

As January Goes

“The time had come, as in all periods of speculation, when men sought not to be persuaded of the reality of things but to find excuses for escaping into the new world of fantasy.”

- John Kenneth Galbraith, “The Great Crash, 1929”

This edition of our Gavekal *EVA* is written by one of my closest friends, who also happens to be my partner, Louis Gave. As Louis points out in this note, January market trends historically set the direction for the full year per his title “As January Goes”. Well, so far, not so good!

As I’m sure most *EVA* readers have noticed, 2022 is off to a rocky start so far, especially for the former high-flyers. Most of these were losing considerable altitude even before the calendar flipped to the new year.

In reality, the damage done in recent months goes beyond the frothy parts of the stock market and has impacted nearly all high-risk “assets”. Louis cites the poster child for aggressive investing, Bitcoin, which has tumbled almost 40% in just two months. For most asset classes, that would be a shocker but for the King of Cryptos it’s just another hiccup on the way to \$1,000,000—or whatever is the latest aspirational price target by its die-hard fans. Regardless, it is a reflection of the “risk-off” mindset that has become increasingly evident and, as Louis discusses, this goes well beyond cryptocurrencies.

On the positive side, the energy sector is off to a strong start and Louis articulates why he thinks it has further upside. As you will see, he’s additionally upbeat on financial stocks and Japanese equities. Those are two of my most favored areas, as well. (He is also bullish on Chinese high yield bonds but those are nearly impossible for US investors to access.)

On a related note, Louis is also highlighting how cheap the Japanese yen is presently. While I agree wholeheartedly, I realize most investors are averse to betting on currency swings. However, there are two ETFs that track the yen, including one that provides twice the upside (and downside). A far more mainstream vehicle is the primary Japanese stock market ETF that should benefit from an undervalued yen due to Japan’s status as a major exporter. This has been a recurring recommendation of our Positioning Recommendations section (formerly, Likes/Neutrals/Dislikes) and, in my view, it remains appealing for the reasons Louis outlines.

That’s enough of a lead-in from me other than to wish all of our clients and readers a healthy and prosperous New Year!

We are only six days into the year, but most investors must hope that the adage “as January goes, so goes the year” does not hold true for 2022. After all, the S&P 500 is down -1.4% and the Nasdaq has shed -3.5%. And behind this pullback in the broader indexes, pain in the more speculative parts of the market is starting to add up. Since early November, the bitcoin price has fallen -36.5% and the Russell 2000 growth index is flirting with bear market territory after a -14.2% pullback. Aggressive growth names, SPACs, and meme stocks have all struggled.

Momentum seems to have turned. Momentum also seems to have turned for the more “value”

parts of the market. Indeed, over the past few weeks:

- **Energy names everywhere have rallied strongly.** This makes good sense for almost everywhere one looks in the world, there is growing energy demand combined with energy underinvestment. Thus, the rise in the WTI oil price over the last month from US\$65 a barrel to US\$77/bbl is telling given the omicron Covid wave, renewed social restrictions in many countries, mass flight cancellations, a further slowdown in China and a very mild European winter.
- **Financials in most regions are rallying hard.** Given the scope for steepening yield curves and rising loan demand, the recent outperformance of banks also makes sense. And given the prevailing valuation of financials, this trend could easily last.
- **Chinese high-yield debt has begun to rally.** Assuming that Chinese bank credit gets loosened over the coming year, this makes sense.
- **Japanese equities have begun to deliver mild outperformance on lower volatility.** This also makes sense considering that Japan is a world leader in industries like robotics, batteries, semiconductors and hydrogen power systems, which should all do well in the future. But perhaps most importantly, after last year's double-digit pullback the yen is now one of the most undervalued major currencies.

The yen is looking severely undervalued



Now, to be sure, it is too early to conclude that energy, financials, Chinese high-yield debt or Japanese equities have started a new bull market. Still, these are parts of the market that have undemanding valuations and seem to be enjoying favorable macro tailwinds (e.g. rising energy prices, steepening yield curves, easing Chinese policy and an undervalued yen). Therefore, as markets decide which way they want to go in 2022, waiting for clearer direction in these underowned and undervalued segments makes sense.

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