PORTSIDE
INVESTMENT ADVISORS

Synthesis

A composition that pulls together the primary themes, analysis and portfolio views from Portside Investment Advisors

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A Changed World

Change can be difficult, and that's especially true for financial markets. The events of the last few weeks were as if a storm blew in, and some of the change is likely to stick around for a while.

For starters, we are now in a world where government interest rates in the US will likely be near zero for a long time. The causes and the implications of this stretch across many areas. Not all the implications are bad, but it is going to be a different environment.

The related changes stretch to the stock market, commodities and currencies. All of this is tied to the fundamentals of the economy. Certain catalysts for the changes include the coronavirus and the assault on oil prices by foreign producers. However, these catalysts had nothing to do with much of the financial market environment that had been developing. The markets had gotten stretched in recent months and euphoric sentiment had crept in.

A lot can be said about the last few weeks in the financial markets, but none of it should be said without the context of where markets had stood prior to the downdraft. At the equity market lows on March 9th, the S&P 500 was down about 19% from its recent highs. This was significant in an historical context because of how quickly it dropped and that the drop occurred from the all-time high. In looking at the same lows, though, it only put the market at levels last seen in June. To go nine months without gains is not too terrible or unprecedented. Equity investors in most regions outside the US have gone a decade or more without getting anywhere.

The US stock market had been the recipient of significant inflows, especially over the last six months. Induced by the Federal Reserve actions in the fall, there had become significant leverage and speculation. All of this mix was in contrast to economic data globally that was showing slow growth at best. This required a reset in prices. While a virus-induced economic slowdown has been the catalyst for volatility, it was highly likely that markets were already due for a bout of uncertainly.

We continue to believe that investing is a process, where there are times to be patient and there are times to make changes. We don't believe this is a time to act abruptly but it is a time to be diligent. There may be reasons to adjust certain elements of a portfolio. US Treasury bonds, for example have worked well as a shock absorber in portfolios recently. This was because the decline in interest rates made the price of the bonds rise. This sort of price action is less likely to occur at the new lower rate levels.

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Risks will likely remain elevated and there is a lot of uncertainty as to whether a recession is emerging right now. For this reason, we believe it is still prudent to control risk. On the other hand, global policy makers, both monetary (central banks like the Federal Reserve) and fiscal authorities (like Congress) are likely to take major steps to offset economic and financial market turbulence. We will be watching closely to see if these steps are received positively by the markets.

The global financial markets are linked by many threads. The changes taking place right now are having profound impacts on all corners of the markets. Some currencies are under historic pressure (i.e. oil producing nations) while others are rising as safe havens (i.e. Japan). This has economic effects as certain exporting/importing is driven by currency exchange levels.

Also, the financial sector is going to be altered by low interest rates. Banks, for example, try to make profits by lending at higher rates than where they borrow. This is becoming difficult in a world where long term rates are not much higher than short term rates. Also, the risk premium required on some lending to some companies (i.e. oil producers) is rising a lot. This makes the financial pressure even greater in a time of declining revenues. A positive to these could be lower equity valuations and higher yields on corporate bonds. Both of these metrics had reached less attractive levels more recently.

We watch these changes with both caution and excitement. With change there is opportunity and we very much look forward to that.

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