MARKET UPDATE

Latest views from the investment team

Selling abates

July finally saw some respite for stocks (and bonds) after a grim first six months of the year – which we discussed in our last monthly update. Globally equities rallied 7% during the month, led by the tech heavy US market advancing 9.2% (it's best month since the vaccine induced rally of November 2020). The US market has led much of the declines this year, with lofty valuations coming under pressure as interest rates have risen sharply in an attempt to combat inflation. With some levelling off in long-term (interest) rates, it was unsurprising to see a relief rally in stocks, particularly those most impacted this year. Time will tell whether this is a so-called bear market rally or if a June bottom for stocks is now in place. The last week in the month was most noteworthy – as some bellwether tech names (Apple, Microsoft, Alphabet and Meta) reported quarterly earnings and the Fed unleased another 0.75% rate hike on the market.

July ended with a flurry of buying – in both stocks and bonds – driven by comments made by Fed Chairman, Jerome Powell, stating:

As the stance of monetary policy tightens further, it will likely become appropriate to ***slow the pace*** *of increases while we assess how our cumulative policy adjustments are affecting the economy and inflation.*

This was enough of a catalyst for bond yields to fall and stocks to rally further. The bond market seems to be positioned for a world in which the Fed brings down interest rates soon, while inflation also comes swiftly under control, all without damaging corporate returns enough to dent the stock market. However, this is not our base case. If anything, our take was that The Fed is now being much more realistic on the inflation problem and are set on avoiding inflation becoming entrenched and self-fulfilling in the economy. Whilst they still target a goal of 2% inflation, we believe that an inflation rate of 3-5% over the medium term would be very manageable and, in fact, helpful for other reasons (such as inflating away covid-induced debt). But, with that comes higher base rates than those currently priced in.

So, whilst it has been pleasing to see some rebound in portfolios, we are a little sceptical of this rally – as nothing has really changed: The Russia-Ukraine war lingers on, and other geo-political tensions (notably in Taiwan) are also brewing; inflation data fails to show many signs of abating; and economic indicators continue to deteriorate. With that, we are maintaining our cautious portfolio positioning.

Finally, on the company earnings – which market attention has turned to. It has been a bit of a mixed bag so far. Most companies highlighted challenges in the macro backdrop and, for US exporters, the strength of the US dollar having an impact. Another common theme was that of labour cost pressure continuing to build, eating into company profits. Volvo's update was note-worthy in that the supply chain issues that have dogged the auto-industry coming out of the pandemic are starting to abate. Of the social media companies and those exposed to ad-spending noted a challenging environment – Meta and Snap both struggled following earnings updates.

ASSET ALLOCTION

Latest portfolio positioning

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			x	■		
Fixed Income	UK Sovereign Bonds		■			
	Int. Sovereign Bonds		x	■		
	IG Corporate Bonds			x	■	
	Tactical Fixed Income			■		x
Real Return				■		
Real Return	Inflation-Linked Bonds		■			
	Defensive Real Return				■	
Absolute Return				■	x	
Equities			■			
Equities	UK			■		
	Europe		■	x		
	US		■			
	EM/Asia			■		
	Japan			x	■	
	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 a few changes to our tactical asset allocation positioning in July, as described below and illustrated opposite.

Within defensive assets, we further increased our fixed income allocations, back to neutral, at the expense of absolute return. US bond yields close to 3.5% and corporate spreads widening, makes the asset class relatively attractive once again, to merit a neutral weighting in portfolios. We do, however, remain biased to short duration bonds.

Within growth assets, maintain a bias to real assets over conventional equities, for the current inflation backdrop. Within equities, we reduced European equity exposure in favour of Japan. Both are big exporting regions and cyclical – however, from a valuation and diversification standpoint, Japan is more attractive in our view. The market can become detached from other developed nations. We also wished to increase yen exposure, a by-product of holding Japanese equities. After a big fall this year in the yen – it is looking very cheap and typically represents a useful haven asset in times of slower growth and geo-political tensions.

For more information, please contact your adviser.