QUARTERLY REVIEW

JULY 2022

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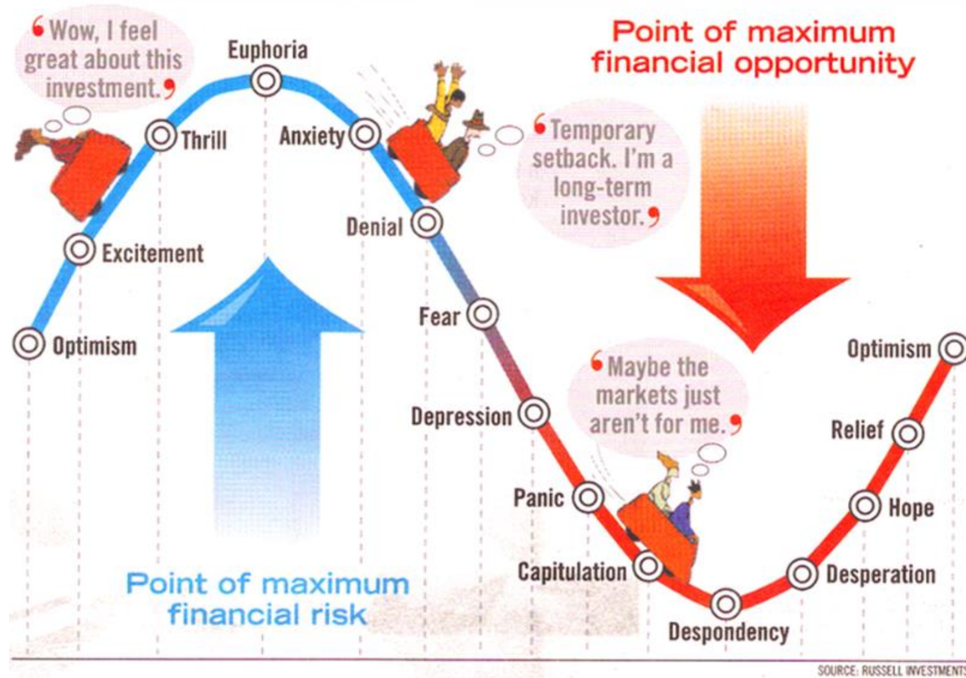
	Q2 2022	Return	Level
Equity	MSCI AW Index	-16.13%	596.77
	S&P 500 Index	-16.45%	3785.38
	MSCI EM Index	-12.36%	1000.67
	MSCI CH Index	4.51%	545.59
	FTSE 100 Index	-4.61%	7169.28
Debt	BBARC GA Index	-8.26%	458.34
	US G2Y Index*	-1.20%	2.92%
	US G10Y Index*	-3.54%	2.98%
	US G30Y Index*	-7.62%	3.14%
Infrastructure	S&P GI Index	-7.42%	6065.58

* TR on TSY futures
Source: Morningstar
As at 30 June 2022.

There are many superlatives to describe the last 3-months market related returns. For sure this has been one of the worst periods in history considering fixed income and equity returns combined. As we pointed out back in February a period of liquidity contraction and higher rates would likely deliver a re-set for asset classes, as markets enter a new economic regime.
We clearly did not foresee the Russo-Ukraine conflict spilling over into war, and one which would aggravate an inflationary backdrop into full-on double-digit inflation in some ways reminiscent of the 1970s. Consequently, equity and fixed income securities have suffered in parallel and there has been very little diversification benefit to be had outside of certain commodities and cash, with most asset classes losing value. The leading US benchmark indices have fallen into bear market territory during the quarter.

After a prolonged period "behind the curve" the Federal Reserve and other central banks have woken up to the issues presented by strong inflationary pressure. Interest rates have been raised twice in US and similarly around the world to control rising prices. Excess liquidity will be removed using quantitative tightening, a relatively new technique and whose side-effects for markets is not fully understood. Simultaneously economies, led by the United States, are naturally slowing and so the ability to create an economic "soft landing" will be tough indeed. The pathway to avoid a recession is narrowing.



Source: Russell Investments
As at 30 June 2022.

Equity values slumped across the board although those so-called growth stocks typified by technology companies and long-term future-facing industries with lower realised profits came off worst. The institutionally popular ARK Innovation Fund for example lost a breath-taking 77% in value. We have of course avoided any such holdings. In the run-up to the market falls Apple sat at the top of the global stocks' leader board as the largest company in the world by market capitalisation. This has of course changed with Aramco (the Saudi state-owned oil company) now occupying the number one position. In many ways this change of running order captures what has occurred more broadly in markets. Valuations for equities are now at or approaching longer term "fair value" but are not cheap. The all- important quarter two earnings season is upon us, and as we have pointed out in previous updates, this will be an important fulcrum for equity price movement.

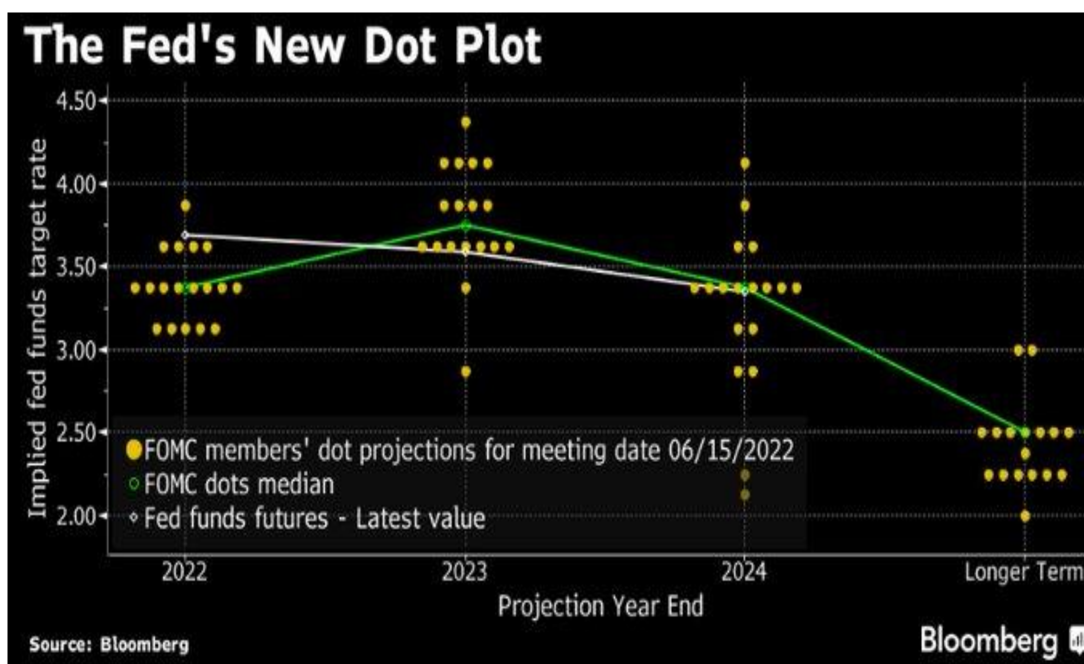
As markets anticipate a possible recession, an earnings slowdown will be factored in and could impact valuations as results are announced. Consumer behaviour will be important from here. For us, a PE ratio on the S&P 500 of around 14-times earnings would be a clear re-entry point and a strong buying signal. With the current PE ratio hovering around 19-times earnings today, we may not reach 14-times earnings, and most investors would understandably be glad if we do not! Indeed, as with the previous decline in 2020, we will be monitoring closely the ideal price envelope (range) to add to our equity positions.

The invisible buoyancy aid that has been US dollar strength has helped investors with North American equity exposure very significantly. Fixed income markets so often renowned for their lack of excitement have been anything but dull during the quarter. Significant falls in value have been recorded with even US treasuries down 10%. The culprit is of course inflation and the knock-on anticipation of rising interest rates which has dragged yields higher and capital values lower. Higher yielding corporate bonds have suffered more so as their default risk has risen. The benchmark 10-year treasury hit 3.49% yield, very close to our target level of 3.5%.

However, glimmers of hope are now appearing – longer dated treasury yields have begun to fall along with some early indications that inflation may have peaked.

Commodity prices for many industrial metals including the leading indicator copper have begun to fall back. Oil price futures are now in backwardation, a technical term referring to future oil prices being lower than current prices is another positive sign. Importantly, the price of shipping a 40-foot container from Shanghai to Los Angeles has fallen back 38% and likewise the Baltic Dry Index, measuring the cost of shipping bulk raw materials around the world has fallen back 60% from its peak. Inventories have surged overall, and many retailers are tempting us with early summer sales. Certainly, it will take time for these indicators to filter through to headline inflation numbers and of course the risk of a wage/price spiral, particularly at home in UK is something to be avoided if things are to normalise anytime soon.

The chart shows the US Federal Reserve famous dot-plot chart pointing to future interest rate movements.



Here at home, UK equities have faired relatively well due to lower technology constituents and higher commodity and mining related listings. However, sterling has been weak. The folly of Mrs. Merkel's energy security strategy is laid bare which has led to concerns about German and Eurozone manufacturing stability with the Euro weakening and certain member states witnessing diverging sovereign bond yields. President Biden's cancellation of the Keystone XL pipeline to deliver Canadian oil to the US looks ill-conceived at the point of writing, although US energy security is not in question. China's slowdown continues, led by ongoing concerns in the vast real estate sector. Manufacturing has picked up and Covid-related lockdowns have eased markedly during the period. The Bank of Japan's yield curve control policy designed to restrain the cost of borrowing has been maintained despite the yen falling in value to a 20-year low point. Whilst this currency move has stimulated export activity, we do wonder how long such low rates can be sensibly maintained with inflation threats at heightened levels, albeit not manifesting in the same way in Japan at the point of writing.

At portfolio level we have raised cash from US equities in a move to take overall risk down – this has worked well with performance relative to peers holding up encouragingly well, although down in absolute terms. Taking advantage of longer dated falling bond yields we have moved a portion of our fixed income exposure to exploit this opportunity. More will follow at the appropriate time. Likewise, we have reduced the short dated fixed income exposure to shelter from the rate rises which have been made. These moves have clearly benefited portfolios.

Infrastructure allocations have dampened risk as have gold holdings. The decision not to hedge US dollar exposure has been superbly rewarded during the troubled quarter and we are delighted with the buffer this has given to portfolio downside risk.

A thoroughly miserable quarter for investors – for sure. However, there are decent emerging signs on the horizon in terms of longer dated interest rates, possibilities for peaking inflation and overall equity market valuation metrics. Equities are a highly efficient discounting mechanism and one that provides the impact of future economic outcomes today. Underlying companies and long-term themes such as green energy, digitisation and infrastructure renewal have not been cancelled, therefore the rewards on offer are still available if we remain on course, stick to the plan, and navigate approaching risks carefully. This is precisely our strategy.

Written by the Alpha Beta Investment Team

Portfolio Returns

AB Core Performance %	Quarter to Date	Month to Date	Since Launch
AB1 Core	-5.40	-3.14	2.29
AB2 Core	-6.49	-3.86	3.29
AB3 Core	-7.51	-4.60	4.29
AB4 Core	-7.82	-4.95	5.75
AB5 Core	-7.86	-5.30	5.95
AB6 Core	-7.83	-5.43	5.82

AB Core Plus Performance %	Quarter to Date	Month to Date	Since Launch
Core Plus Cautious	-5.20	-3.13	3.59
Core Plus Cautious Balanced	-6.41	-3.97	4.39
Core Plus Balanced	-8.08	-4.85	5.86
Core Plus Balanced Growth	-8.09	-5.00	7.58
Core Plus Growth	-7.07	-4.36	7.10
Core Plus Adventurous	-6.95	-4.40	7.35

SRI/Ethical Performance %	Quarter to Date	Month to Date	Since Launch
SRI Defensive	-10.08	-6.27	8.66
SRI Balanced Income	-9.64	-5.34	5.86
SRI Balanced Growth	-6.39	-4.24	3.94
SRI Adventurous	-6.56	-3.58	3.20
Ethical Balanced Income	-9.52	-5.25	5.88
Ethical Balanced Growth	-7.00	-4.55	3.86

Source: Morningstar

As at 30 June 2022.

CONTACT

Andrew Thompson

Tel: 020 8152 5117

Email: at@alphabetapartners.co.uk

Address: Northgate House, Upper Borough Walls, Bath BA1 1RG.

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The Five Diamond rating awarded on Alpha Beta's Core portfolio range.