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Key Takeaways

- Recessions always catch people by surprise and are not widely predicted.
- The bursting of the tech bubble will damage investor psychology and economic prospects, but a downturn similar to the 2000 – 2002 period is not in the cards.
- Fantasy money is out and fundamentals are in. The market will continue to reward industries and sectors that can deliver now rather than forecasts for future growth.

ASK FORSTRONG:

In hindsight, paying millions of dollars for a digital drawing of a monkey may not have been the most prudent strategy. Ditto for profitless startup stocks, cryptocurrencies named after dogs and even an electric car company with a trillion-dollar valuation (at one point, worth more than the next ten most valuable global automakers combined, along with a CEO that walked on water). One by one the market has brought back to earth every asset in the technology sector.

Welcome to the other side of the technology bubble, ladies and gentlemen. For those, like us, who have spent the last year uncomfortably watching a crescendo of profligacy, we feel your pain. It has been quite the show. But it was always meant to end this way: abruptly and without much warning.

Looking back to the sluggish decade of the 2010s, any asset that hinted at higher growth gained a steady bid. But in the froth of every boom, fact becomes blurred with fantasy. Forecasts become bolder. Promoters compete to promise an ever-brighter future. By the end of the bull market, all things seem possible.

Now, we have just witnessed a natural culmination of the tech boom that began in 2009 and then super-sized during the pandemic. History has turned 180 degrees.

This is not an [“I told you so”](#) column. We have blown out far too many birthday candles to claim flawless clairvoyance. Rather, we grapple with the immediate fallout and immense wealth destruction of the pricking of this bubble amid a rapidly-changing market climate.

This is why the big recession question is so important. To see a sustained extension of the current market downturn, we also need to see a substantial downturn in economic activity. Large and widespread bear markets are just not typical outside of recessions.

History's Most Predicted Recession

A crucial concern is that the current tech collapse is another version of the 2000 – 2002 dotcom crash. Back then, the first 30% drop in the Nasdaq led to another 68% meltdown over the next two years and a nasty recession. But there are significant differences between 2000 and 2022. Unlike the dotcom era, many of the most valuable publicly-traded tech companies today are actual companies — they make and sell things people value and make a profit doing so. While the FANGs have all seen share prices tumble this year, it doesn't mean their businesses are disappearing — just that investors no longer believe in their high growth prospects and the valuations attached to them. That is far different from the dotcom era, where thousands of companies simply went out of business, shareholder value vanished and the economy tanked.

Another key concern is that the global economy is already in recession, or that one is imminent. There is no shortage of commentators on the internet willing to make this claim. But there is a glaring hole in this argument: no hard data is yet showing a serious downturn in activity. Recession is still just a theory. Yes, numerous headwinds have surfaced: the tech crash potentially weakening labor markets, China's growth prospects hammered by lockdowns, corporate profits pinched by rising wages, households experiencing soaring energy costs and, most worrisome, the Fed's willingness to slam on the brakes to curtail inflation.

But we are not yet seeing a large slowdown in activity that would signal imminent recession. Consumption is still growing. The labour market remains robust. Capital expenditure is positive.

Now, to be sure, global growth is decelerating. That should not be surprising after the mother of all V-shape dips out of the pandemic lows. This was not a normal recovery, and the pandemic is not over. Different countries are normalizing on different timetables. There is still noise in the data.

But a large economic contraction similar to 2000 or 2008 is unlikely. Today, we simply do not have the same economic and financial imbalances as we had prior to those periods. The decade after 2008 was an extended period of debt reduction, cleansing of excesses and overall financial system repair. This time around structural factors argue for a slowing of growth, perhaps even a modest decline for 2 quarters or so, but not a bona fide financial crisis.

The final overlooked observation is that several dynamics could turn positive in the coming months. First, China's lockdown will not last forever. And, quietly, Beijing has been steadily easing monetary and fiscal policy in the last few months. The world's second largest country is setting up for a far stronger period of growth in the second half of 2022.

Most importantly, household consumption patterns are changing quickly. The weakness in goods spending is now showing up in strength in services spending. This summer will be the first opportunity for many to traverse a less restricted world — to indulge a long-frustrated wanderlust. Tourist traffic will soar this year and goods purchases will decline. The above is a crucial dynamic for inflation. Coupled with the buildup of inventories and over-ordering,

pressure on supply chains will ease and inflation will moderate from here (which will ease pressure on central banks to keep raising rates).

Adding all of the above, growth may actually accelerate into 2023. Investors, parched for good news, will lap it up.

Investment Implications

The last few months have seen one of the most brutal clusters of selling pressure in market history. One would have to reach back to the 1930s or 1970s to witness such a destruction in value and complete absence of assets that protected on the downside.

Of course, the bursting of the tech bubble has validity. Valuations are still sky-high, the narrative is shifting and more carnage is likely. But there has also been indiscriminate liquidation, with the market busy pricing in a coming recession across all asset classes. Yet markets can only continue to price in a recession for so long if it is not validated by the underlying economy.

The reality is that we have just witnessed one of the fastest value restorations in history. Yields are far higher, stock valuations are far lower. Future return prospects now look brighter.

But suddenly, fantasy is out and fundamentals are in. Investors are no longer obsessed with finding treasure island. Instead, they are becoming intrigued by such quaint things as steady earnings growth, robust balance sheets and, most crucially, cash in the hand. The market will continue to reward industries and sectors that can deliver this now rather than a promise out to 2030. In other words, the world is getting back to reality. Investors should not lose sight of this when setting asset mix.