3EDGE ASSET MANAGEMENT

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Seasons of the Market

Investing During Times of Radical Uncertainty

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It is a truism that investing comes down to making decisions under conditions of uncertainty, and the current environment might even be described as one of radical uncertainty. The future direction of the economy and the markets seems particularly challenging to predict, and investors are confronted by two opposing and vastly different narratives. Should investors position portfolios for a continuation of the equity market rally that began in October of 2022, or take the equivalent of the investment off-ramp and raise cash until things settle down and there is more clarity?

"Invest in preparedness, not predictions."
Nassim Taleb

The Optimistic Scenario

The optimists believe we may be in a Goldilocks economy where growth is strong enough to avoid a recession yet slow enough not to trigger a rebound in inflationary pressure. They may believe in what is referred to as "immaculate disinflation," whereby inflation can continue to come down to the Fed's 2% target without additional rate hikes or a recession. In this scenario, not only would the Fed not need to raise interest rates further, but could begin to cut rates in early 2024. In this scenario, we could enjoy a period of sustained economic growth, and corporate profits could continue to rise with potential productivity breakthroughs from the application of generative A.I. Lastly, the current conflicts in Ukraine and the Middle East may not escalate and draw in other actors. The optimists may be proven correct – only time will tell.

"A common trait of human behavior is the burning desire for certainty, despite living in a highly uncertain and probabilistic world."
Morgan Housel

The Pessimistic Scenario

On the other hand, some fear that we could be headed into a recession due to 18 months of aggressive monetary tightening, rising interest rates, and the inversion of the U.S. Treasury yield curve. There is also the risk of a potential re-acceleration of inflation and a possibility that it will be a while before it comes down to the Fed's 2% target. Sticky inflation could mean the Fed would need to keep interest rates higher for longer, which could slow the economy and squeeze corporate profits. In addition, some pessimistic scenarios go one step further, with inflation remaining elevated and the economy potentially entering a period of stagflation (recession along with rising inflation) similar to the 1970s. Lastly, there is a possibility of an escalation and widening of the conflict in the Middle East, which could draw other actors into the fight. Time will tell if the optimists or the pessimists prevail.

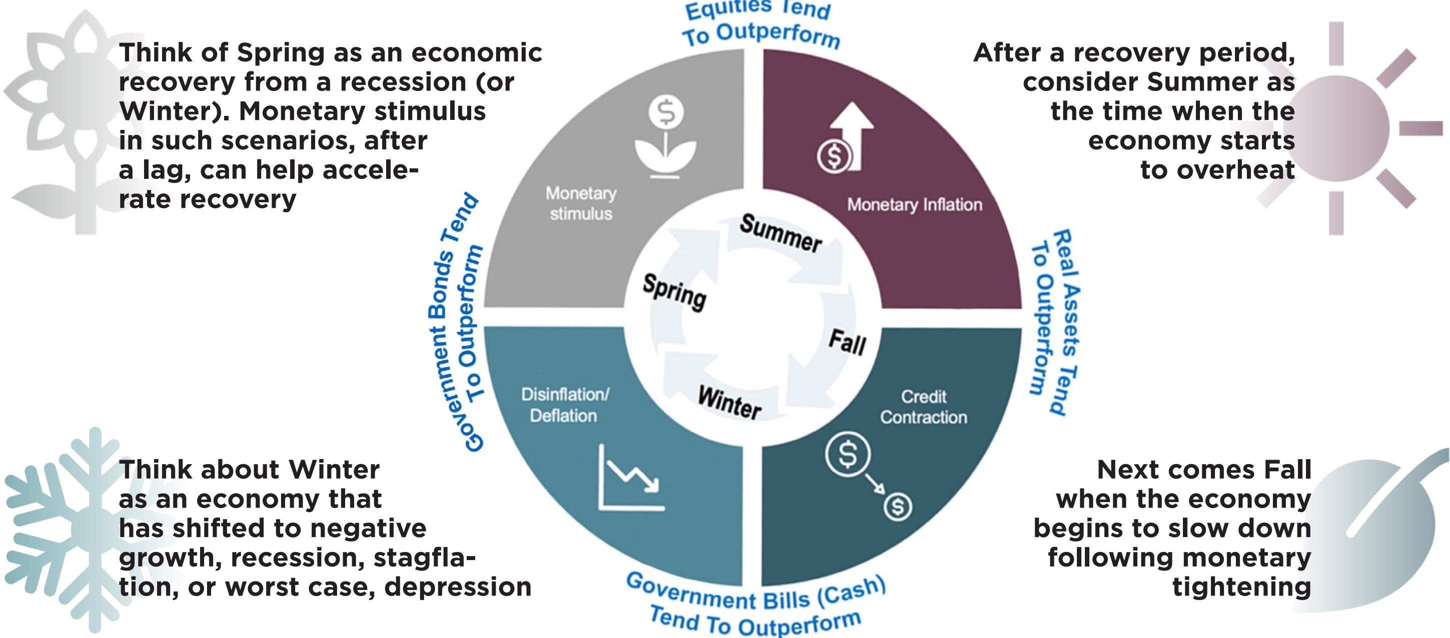
The Seasons of the Market Framework

At 3EDGE, we often talk about the seasons of the market and how one can think of the rotation of economic and market cycles like the rotation of seasons in nature. It's a helpful framework because it allows you to anticipate what might come next. By applying this concept, we can see how different asset classes tend to perform historically depending on where we may be in the economic and market cycle. These seasons typically appear in sequence and are driven by a series of cause-and-effect factors like the Fed's monetary policy, inflation, and economic booms or busts.

Below you will find a visualization of this sequence of seasons. The cycle can be traced in a clockwise direction, with the impacts on various asset classes outlined in the transitions between any two seasons.

Let's start with the period between Winter and Spring. The Federal Reserve Board typically adds monetary stimulus to get the economy out of a recession, get economic growth going, and allow inflation to return to target. Bonds tend to do well during the Winter cycle as interest rates typically come down. Because the effects of monetary policy usually operate with a lag, Equities eventually tend to rebound in the Spring cycle as investors anticipate that things will get better following a period of monetary stimulus.

Now, let's move to the period between Spring and Summer. The economy could now be in a period of prolonged growth, which continues to be favorable for Equities. There may be continued monetary stimulus, and inflation could start to pick up. This scenario is not so good for Bonds, but Real Assets like Commodities and Gold may begin to respond to the sustained monetary stimulus and appreciate in value.



As we move from Summer to Fall, we have a different period where the Federal Reserve typically, sometimes earlier, sometimes later, recognizes that the economy is overheated, and inflation is getting out of hand. This could lead to reduced monetary stimulus and a pullback on credit. The result is credit tightening, which is unfavorable for Equities. Commodities may continue to do well for some time, feeding off the inflation created in the period before. But this may be a good time for investors to start raising Cash or buying short-term Treasuries, which may perform best in a credit contraction.

Finally, we move from Fall to Winter. Again, this period is not great for Equities because the economy is slowing down or going into reverse. It is no longer a favorable environment for Real Assets because tight monetary policy and high interest rates dampen demand for Commodities and Real Assets. This environment starts to be supportive not just for Cash but also for Bonds as interest rates begin to come down again. If the Winter cycle is stagflationary, then TIPS (Treasury Inflation-Protected Securities may perform best.

Conclusion: Neither Optimistic nor Pessimistic, but Realistic

We believe that to prepare for the uncertainties that lie ahead, a flexible, tactical investment approach may be required. As a tactical investment firm, 3EDGE seeks to apply its knowledge of the cause-and-effect relationships within the market ecosystem to adjust our strategies and best position them for these different phases which can present different risks and opportunities. In addition, we always maintain a degree of broad asset diversification through a full complement of asset classes beyond traditional stocks and bonds. Rather than choosing between optimistic or pessimistic scenarios, we believe that in a time of radical uncertainty, avoiding overconcentration in any one asset class may also be best. It can be wise to be cautious and avoid chasing trendy markets such as today's S&P 500 Index, which our model research indicates may be overvalued.

Visit our website at 3edgeam.com, or check out the 3EDGE YouTube channel to learn more about our approach to tactical investing

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