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Weekly Commentary

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Macro View

By Hubert Marleau

Is There a Way Out?

Submitted March 13, 2022

The Weekly Snapshot of the Market:

Volatility in the financial and commodity markets has bewildered investors all week. They have been scared of making wrong moves, letting the hedge-fund traders, who were entirely responsible for the sell-offs and the rallies, drive the markets. In fact, retail clients of the BofA kept on buying - just as they have every week this year, and so have institutional clients: a see-saw that explains the inexplicable intraday price swings. Indeed, investors have been subjected to some ludicrous trading sessions as markets remained hostage to headlines about the Ukraine war, since there was no consensus on how Russia's invasion would play out. Although we had Wednesday a “dead-cat bounce” for the ages, perhaps it could turn out to be the beginning of the end.

In the week ended March 11, the market could not overcome the dragging effect of the war, the accentuated increase in the inflation rate and the prospects of a higher cost of money at a time when predictions for slower economic growth are becoming the consensus with a rising chance that a recession is possible in 2023. Models based on the shape of the yield curve, (which is affected by the potential negative effect of high energy and food prices on personal disposable income), are suggesting that there are 27.5% recession odds. In this connection, Goldman Sachs reduced modestly their 2022 S&P 500 EPS estimate by $5 to $221, but upgraded profit expectations for the banking and energy sectors. With all of that going on, consumer confidence unsurprisingly declined, according to the University of Michigan. The S&P 500 ended at 4204, down 125 points or 2.9%.

Thank God the economy accumulated a lot of extra-savings during the pandemic. It should prevent those recession odds from crossing the dangerous 60% level. Meanwhile, reminiscent of the 1950s, billions of dollars have fled EU equity funds over the past four weeks. And, according to anecdotes of people familiar

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with cross-border flows, a huge portion seems to have flowed into the North American stock markets, especially the Canadian one.

In fact, American behavioural models are showing extreme readings which in the past have corresponded to bottoms for equities. Yves Lamoureux, a reputable forecaster, believes that we are near a capitulation bottom. He shared his opinion in “Market Watch” suggesting that the Russia-Ukraine war had brought forward faster the trilogy of rolling bear markets - the first took place in March 2020 and the second in September 2020. Sooner or later, there’s going to be an end to the war and if it turns into a nuclear one, nothing will matter anyway. He may be right. I also conclude that as soon as we have some clues that there is a way out of this mess, the market will swiftly change direction. There was an overture on Friday. Zelenscky’s deputy chief of staff, Ihor Zhovkva said that Kyiv was in favour of a diplomatic solution. Talks are taking place and not much is revealed by either side. But, on Friday, Putin declared: “There were certain positive shifts, in talk with Ukraine.”

Yet, the Russia-Ukraine war will be remembered for years to come. There has been an irreversible change that makes geopolitical uncertainty certain, and the idea that there will always be competing global spheres of interest is a realistic proposition. Thus the best and only way to handle the potential fatality of great power rivalry is to try to avoid a war - read Destined For War by Graham Allison. This lack of visibility makes it very difficult to form consensus about long-run macro forecasting. Global economic, monetary and financial systems will shift, the world geopolitical order will re-adjust, the importance of national security will be second to none, and dependency on one’s self will rise. Defending freedom is a costly enterprise.

Thus government policies, corporate models and investment strategies will need to be defensive for protection and prepared to de-risk for a wide range of economic consequences, including diminishing living standards, reunification of the political divide, a newfound Western solidarity, more migration, a coming boom in capital spending, resentment about the global dollar dominance, a general increase in the rate of inflation, international competition for making allies in the developing world, and reduced supply of key commodities like energy, food, metals and rare earths. .

Put simply, Covid-19 and the War will likely domesticate investors' portfolios even if there were confirmation that geopolitics were about to stabilize because the Russian incident will be remembered for a long time. Investors will be drawn to Canada, Australia, South America, New Zealand and the U.S. for safety. While far reaching changes are in our midst, however, it does not mean that globalization is over. Irene Finel-Hongman, an adjunct professor at Columbia University’s school on International Affairs made the following compelling

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comment: “In many ways, Russia’s war isn’t de-globalization of the world so much as revealing how globalization works.” Countries still depend on each other to contain and punish foes.

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