NORTH
CAPITAL

MONTHLY MPS UPDATE

Market and asset allocation update for managed portfolios

JUNE 2022

For Professional Advisers Only

MARKET UPDATE

Latest views from the investment team

Recession or no recession?

The summer months are now upon us, which can often see a lack of direction in equity markets. We feel this year is likely to follow a similar path. Global equities end May down some 13% for the year (in US dollar terms). We don't see any immediate catalyst for a move back up – as the outlook for economic growth (which has been slowing) and inflation remains uncertain. Whilst we try to avoid fence sitting in our views, it will be a couple of months before we are clearer on whether we are in a period of "slowdown" or impending recession – which will likely dictate the path of equities. With that, our positioning in multi-asset portfolios remains cautious, balancing economic growth and inflationary dynamics in a sensibly diversified manner.

The narrative driving global markets has shifted from worries about inflation, to fretting about the risk of recession. Although headline inflation remains high (8.3% year-on-year in the US and 8.1% in the eurozone), inflation pressures appear to have peaked (for now). But signs are emerging of a slowdown in economic growth. From their peak, US equities have fallen by nearly 20% - not over the last 40 years have they fallen more than this, outside of a recession. So, if the US economy was able to avoid a recession, one could reasonably expect that the worst is behind us from an equity market correction perspective.

We see absolute justification for equity market behaviour this year, against the backdrop of rising inflation and corresponding move in rates. A recalibration of "value" (the price one pays for a stock) has been a long time coming. Financial conditions have tightened – bringing to an end a decade of "free money" – and pressures are being felt across industries on supply chains and labour costs. Whether this ends up being a period of slowdown or tipping over into recession is still unclear.

Will there be a recession in the next 12-18 months?

We think there is a 50% chance. We look at a range of data points that are reasonably reliable indicators of an impending recession. And while no two recessionary environments are created equal, most tend to have some similar hallmarks and precursors. At present, the dashboard remains on amber watch. Indicators such as: the path of interest rates; yield curve inversion; rise in credit spreads; and profit margins rolling over are still borderline.

Questions are being asked by investors how to position portfolios from here, in the face of significant recessionary risk. Our view is to be more purposeful in allocations. Bonds are becoming investable again and are likely to provide support in the event of growth falling below trend. Defensive equity sectors allow for participation on the upside but some buffer on the downside. Real assets remain a core element of portfolios on diversification, yield and inflation protection grounds. Finally, having some powder dry either in cash or near cash fixed income allows for deployment in the event of any significant further downturn in stocks.

ASSET ALLOCATION

Latest portfolio positioning and changes

Below is an is an indication of our current tactical asset allocation (TAA) for discretionary portfolios. This represents our shorter term (1-3 years) positioning in portfolios and corresponding deviations from our long-term strategic asset allocation (SAA). This is updated monthly, with any changes from the prior month illustrated.

Asset Allocation

Asset Class		Tactical View				
		-2	-1	0	1	2
Overall Risk (Defensive Vs Growth)						
Cash						
Fixed Income						
Fixed Income	UK Sovereign Bonds					
	Int. Sovereign Bonds					
	IG Corporate Bonds					
	Tactical Fixed Income					
Real Return						
Real Return	Inflation-Linked Bonds					
	Defensive Real Return					
Absolute Return						
Equities						
Equities	UK					
	Europe					
	US					
	EM/Asia					
	Japan					
	Tactical Equities					
Real Assets						
Real Assets	Infrastructure/Clean Energy					
	Property					
	Gold/Precious Metals					
	Tactical Real Assets					

Current Positioning

x Prior month

Positioning and changes

There have been no changes to our tactical asset allocation positioning in May, however there were active debates in a few areas, as discussed below.

Within defensive assets, we still favour absolute return strategies over conventional fixed income. However, the investment committee discussed bringing the fixed income weighting back to neutral as US Treasury yields reached 3% - becoming an investible asset class again and likely to provide some protection in the event of economic growth falling below trend (recessionary). We also discussed an increase in investment grade bonds on relative value grounds. We still favour being short duration within fixed income.

Within growth assets, we previously shifted some of our risk allocation from core equities to real assets, given the inflationary backdrop as well as the diversification benefits and opportunity set currently available within real assets. This remains our view. Within equities, we do not have strong regional conviction at present, other than a modest underweight to US equities, which we may look to close on any further weakness. Ongoing research is being done by the team on possible beneficiaries of a weaker dollar, as it becomes increasingly overvalued.

For more information, please contact a member of the investment team.

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