&P 500 to fall by around 50 percent. In the past, super bubbles have preceded market declines of at least that amount.

Robert Shiller

Robert Shiller is an American economist and Nobel Prize, laureate. He's best known for his work on asset bubbles, and he's been warning about a stock market bubble for quite some time.

Shiller pointed out that the CAPE ratio, which is a measure of stock market valuations, is currently at its second-highest level in history. The only time it was higher was just before the stock market crash of 1929.

Shiller has also warned that, like the housing bubble of 2008, the current stock market bubble could have devastating consequences. He believes that a market crash is inevitable and that we're currently in the late stages of a long bull market.

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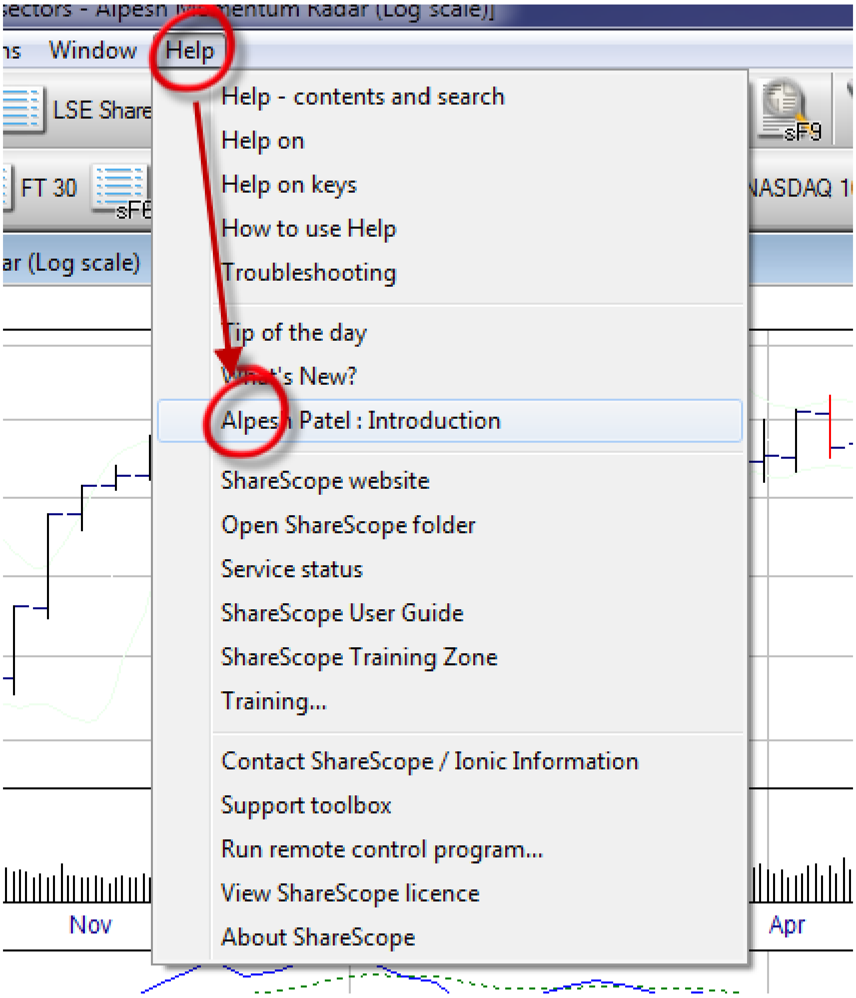

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