MARKET UPDATE

Latest views from the investment team

Batton down the hatches

The summer months brought a brighter tone to markets, after an extremely tough first half of the year. However, late August saw selling resume across most asset classes – again fuelled by inflation concerns and the knock-on impact on (economic) growth. We expect the autumn and winter months to be challenging. Central banks are now taking inflation very seriously and are likely to continue with forceful policy responses, even if that means triggering a recessionary environment. We also expect governments to step in, in those regions where the energy crisis is spiralling out of control (not least here in the UK). Critical to central banks' policy now, is seeking to avoid entrenched and self-fulfilling inflation.

In last month's update, we expressed our caution on the summer rally in stocks. Whilst it provided a pleasant respite, we had little conviction in its longevity. Extract below:

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.

This year has confirmed our view, that we were building last year, of a regime shift in markets, that we believe could last as long as a decade. A period where the supply of money becomes far less abundant, inflation remains high (but manageable) and where the price one pays for an asset becomes a lot more important. We expect this environment to favour high quality businesses and dividend payers. We also expect, once through the worst of the inflation crisis, for value stocks to fare relatively well, as higher interest rates make the price one pays for a stock much more important. In this environment, money can be made – but the source of returns may differ from those that have led in the prior ten years. It is why providing true diversification is so important in multi-asset portfolios and ensuring one has exposure to a range of outcomes that may lie ahead, for a smoother journey.

As for the immediate future, into the year end, the only positive thing for markets is that everyone is very negative/gloomy! And often sentiment is a good contra-indictor. September will be all about the macro backdrop (on inflation and interest rates) before the micro (company earnings) become the focus in October (third quarter earnings season). We believe this upcoming earnings season will be one of the most important since the pandemic. In recent quarters, companies have been able to pass through costs to consumers relatively well and have appeared relatively resilient. Whilst valuations are now much more reasonable for stocks, it is the earnings (E) component of a stock's valuation (the price/earnings ratio) that will be important. Our portfolios remain cautiously positioned, but attractively valued – focused on short duration, higher quality bonds, within fixed income; and lower volatility, higher quality, within equities. Our meaningful exposure to inflation-sensitive assets (index-linked bonds, infrastructure, property, commodities and gold) remains.

ASSET ALLOCATION

Latest portfolio positioning and changes

Below 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 August, which remains as described below and illustrated opposite.

Within defensive assets, our fixed income allocation remains at neutral, as does our exposure to absolute return. US bond yields close to 3.5%, and corporate spreads relatively wide, makes fixed income relatively attractive once again, to merit a neutral weighting in portfolios. We do, however, remain biased to short duration bonds.

Within growth assets, we maintain a bias to real assets over conventional equities, for the current inflation backdrop. Within equities, we are underweight 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. From a style perspective, our exposure remains biased to minimum volatility stocks and quality – which typically fare best in a downturn/recessionary environment.

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