Terrible Markets! Can It Get Any Worse?

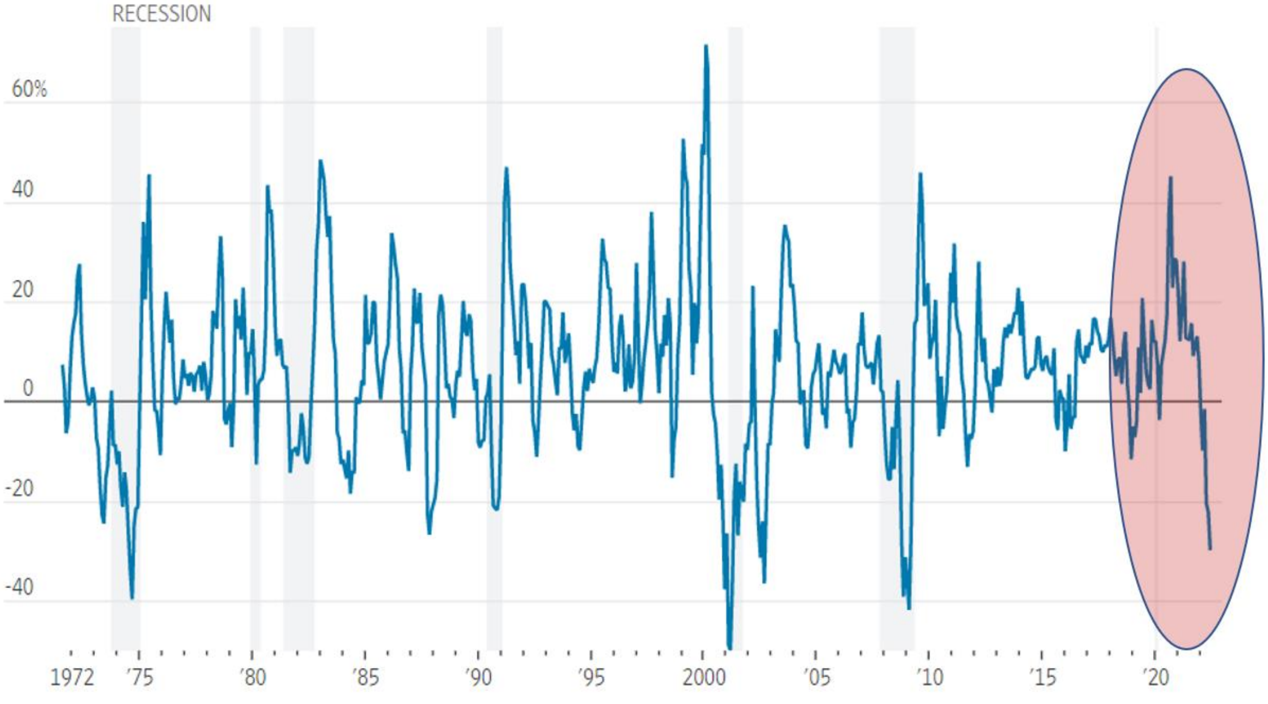
By Frank R. Suess

2022 has been terrible for financial markets so far. The shift to an inflationary climate has been accompanied by a myriad of other uncertainties and disturbances: impeded supply chains, a war at the gates of Europe, the apparent re-emergence of a Cold War era, China's economic slowdown, the tightening of central banks, and now a looming (and potentially deep) recession. Obviously, the question is justified: Can it get any worse?

The first half of the year was focused on inflationary expectations and implications, resulting in the biggest selloff in bonds in forty years, a historic plunge in tech stocks, and the collapse of crypto assets. Now, contrary to the optimistic economic forecasts earlier in the year, recessionary fears have taken over and taken down much of the rest of the markets.

Tech Crash 2022

(Six-month change, monthly data, since 1972)



Source: Refinitiv

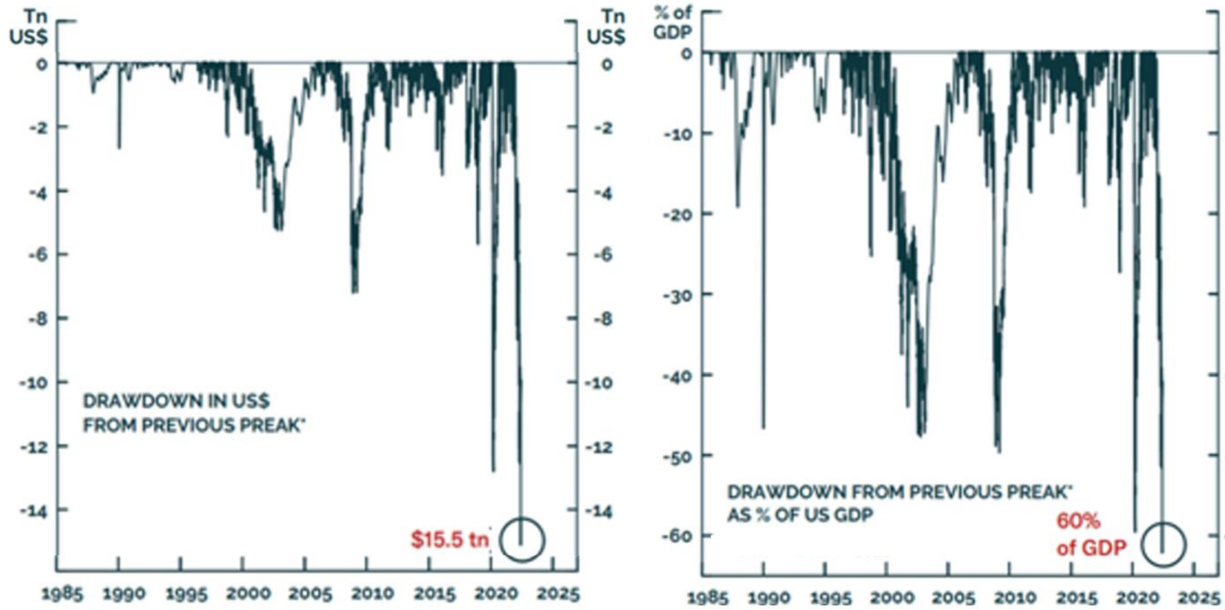
Meanwhile, more uncertainty is being added to the mix. Japan is looking to finally come off its decades-long "Japanification" mode, forced to allow bond yields to rise, which could result in Japanese investors dropping their overseas bond investments and sucking a good chunk of capital out of US dollar and Euro fixed income. In Europe, a replay of the 2012 debt crisis could be in the making: Italy and some of the other "usual suspects" are already pushing for financial support, as rising interest rates are starting to strain their debt financing capabilities.

Investors understand that the outlook is getting darker. Recession risks and fears are growing. Therefore, another leg down in financial markets is very possible. Or the next large-scale intervention by central banks, once again led by the US Federal Reserve, might buy markets another round of relief. This scenario is now widely discussed as the "U-Turn from the U-Turn" and does appear to be that last shimmer of hope that markets are hanging on to. It could indeed lead to another significant, albeit temporary, rally in stocks and bonds. The ultimate end game, the bill for decades of monetary and fiscal excess, does still appear near. This raises the question: What to do as an investor?

Putting 2022 into perspective

It is noteworthy that the wealth destruction in 2022 has been the most dramatic in the last half century. When adding up all US equity and bonds in terms of their market value, the correction in financial markets has destroyed roughly USD 15.55 trillion of wealth, or 60%(!) of US GDP.

Record Wealth Destruction in US Stocks and Bonds
(US equity plus all US bonds market value)



Source: The Daily Shot, BCα Research 2022

It's important to note that while the "implosion" of crypto has been severe, the impact is benign compared to this wealth destruction resulting from the correction in stocks and bonds.

Conclusion

In anticipation of central banks going back to doing what they have been doing for the past decade, there is justified hope that the recession will be relatively mild. And it might not even hit fully until next year. Financial markets could go into a significant rally this coming fall. But the economic and geo-political trend is currently going the wrong way. Higher interest rates have not even started to impact households yet.

The hope is that things will get better before they get even worse. We can buy time. But it is improbable that the excesses of the past will go unpunished.

At BFI, our position remains cautious. We are preparing to increase our exposure to equities in specific sectors, including technology, energy, and commodities. However, we are operating in a “full-time” hedged mode at this point, with equity exposures protected on the downside. We are very hesitant about exposure to bonds altogether. Instead, we seek low-volatility income in specialized strategies. Finally, we retain our overweight exposure in physically allocated precious metals.

About the Author

Frank R. Suess is the Owner and Executive Chairman of BFI Capital Group Inc. He is a serial entrepreneur and advises wealthy families and entrepreneurs in the cross-border planning and wealth management needs.

BFI Capital Group Inc.
Bahnhofstrasse 29
CH-6300 Zug
Switzerland
Tel. +41 41 712 2710
Fax +41 41 712 2711
info@bficapital.com

www.bficapital.com