SINTRA
CAPITAL

Opportunities in Uncharted Waters

When central banks purchase government bonds and other financial assets they expand their balance sheets and effectively inject liquidity (or money) into the financial system. This is otherwise known as Quantitative Easing (QE), where the excess liquidity created typically finds its way into asset prices.

Currently, the major central banks are shrinking their balance sheets. Withdrawing liquidity while simultaneously increasing interest rates is not something the economy has previously experienced. We find ourselves in uncharted waters.

Combined with higher inflation and the associated recessionary fears, the 12-month forward global market price-to-earnings ratio has de-rated 6 points since the start of 2022.

History suggests a strong correlation exists between the amount of QE delivered by the US Federal Reserve and the S&P 500 (see chart below). Based on our calculations and assuming all else equal, during the QE periods of 2012-2014 and 2020-2022 the S&P 500 added 40 points for every US$100bn of additional stimulus.

source: Sintra Capital, Bloomberg

The S&P 500 has declined by approximately 1000 points since the January peak. Notwithstanding other influences, using the same maths as for QE, the market is pricing US$2.5bn of Quantitative Tightening or 28% of the entire Fed balance sheet. Taking away the punch bowl just as the party begins is one thing but turning off the music as well…

Will the Fed pivot and reverse course? Regardless, it is our belief the market is providing excellent long-term opportunities to accumulate high quality companies with strong balance sheets, superior earnings growth and proven management teams at attractive prices.