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There's No Such Thing as a "Safe" Asset

Two weeks have gone by since our last communication and not much has changed, except markets are lower. The reasons are mostly the same. Central banks, led by the Federal Reserve, are raising interest rates aggressively to fight inflation, while preparing to sell off assets from their balance sheet. The net effect will be a reduction of liquidity from the financial system and a tightening of financial conditions. At the same time, the world is still grappling with key resource shortages and supply chain shocks. In a stable economy, this would be a challenging, but navigable, environment for investors. The question investors are grappling with now is whether the economy is in fact stable.

As we highlighted in our prior letter, leading economic indicators are decelerating and data points from housing starts to factory orders to consumer sentiment are declining. Real-time data from company earnings have been mixed. While companies such as Visa and Home Depot have pointed to consumption strength, results from Amazon, Walmart and Target suggest the opposite.[1] What may be the case is that the high-end consumer is doing ok, while the average household is starting to materially feel the effects of inflation and, understandably, cutting back spending. If the stock market falls more, the high-end consumer will surely follow in the average spender's footsteps. Unfortunately, these aren't the hallmarks of a stable economic environment.

For the last decade, there's been this mantra of "TINA" – there is no alternative – that many investors have used to justify elevated stock valuations. We've understood this, but never really liked the concept. Just because one asset class is extraordinarily expensive (bonds) doesn't mean that another asset class (stocks) should also benefit from higher valuations. The risk of TINA was that if bonds ever repriced (meaning yields went higher) that stocks would also reprice (meaning multiples would go lower). To some extent, that is happening right now.

As a corollary, many investors have "parked" money in "safe" assets. In a risky, highly valued market without many compelling investment options, where should one turn to? Well, for years the answer was boring stuff like consumer staples. But even boring companies are subject to economic pressures, ranging from consumer spending weakness to input cost inflation. When the "safe" stocks trade at earnings multiples double that of companies growing 20% annually like Alphabet (GOOGL), they have a swift fall ahead should earnings disappoint. Hence the close to 25% declines (last week alone!) for companies like Target and Walmart.

This is not an investing environment where investors should "park" cash for lack of a better idea. That's what cash is for. Yes, cash can lose to inflation. But contrary to many investment strategists, cash is not trash. In fact, cash is the best performing asset class this year, even on an inflation-adjusted basis. There is no such thing as a truly risk-free asset, especially not stocks whose operating fundamentals are subject to frequent changes based on the economy and business-specific developments. If you're looking for safety, cash is about as close as you can get.

With the S&P 500 down close to 20% now this year and the Nasdaq Index (of mostly growth stocks) down close to 30%, the question is what to do. If you need cash, we don't want to dismiss the chance of asset prices further declining. So, raise it. If you have cash you feel comfortable investing, however, and a long-term outlook, many assets are trading at valuations that are pricing in a recession. That could absolutely materialize, but if a bad scenario is accounted for in an asset's price, that asset is in a way now "safer." It already reflects a bad development.

Remember, that discerning and patient investors in a position to provide liquidity during periods of illiquidity like the present one, often get rewarded with attractive entry prices. Better to be an opportunistic buyer when everyone else is selling than to buy just because there are no good alternatives.

Without question, experiencing high volatility and asset price declines in your portfolios is painful, but in times like these one must keep a level-head and think rationally rather than emotionally. The critical thing we always want to ensure is that your investment goals and horizon are in alignment with what you own.

Please reach out with any questions or concerns. This is a difficult market environment, but we are here to help you navigate through it.

Sincerely,

Peter Karmin
Managing Member

Stuart Loren
Director

Citations and Disclosures

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[1] Bloomberg. All data cited herein is from Bloomberg unless otherwise noted. *This letter is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of the date noted above and may change as subsequent conditions vary. The information and opinions contained in this letter are derived from proprietary and nonproprietary sources deemed by Fort Sheridan Advisors LLC ("Fort Sheridan") to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Fort Sheridan, its principals, employees, agents or affiliates. This post may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will materialize. Reliance upon information in this post is at the sole discretion of the reader.*

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