

CAPITULATION CATAPULT

As with most people, financial markets can experience bouts of tunnel vision. After all, asset prices are derived from the intersection of a multitude of human perspectives (and perhaps the logic humans program into machines as well). At times, attention can become fixated on binary outcomes; overlooking nuance and the sprawling grey area in between black and white. Recently, the hyper-focus on whether or not the US economy is headed into (or currently in) recession has dominated the narrative. What could markets be overlooking?

Firstly, there is a lack of clarity on what exactly constitutes a recession. The US National Bureau of Economic Research (NBER) states it is “a significant decline in economic activity that is spread across the economy and that lasts more than a few months.” Clearly, there is a heavy dose of purposeful ambiguity built into the distinction. With two consecutive quarters of negative US GDP growth just recorded, some may conclude we’re already in a recession.

But whether or not a “technical recession” is upon us is the wrong question. Economic downturns come in all shapes and sizes, varying significantly in depth and duration. This is where current market conditions seem to have veered astray. At the risk of sounding hyperbolic, investor sentiment has turned apocalyptic. Most indicators (including the AAll bull-bear spread chart below) are showing readings as bad or worse than those experienced during the darkest days of the Global Financial Crisis in 2008. While impossible to concurrently declare full market capitulation with any degree of certainty, the conditions that we have seen during other durable market bottoms are here.

Undoubtedly, monetary tightening will take a bite out of aggregate demand and cause a deceleration in

growth. But this is not 2008. Household balance sheets are much healthier after a prolonged deleveraging process and critically, there are few credible threats to the global financial system. Furthermore, we are very likely at or near peak inflation (for a broader inflation overview, please see our most recent [Ask Forstrong](#) publication), which should take pressure off of central banks to continue aggressively hiking interest rates.

The more important question for asset prices is thus: will the economy be stronger or weaker than the consensus currently expects? And based on the above, we believe the consensus has turned far too negative, and markets are susceptible to considerable upside risk. With many assets priced for imminent disaster, positive surprises will likely cause a sharp upwards re-rating.

With slowing growth, elevated volatility and widespread pessimism, it may feel counterintuitive or even reckless not to scale back risk in one’s portfolio. However, as we frequently note, extracting emotion from investment decisions, objectively assessing economic conditions and challenging entrenched consensus views can produce attractive opportunities. This is doubly true when financial markets are at extremes as they are today.

GLOBAL STRATEGY OVERVIEW

CASH

Foreign currency volatility has been elevated this year, with widening interest rate differentials at the root of swings in major pairs. From a risk management perspective, it is prudent to cling close to shore during such periods, especially as the loonie has tailwinds from a relatively hawkish Bank of Canada and high energy prices. We have maintained partial hedges on US and European currency exposures in client portfolios this quarter.

BONDS

The surge in nominal bond yields in response to inflationary pressure and central bank rate hikes has sharply improved the long-term expected return outlook for the asset class. However, stubbornly sticky inflationary pressure is keeping real rates deeply negative, which has done little to reverse investors' near-record aversion to bonds. Fixed income exposure has been increased but remains modestly below neutral levels in client portfolios.

EQUITIES

China's punitive COVID lockdowns have caused a severe economic disruption. While the timing of a full re-opening is difficult to forecast with any precision, restrictions have begun to gradually ease. Policy-sensitive onshore stocks should benefit from increasingly accommodative monetary and fiscal conditions, as policymakers attempt to repair the damage. Overweight exposure to onshore Chinese (A share) equities has been maintained this quarter.

OPPORTUNITIES

Mortgage REITs (mREITs) have had a challenging year, as mortgage-backed security (MBS) spreads widened on US recession concerns. With US consumers still in good financial health despite slowing economic activity, MBS spreads should stabilize and delinquency rates should remain muted; allowing mREITs to produce an attractive yield without further book value impairment. mREIT exposure has been increased in income-oriented strategies this quarter.

FORSTRONG STRATEGIES	INCEPTION DATE	1 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEARS	SINCE INCEPTION
GLOBAL SERIES								
Global Income	30/06/08	-3.18%	-10.08%	-8.29%	0.27%	2.11%	5.62%	6.84%
Global Balanced	30/06/03	-4.41%	-11.90%	-10.23%	2.87%	3.99%	7.07%	6.60%
Global Growth	30/06/03	-5.22%	-13.25%	-10.13%	4.91%	5.60%	8.86%	7.75%
Core Income	30/06/08	-2.98%	-8.66%	-7.18%	1.23%	2.53%	4.81%	5.87%
Core Balanced	30/06/03	-4.81%	-8.80%	-7.43%	3.95%	4.51%	6.39%	7.05%
Core Growth	30/06/03	-5.88%	-9.87%	-6.85%	5.97%	6.05%	7.96%	7.74%
GLOBAL EQUITY								
Emerging Markets Equity Focus	31/01/19	-0.45%	-7.38%	-11.54%	1.49%	-	-	1.67%
Global Ex-North America Equity Focus	31/12/19	-4.74%	-14.50%	-16.05%	-	-	-	-1.01%
THEMATIC								
Special Opportunities Focus	31/12/13	-2.88%	-12.75%	-13.29%	0.81%	2.23%	-	5.14%

* Performance as of June 30th, 2022

Performance statistics for ETF Managed Portfolios are calculated from documented actual investment strategies as set by Forstrong's Investment Committee and applied to its portfolios mandates, and are intended to provide an approximation of composite results for separately managed accounts. Actual performance of individual separate accounts may vary with average gross "composite" performance statistics presented here due to client-specific portfolio differences with respect to size, inflow/outflow history, and inception dates, as well as intra-day market volatilities versus daily closing prices. Performance numbers are net of total ETF expense ratios and custody fees, but before withholding taxes, transaction costs and other investment management and advisor fees. Past investment results provide no indication of future performance. Future returns are dependent on the general investment environment, the nature of the investment mandate and specific portfolio risks. A rate of return for one year or less is not annualized.