

The Year It's Been

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Imagine an investor who had prior knowledge of this year's major events—but no idea how the market would react to them. Specifically, imagine an investor who, a year ago, had been told that in the course of 2022:

- **Europe would experience a major land war and inflation in the US would reach 8.5%.** That investor would probably have bought gold. And our investor would now be roughly flat for the year.
- **Nord Stream pipelines would be blown up, French nuclear plants would shut down** (see **An Own Goal Of Epic Proportions**), **the US-Saudi relationship would break down and Iran would flirt with a revolution.** Our investor would have likely bought crude oil futures, and he or she would now be down marginally for the year.
- **Oil prices heading into late December would be down.** Our investor would have likely avoided energy stocks. In the end, energy stocks were the only mainstream option for equity investors to get positive returns.
- **In addition to war, Europe would face an energy shock, the rise of the populist right in both Sweden and Italy, and political chaos in the UK.** Our investor would have likely chosen to underweight European equities and overweight US equities. That would have been the wrong call.
- **OECD leading indicators and ISM surveys would both swing into negative territory.** Our investor would have likely chosen to buy OECD government bonds, only to face a drawdown not seen for a generation.
- **Any prescient investor who saw the chance of the S&P 500 shedding about a fifth of its value would have loaded up on long-dated US treasuries**—only to see his or her capital melt by a similar amount.
- **Meta would lose about two thirds of its market value, Amazon, Tesla, Nvidia and Netflix around a half, Disney and Alphabet a third and Microsoft and Apple a quarter of theirs.** Our investor would likely have expected a bloodbath in global equity markets. As it turned out, Indonesia and India delivered gains in local currency terms, while Mexico and Brazil experienced only small losses (see **Brazil's Fiscal Test**).

In short, 2022 was a tough year to navigate as relationships and trends that investors have come to rely on either broke down or, worse still, reversed—for example, the inverse correlation between government bonds and equities, and the outperformance of Big Tech and US equities in general. Looking forward, investors could take the view that trends of the 2011-2021 decade remain in place, and 2022 marked a pause to shake out “weak” or “leveraged” players. On the other hand, they could conclude that there is a deeper reason for the current bear market; namely, to mark a structural shift in the global economy and facilitate a shift in leadership from one group of stocks to another (see **Themes For 2023: Consequences Of The US Bubble Implosion**).

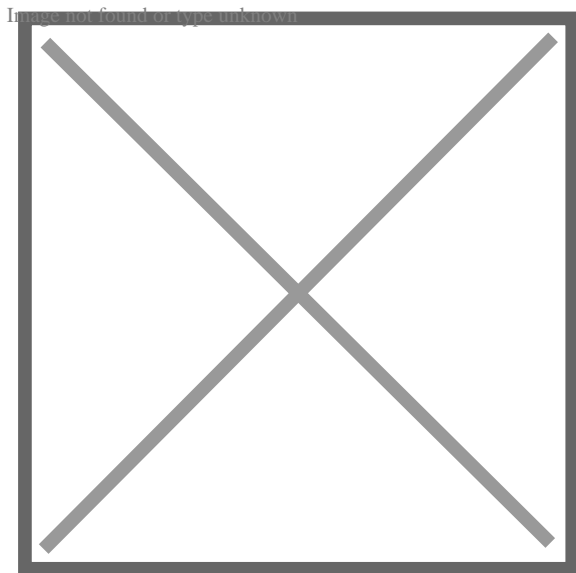
In recent years, most articles and books published by Gavekal have pointed to this latter scenario and today the investment landscape is indeed shifting: from globalization to deglobalization; from plentiful energy to scarce energy; from “Washington consensus” to great

power conflict; from population growth to rapid aging, and from disinflation to inflation.

This should make for dramatic shifts in portfolio construction. Yet, amazingly, pretty much all major private banks and wealth management firms maintain the same processes: after filling out a questionnaire, a new client is deemed to be either “conservative”, and thus given a portfolio comprising 60% bonds and 40% equities, or is alternatively deemed “aggressive”, and thus advised to deploy 60% of their capital in equities and 40% in bonds.

Needless to say, this strategy worked like a charm for 30 years—for both clients and money management firms. But it stopped working two years ago. Yet, most people’s assets are still managed on the premise that because the strategy worked for 30 years, we will ignore the fact that it failed dismally in the past two years.

As such, perhaps 2023 will be the year when investors accept that the good old days of balanced portfolios are well and truly over. In which case, investors will hope that Santa leaves more of 2022’s outperformers—energy, materials, emerging markets and perhaps financials—in their stockings. On this note, may I take the opportunity to wish all of our readers a very merry Christmas and thank each of you for your continued support, friendship, and feedback in what was a decently challenging year.



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