INVESTMENT UPDATE

SEPTEMBER 2022

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August used to be a quiet time with holidays taking centre stage. Not so in 2022, with some notable moves in markets and shaping of economic strategy. Let's look a little closer.

Joe Biden's curiously named Inflation Reduction Act (IRA) in fact pumps more money into the economy already suffering the worst bout of inflation in 40-years. The IRA effectively sees the return of big government to the United States with $739 billion available for green projects, shaping the pharmaceuticals industry and so-called debt forgiveness for students amongst other more liberal spending. The Federal Reserve Open Markets Committee minutes offered a more hawkish tone than traders had expected, and this, in many ways stemmed the rise in key equity indices. The S&P 500 turned away from the important 200-day moving average, rolling over and headed into a renewed period of volatility – as shown in the chart below. Last month we suggested the strong equity market rally was likely to run out of steam as nothing fundamental had changed. This warning of possible "fool's gold" sadly proved accurate.

Source: Investing.com
As at 30 August 2022.

Each August the beautiful Wyoming resort of Jackson Hole plays host to the global central banker's economic symposium – a summer camp for central bankers if you will. Freed from the otherwise strict protocols of more regular communications, speeches are considered important. Following a doveish and inaccurate speech in 2021 when Federal Reserve Chair Jerome Powell stated inflation was "likely to prove temporary"; that there was "slack" in the labour market with "little evidence of wage increases that might threaten excessive inflation"; and that "global disinflationary forces … will continue".

This year Mr Powell's speech was altogether shorter, lasting only 8 minutes, seemingly for effect, harder in tone, and unambiguous. He even directly quoted the 1970's Federal Reserve Chairman Paul Volcker who is credited with halting the soaring inflation of the 70's and 80's era by raising rates higher than many expected. Mr Powell gave a commitment to halt inflation even if it means a "sustained period of below-trend growth and softness in the labour market, as these are the unfortunate costs of reducing inflation." This is central banker speak for a recession and increasing unemployment. Despite the meandering path of central banker prose, we at Alpha Beta Partners have maintained a rock-solid view of inflation remaining higher for longer for well over a year now. The lagged effect involved in the calculation methodology of inflation will mean headline numbers remain above targets for longer and central banks are likely to "keep at it" without a policy pivot until they are convinced the inflation dragon is finally slayed.

The US housing market is beginning to show distinct signs of weakness, as did the Purchasing Managers Index and this aligns with Federal Reserve policy of cooling economic activity. Whilst we can be persuaded that US inflation has peaked, the stickier components of a tight labour market, home equivalent rents and of course food are likely to mean inflation around the 4% mark into quarter 2, 2023 and a possible overshoot of the Federal Reserves 2% target for the year 2023. At home, the summer of discontent could well become a winter of industrial disputes - a new Prime Minister will have a full in-tray of pressing matters to attend to. The energy crisis is presently most acute in Europe and particularly Germany of course. A Europe-wide recession looks distinctly on the cards.

In Japan inflation has marginally increased although the policies of yield curve control at the expense of a much weaker yen are broadly holding up to scrutiny. Irrespective of geography much of the global inflationary pressure is beyond central bank control and resides squarely in the geopolitical category. China has already begun cutting interest rates, as the economy slows markedly impacted by the duo of Covid-19 lockdowns and a significant real estate sector problem.

Set against the backdrop of bad news we turn now to consider – what next? The equity bounce allowed us to take further profits and raise cash levels in good time in August before markets turned lower. Portfolio risk sitting now at the lowest levels in some time, whilst we wait to make our next move. The anticipated recession will lead to longer dated fixed income yields falling (and capital rising) in anticipation of lower future rates. We have already begun positioning for this and will do more as opportunities present themselves.

The dollar remains firm, as expected, which acts as a super-helpful buoyancy aid to our US denominated holdings whilst the euro, sterling, renminbi, and yen all depreciate. Infrastructure investments continue to do their job by diversifying risk and helping capital values. The Federal Reserve so-called pivot in interest rate setting policy is predicted to come during the early part of 2023. Of course, things can and do change but always remember the stock market is an efficient discounting mechanism – it trades on future expectations. Markets fall before economic issues become manifest and rise before economies emerge from recession. We have sufficient "dry gun powder" ready to deploy when we are confident investors will benefit the most. In the meantime, we remain vigilant.

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