

General market conditions: what matters is not the forecast, but the consequence

A structural view of current conditions and why sequencing risk matters for retirement investors

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Markets are often discussed in terms of forecasts - where they are heading, what risks may emerge, and which outcomes are most likely to occur.

This note takes a different approach. It examines general market conditions from a structural perspective, rather than attempting to predict market direction.

The question is not what markets will do next. It is how portfolios behave if conditions change.

Stability and dependence

Recent market behaviour has been characterised by relative stability. Volatility has remained contained. Risk assets have continued to perform.

Market movements have, in aggregate, appeared orderly. This environment can be interpreted in different ways. One interpretation is that risks are low. Another is that markets have adjusted to a stable equilibrium.

There is, however, a third way to interpret this. Markets can appear stable while becoming more dependent on that stability continuing. This dependency is not visible in forecasts. It is visible in structure. This distinction matters.

Conditions that rely on stability

A number of structural conditions are currently present across global markets. Individually, none of these determine outcomes.

Collectively, they share a common feature: they rely on stability continuing.

These include:

Elevated valuations

Valuation levels in several major equity markets remain above long-term averages.

This does not determine when markets may adjust. It does, however, reduce the margin for disappointment if earnings or liquidity conditions change.

Earnings concentration

A significant portion of earnings growth has been concentrated in a relatively small number of companies.

This creates narrower support for broader market performance. When outcomes depend on fewer drivers, sensitivity to change increases.

Funding structures

Certain market strategies depend on stable funding conditions, low volatility, and predictable currency relationships. The yen carry trade is one example. Such structures are not inherently problematic, but they assume that liquidity will remain available when positions are adjusted.

Refinancing requirements

Segments of credit markets, including commercial real estate, face ongoing refinancing requirements. These assume continued access to credit at workable terms.

Changes in funding conditions can influence how smoothly this process occurs.

Inflation dynamics and policy constraints

Inflation remains an important consideration. Not necessarily as a forecast, but as a constraint. If inflation proves persistent, it may limit the flexibility of central banks to respond to weaker market conditions.

These conditions are not unusual in isolation. What matters is that they share a common dependency.

A structural observation

Individually these conditions may be manageable. Collectively, they highlight a broader point.

Markets do not need to be fragile to fall. But when multiple structures rely on stability, the consequences of change can become more significant. This is not a statement about timing.

It is a statement about sensitivity.

From conditions to consequences

The distinction between conditions and consequences is important.

Most market commentary focuses on the likelihood of events:

- Will markets correct?
- Will growth slow?
- Will inflation persist?

These are inherently uncertain questions.

A different approach is to consider the consequences if conditions change, regardless of whether or when that change occurs. This shifts the focus from prediction to structure.

Sequencing risk

For many investors, particularly those in the accumulation phase, short-term market movements can be absorbed over time.

For lower-risk investors, and especially those drawing income, the situation is different. The sequence of returns becomes critical.

Two portfolios can achieve identical average returns over time. Yet if losses occur early, the long-term outcome can be materially different. This is not theoretical. It is a structural feature of how capital is deployed and withdrawn.

When withdrawals are made from a portfolio experiencing early losses, the capital base is reduced. Subsequent returns are then applied to a smaller base, limiting recovery.

The result is that timing, not just magnitude, influences outcomes.

Market cycles and recovery

History provides a useful reference point.

Market corrections and major sell-offs have been a regular feature of investment cycles. They vary in magnitude and duration, but they occur with consistency over time.

Recovery periods have also varied.

In earlier time periods, recovery to previous market highs often took extended periods, sometimes approaching a decade. More recent cycles have seen faster recoveries, supported in part by policy responses and liquidity provision.

This does not establish a rule for future behaviour. It does, however, highlight that recovery timeframes are not constant. They are influenced by the conditions that exist at the time.

Implications for portfolio construction

If outcomes are uncertain, but consequences can be significant, the focus naturally shifts.

From:

- attempting to predict market direction

To:

- structuring portfolios to respond to a range of scenarios

This is a different problem. It is not about forecasting events. It is about preparing for the possibility that events do not unfold as expected.

In this context, diversification can be considered not only across asset classes, but across market conditions.

- Falling markets.
- Volatile markets.
- Stable markets.
- Rising markets.

Each presents different challenges.

A portfolio designed for one environment may not perform as expected in another.

The role of protection

Protection is often associated with defensive positioning in response to perceived risk. A structural perspective leads to a different interpretation.

Protection is not a response to prediction. It is a response to the consequences of being wrong. This is an important distinction.

If forecasts are uncertain, and outcomes can vary, then the role of protection is to address the impact of adverse scenarios, not to anticipate their timing.

A different lens

Viewed through this lens, general market conditions are less about identifying immediate risks, and more about understanding dependencies.

Where conditions rely on stability, outcomes can become more sensitive to change. This does not imply that change is imminent.

It simply recognises that the consequences, if it occurs, may be more meaningful.

Conclusion

Markets will continue to fluctuate, and forecasts will continue to vary. The future path of markets will remain uncertain.

In this environment, the key question is not what will happen next. It is how portfolios respond if conditions do not remain as they are. What matters is not the forecast, but the consequence.

Protection, in this context, is not about predicting outcomes. It is about recognising that the cost of being wrong can be significant, particularly when timing and sequence matter.

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