

Wickham Investment Counsel Inc.

Quarterly Review

Mar 2022

The Fear Gauge

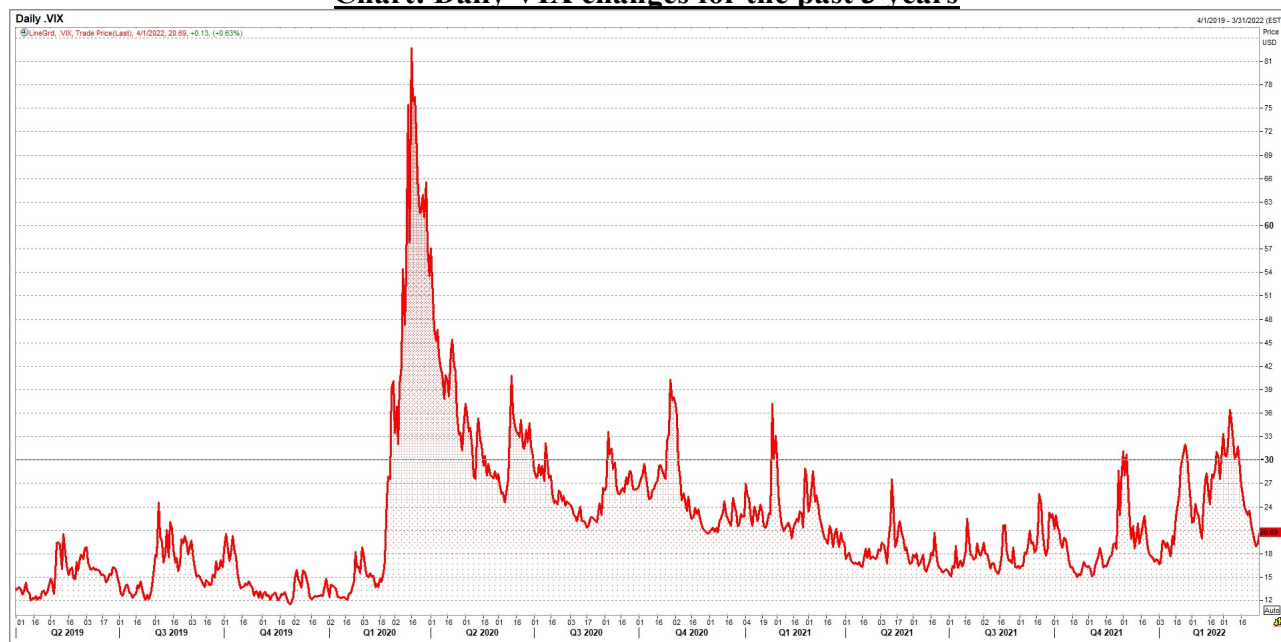
The VIX, as measured by the CBOE Volatility Index, is a real time measurement of the expected market volatility in S&P 500 index call and put options in the next thirty days. As a measure of investor emotions, it is affectionately known as the fear gauge as shown in the attached Table. The VIX reached a record close on March 16, 2020 of 80.7, the same day as the S&P 500 dropped by 12% during the onset of Covid. The VIX is probably the single most important factor as to whether the markets are irrational or will trade on fundamental values.

A normal range for VIX is 12–20, however when it spikes above 30, as it has recently with the Russian invasion of Ukraine, it is a sign of intense volatility. While fear is still high in the markets, the VIX has eased back under 30 as geo-political events take their course. Corporate fundamentals have taken a back seat to the European conflict and the upset in commodity markets, in particular energy, on fears of war driven supply constraints. Amid this turmoil, the S&P 500 index declined by 12% overall and the technology heavy NASDAQ index by almost twice this amount. Both have partially recovered by the end of the first quarter and the more commodity heavy TSX index has fully recovered its losses. Corrections of 10% + have occurred once per year on average since 1930 and have lasted 54 trading days on average. Bear markets of 20% + occur every 3-4 years and are usually associated with economic recessions. So prior geo-political shocks with no fundamental long-term implications generally offer buying opportunities.

While the Russian invasion is top of mind for investors, other concerns are inflation and the need for central bankers to raise rates during the year. Consumer price inflation is running at 5.7% in Canada and 7.9% in the US. The government bond yield curve has shifted sharply higher on expectations of inflation and future economic growth. At the same time, the yield curve has been flattening and the bond market is registering concern, resulting in large losses for bond investors. An upward sloping yield curve is associated with a healthy, growing economy. An “inverted” yield curve, where the short-term ninety-day rate is higher than the ten year rate, is usually a sign that monetary policy has turned too restrictive and may precipitate a recession. An inversion in the yield curve is considered to be a reliable predictor of a recession in the next nine months, in particular with the doubling in the price of oil.

With the policy fight against a much too high rate of inflation at the top of the agenda, central bankers will be walking a fine line between bringing policy rates to a “neutral” level of 2.25–2.50% (from 0.50 % today) where rates start to slow the economy and inflation, without causing a recession over the next year. At this point, the bond market is making a gloomier assessment than the equity markets of the eventual outcome. The fear gauge will likely reveal all as the year unfolds.

Chart: Daily VIX changes for the past 3 years



Source: Refinitiv Eikon

	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Mar 31, 2022	% Change Dec-Mar
Stock Market Indices									
S&P/TSX Comp.	13,010	15,288	16,209	14,323	17,063	17,433	21,223	21,890	3.14%
Dow Jones Ind.	17,425	19,763	24,719	23,328	28,538	30,607	36,338	34,678	-4.57%
S&P 500	2,044	2,239	2,674	2,507	3,231	3,756	4,766	4,530	-4.95%
Nasdaq Comp.	5,007	5,383	6,903	6,635	8,973	12,888	15,645	14,221	-9.10%
Commodities									
Gold - US\$	1,060	1,252	1,309	1,281	1,523	1,895	1,829	1,954	6.83%
Crude Oil WTI - US\$	37.04	53.72	60.42	45.41	61.06	48.52	75.21	100.28	33.33%
Natural Gas - US\$	2.35	3.74	2.95	2.94	2.19	2.54	3.73	5.64	51.21%
Currencies									
€ in Cdn \$	1.50	1.42	1.50	1.56	1.46	1.56	1.44	1.38	-4.17%
£ in Cdn \$	2.04	1.66	1.69	1.74	1.72	1.74	1.71	1.64	-4.09%
US\$ in Cdn \$	1.38	1.34	1.26	1.37	1.30	1.27	1.26	1.25	-0.79%
Interest Rates									
Cdn Prime rate	2.70	2.70	3.20	3.95	3.95	2.45	2.45	2.70	10.20%
US Prime rate	3.50	3.50	4.50	5.50	4.75	3.25	3.25	3.25	0.00%
Cdn 10 Yr bond	1.41	1.72	2.04	1.95	1.64	0.70	1.45	2.43	67.59%
US 10 Yr bond	2.27	2.44	2.40	2.69	1.92	0.93	1.52	2.32	52.63%

Source: The Globe & Mail