thenavigator

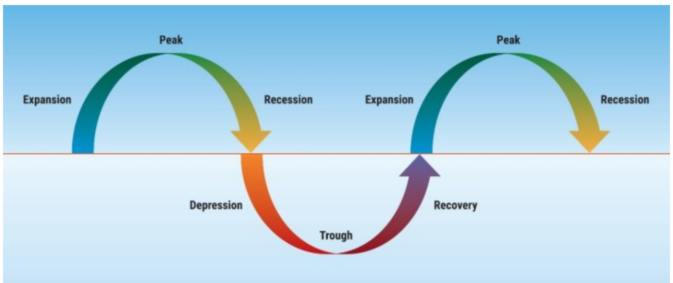
Autumn 2023

Three (3)

1. Is three the most important number to humanity?

The number three appears absolutely everywhere.

In Christianity, the Holy Trinity is made up of the Father, the Son and the Holy Spirit, and it is believed that Jesus Christ died at 3pm. In popular culture, there are many examples of the number three, such as the Three Musketeers, the Three Stooges and the Three Amigos. The phrases “Good things come in threes” (and so do bad things) and “third time lucky” are also popular sayings. The Greek Pythagoras gave the number three extra significance when he discovered the Pythagorean theorem 2,500 years ago. In Greek mythology, there were three main gods: Zeus, Poseidon and Hades. Norse mythology has three realms: Niflheim, Midgard and Asgard. The Norse gods Odin, Thor, Freyr and Freyja all have three weapons. The number three also represents important life events: birth, life and death. In astrology, the number three is linked to Jupiter, the planet of joy, abundance, success, good fortune and wisdom. In tarot, the third card is the Empress card, which is connected to abundance, creativity, life force, growth and optimism. In art and photography, we often follow the rule of thirds. Even the business cycle is often divided into three phases: expansion, peak and recession; depression, trough and recovery.



Financial markets are always doing one of three things: going up, staying the same or going down. The same can be said of interest rates and inflation. So, does this mean that we only have a 33.33% chance of getting financial predictions right? While equities have historically outperformed other asset classes over the long term, there have been periods when they have underperformed, such as the 1970s and late 1920s. What if you just happen to hit a period like that? Or what if you pick the wrong stocks or the only indices that don’t go up? Perhaps 33.33% is the best we can hope for from a bigger picture level? If I told you that if you drove to work in the morning you had a 33.33% chance of getting there safely, I am not certain you would go! So how do we narrow the odds and load the dice in our favour? The answer is, of course, threefold:

- Maintaining perspective
- Thinking differently (with humility)
- Looking at the micro (research)

2. Three observations on the bond and equity markets

One: S&P 500 still in a bear market

Chart 1: S&P 500, 5-year chart, 3 October 2023. Source: www.bloomberg.com

The S&P 500 is still in a bear market, as the old 2022 highs have not yet been taken out. This means that the overall stock market is still trending downwards.

Two: is the Euro Stoxx 50 in a new bull market?

Chart 2: Euro Stoxx 50, 5-year chart, 3 October 2023. Source: www.bloomberg.com

The Euro Stoxx 50 is a European stock market index. The 5-year chart above seems to suggest that it is in a new bull market cycle now that the old 2022 highs have been surpassed.

Three: is Europe undervalued?

Chart 3: Euro Stoxx 50 since 1985, 3 October 2023. Source: www.bloomberg.com

In the long term, the same Euro Stoxx 50 has never fully recovered since the 2000s. With generally negative sentiment towards European stocks compared to their US counterparts, does Europe have much further to run?

European stocks are cheaper than their US counterparts, with a price-to-earnings (PE) ratio of 11.44 and a dividend yield of 3.59%, compared to the 10-Year Bund yield of 2.91%. Could this be a story similar to David and Goliath?

The S&P500 has a PE ratio of 19.53 and a dividend yield of 1.61%, compared to the US 10-Year Treasury yield of 4.68%. Is this relatively risk-free rate bar too high for US equities to climb?

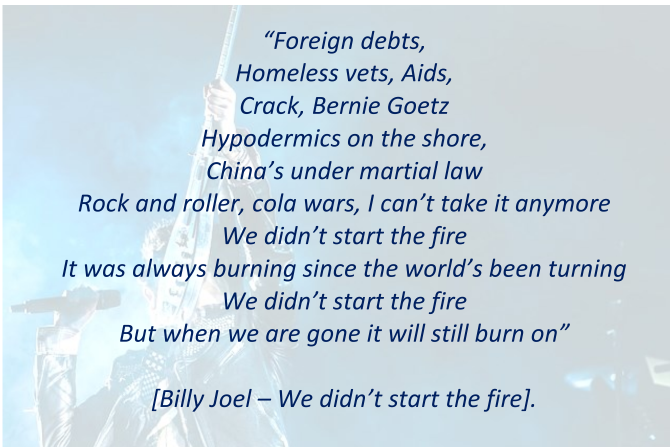
Chart 4: US 10-Year Treasury Yield, 5-year chart, 3 October 2023. Source: www.bloomberg.com

The market also seems challenging for those investors attracted by government bonds, especially US bonds. The dramatic rise in the yields of US 10-year government bonds, summarised in the chart above, caused the price of existing bonds to fall, thus generating losses and stress for such investors.

However, this Loki-like market could be less daunting if you obtain some distance and a more realistic perspective.

Chart 5: US 10-Year Treasury Yield, 60-year graph, 3 October 2023. Source: www.bloomberg.com

3. Conclusion



"Foreign debts,
Homeless vets, Aids,
Crack, Bernie Goetz
Hypodermics on the shore,
China's under martial law
Rock and roller, cola wars, I can't take it anymore
We didn't start the fire
It was always burning since the world's been turning
We didn't start the fire
But when we are gone it will still burn on"

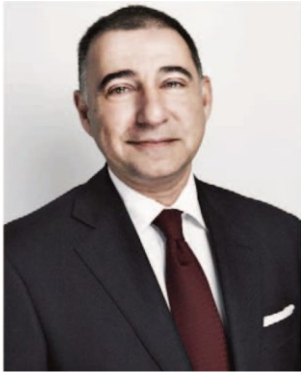
[Billy Joel – We didn't start the fire].

In conclusion, things are perhaps not as scary as they seem and are just returning to the longer-term norm. Of course, normal can be scary for those investors who have only known declining bond yields for the past 20 years: at least now they are gaining a different perspective! It is possible that the US 10-year Treasury yield will rise above 5% and remain elevated for a significant period of time, as inflation remains above central bank targets.
Central banks have warned market participants that this would happen, but not many have been listening. The constant volatility in both bond and equity markets on the back of economic data and central bank rhetoric shows that perhaps people are just gambling on the outcome they want to happen.

Another plausible explanation is that maybe investors are going through the five stages of grief as postulated by the Swiss-American psychiatrist Elisabeth Kübler-Ross: denial, anger, bargaining, depression and acceptance. It is of course difficult to pinpoint exactly where markets are in this cycle. Our guess is that we are perhaps in the bargaining stage, heading towards depression. But for things to truly stabilise we need to get to the acceptance phase.

After all, with the US 10-Year Treasury yield averaging 5.86%, and in many instances significantly higher, the world, economies and markets have done just fine.

...and no, it was not a coincidence that this Navigator was structured in three parts: after all, every good story needs a beginning, a middle and an end. Three again!



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