

Looking ahead

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2022 is a year when equity markets and bond markets fell in tandem. This makes it an unusual year as the historic correlation of these two asset classes is very low. At Tacit we distinguish between absolute loss of value and volatility, which has distinguished us from most of our peers over the past decade. It is therefore comforting that our strategies have fallen by less than the peers in a year in which bonds have provided no cover for falling equity markets.

We do not believe the low correlation between bonds and equities has permanently broken down and foresee the historic relationship between these two assets reasserting itself over the coming year as inflation peaks in the US and elsewhere. The jolt from very low interest rates to what are currently closer to the long-term historic average has precipitated a painful adjustment in market valuations, but we see this as a healthy development and an opportunity.

Over the past 15 years, central bank intervention has artificially depressed bond yields. Cheap borrowing, culminating in zero interest rates for a time, has led to the price of many assets becoming inflated as investors feared missing out on the returns being generated in ever-more esoteric investments. Within the range of assets which we consider for investment this is visible in the very high positive correlation between longer dated government bonds and non-profitmaking technology companies. In investment terminology, these are referred to as 'long duration' investments and they benefited greatly from an ever-lower discount rate being used to capitalise their future expected cash flows. It should not then be a surprise to any investor that the prices of these assets fell significantly when the interest rate cycle turned, and the discount rate rose.

In a year in which investors have seen values drop, it is tempting to wistfully wish that one had had the foresight to turn everything into cash and 'buy the bottom'. In reality, as the old sports analogy goes, you have to play the game to win. What we mean by this is that successful investment is not the same as an uninterrupted, steady rise in value; an asset that went up three times in value and then fell by 25% has still generated a return of more than double your initial investment. So, was it better to invest or not invest?

Acknowledging risk is important; however, generating positive real returns requires an investor to embrace risk when the odds allow. Our strategies falling by less than others during 2022 is a comfort, but we recognise that our clients expect to see their wealth increase and are not that interested in how Tacit has navigated tricky markets relative to other managers. Ultimately positive returns are the only thing that can achieve our clients' objectives. It is for this reason that our process aims to embrace volatility during periods such as this to acquire investments at compelling valuations while others are selling. This provides us with the opportunity to generate better positive returns when the environment is more conducive.

We do not forecast the future path of markets, but we can use the embedded value within our strategies to predict better returns in the future based on one fundamental belief: cashflows which are growing ultimately pull up equity prices irrespective of the political or economic issues from day to day. Today, the Tacit team sees a significant disconnect between the growth in cashflows of our underlying investments and the prices they are trading at. When investors decide the environment has improved, the turnaround in values will be as swift as it will be unexpected. The Tacit Team would like to take this opportunity to wish you a Merry Christmas and a Happy New Year.

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