MONTHLY UPDATE

Latest views from the investment team

Unchartered Waters

During our most recent investment meeting we implemented a number of changes across our portfolios. Our goal was to ensure balanced exposure to the two primary drivers of asset prices - the volume of economic activity (growth) and its pricing (inflation). The reason for this is that the range of market scenarios that could lie ahead in the next year is as broad as we've known in a long-time. We are not alone in this view: Stanley Druckenmiller – one of the most consistently successful investors of our generation – noted recently that the current environment is the most uncertain he has known in his 45 years of investing.

The current macro-economic environment has few precedents in history. The high inflationary environment we have experienced in the last 12 months appears to have peaked, but there is no guarantee that is not a lull before a renewed period of inflationary pressure, comparable to what we saw in the 1970's. If central banks turn more dovish and allow interest rates to abate (as the market is expecting), there is the potential for this to reignite the inflation embers that lie burning for some time after bouts of high inflation. However, if monetary policy continues to be tight; whilst that may help with fully extinguishing inflation, it is more likely to induce a recession. This is the tough spot central banks find themselves in today.

Alongside this, trying to figure out where we are in the business cycle is especially tricky at present because of the disparity between manufacturing and services. Consumers brought forward purchases of goods (laptops, furniture etc.) during the pandemic when they were locked down, but are now fulfilling pent-up demand for services (travel, recreation etc).

The nature of our investment process is such that we don't need to have strong views in order for our investors feel sensibly invested. We have a carefully constructed long-term strategic asset allocation, where – in the event that we don't have strong tactical conviction – we can move closer to.

Bottom line:
We are neutral on growth assets, relative to defensive assets given the backdrop discussed above. We prefer non-US assets, in favour of Japan and Emerging Markets. We are biased to inflation sensitive assets: Index-linked bonds, commodities, infrastructure, and gold – in order to help properly diversify portfolios for the uncertain period we are in.

Month by numbers

Change in various markets over the month:

Asset		Change/Value
Equities		
UK	↑	**3.60%**
Europe	↑	**2.17%**
US	↑	**1.24%**
Emerging Markets	↓	**-0.70%**
Japan	↑	**2.68%**
Bonds/Rates *Absolute change (%)		
UK Base Rates	-	**0.00%**
		4.25%
Fed Funds Rate	-	**0.00%**
		5.00%
UK 10-Year Yield	↑	**0.23%**
		3.72%
US 10-Year Yield	↓	**-0.05%**
		3.43%
Currencies		
GBP/USD	↑	**1.63%**
		1.26
GBP/EUR	↑	**0.66%**
		1.14
DXY (USD Index)	↓	**-0.83%**
		101.66
Commodities		
Gold	↑	**1.06%**
		1990.03
Oil (Brent)	↓	**-0.29%**
		$79.54
Noteworthy		
Smith & Nephew	↑	**17.16%**
First Republic Bank	↓	**-74.91%**

May

As of 30th April 2023

Q&A

What's on your mind?

With cash now yielding near 4%, should I still be investing in stocks with the outlook so uncertain?
Over the last year and a half, the case for investing in cash has drastically changed. The typical yield on a Sterling money market fund is currently around 4%, whereas at the end of 2021 it was 0%, making it an almost uninvestible asset class. It is therefore natural to wonder whether it is more sensible to invest in cash at this level, compared to a riskier equity investment, especially during this uncertain environment. We would argue that the answer to this is no. Firstly, a yield around 4% is attractive relative to recent history, but in the context of higher inflation a cash investment is still providing a negative real return. Moreover, this yield will likely start to fall as central banks unwind policy as inflation cools.

The second reason is clear when we consider the long-term. Investors typically should not consider investing in equities unless they have a minimum time-horizon of five years – this is to give sufficient time to ride out market volatility. Over this period, and longer, equities tend to be a relatively reliable inflation hedge. It is often said that time-in, not timing, the market is the most important factor in generating return, typically investors who attempt to time the market and avoid investing through periods of uncertainty will miss the start of the recovery and be uninvested on the best trading days. According to J.P. Morgan Asset Management (2022) missing the 10 best trading days reduced the annualized return of a 20-year US equity investment by half. It is for this reason that we believe an investment in equities, as part of a diversified portfolio, remains a sensible choice for investors who are looking to protect the real value of capital over the long-term.

Are Emerging Markets still "emerging"?
The phrase emerging markets (EM) has been around for several decades. Nowadays it is typically used by investors as a catch-all term to describe markets who do not fit into the more typical regions of Europe/UK, North America, and Japan. The most commonly used EM index provides a breakdown of this universe by geography and three of the main regions in the index – China, India, and Brazil – may fit into the narrative which may be associated with EM. That is, a growing consumer market and middle class, rapid economic development over recent years, a strong manufacturing base, however remaining behind the large western economies in terms of economic development and freedom. It could therefore be surprising that two of the major geographies in the index are Taiwan and South Korea who are generally ranked amongst the wealthiest countries in the world (on a per capita basis) and who are both leaders in highly specialized manufacturing. This simple example illustrates that EM remains a broad and catch-all term in the investment world. At present, we have a bias to emerging markets in our portfolios on valuation grounds, and our view that the dollar is likely to weaken in the years ahead (which generally favours EM assets).

For more information, please contact your adviser.

Disclaimer

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