Alpha Beta PARTNERS

Investment Update June 2022

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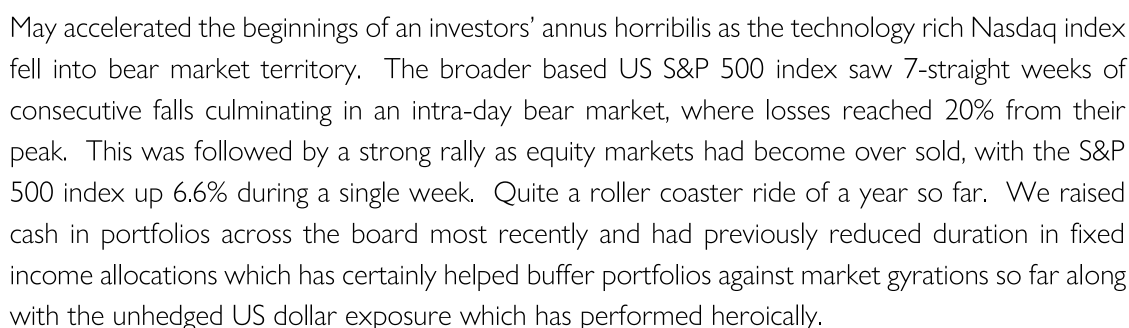


May accelerated the beginnings of an investors' annus horribilis as the technology rich Nasdaq index fell into bear market territory. The broader based US S&P 500 index saw 7-straight weeks of consecutive falls culminating in an intra-day bear market, where losses reached 20% from their peak. This was followed by a strong rally as equity markets had become over sold, with the S&P 500 index up 6.6% during a single week. Quite a roller coaster ride of a year so far. We raised cash in portfolios across the board most recently and had previously reduced duration in fixed income allocations which has certainly helped buffer portfolios against market gyrations so far along with the unhedged US dollar exposure which has performed heroically.

Oscar Wilde famously said, "the truth is rarely pure and never simple", which perfectly captures events during 2022 so far. However, we shall seek to scythe a clear path through the fog in our descriptions which follow.

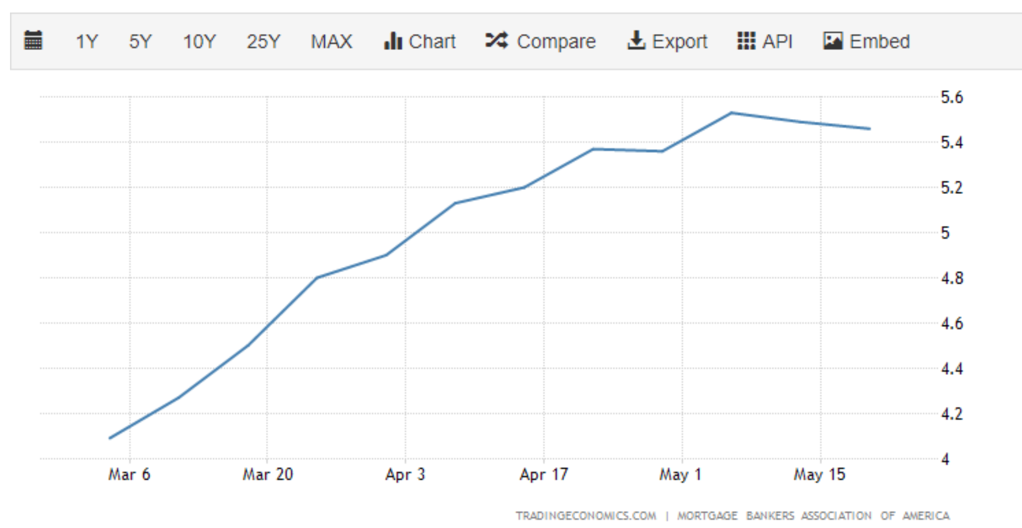
The unwinding of excessive liquidity by central banks has been anticipated and factored into strategies for several months. The imperative of controlling inflation and allowing structurally stronger economies the ability to thrive without artificial stimulus was a destination point that had been an ambition since as long ago as 2009. We wrote about this back in early February. The invasion of Ukraine was of course an unknown and accelerated geopolitical uncertainty but particularly aggravated inflation of key commodities (food and fuel) at quite the worst moment. This forced bond yields even higher and undermined the valuation of many stocks, those of technology companies have fallen the most as they are notably sensitive to rising interest rates – which is the time-honoured go-to solution for controlling inflation. This places central bank policymakers into a tight spot because the momentum of key economies is naturally slowing following the turbo charged and liquidity fuelled recovery from the worst of the pandemic. Tightening monetary policy too much and too fast could tip economies into recession. Interest rate hikes suppress demand by taking money out of people's pockets, but rate hikes cannot solve a lack of supply.

We anticipate a 0.5% interest rate rise announced by the Federal Reserve at the forthcoming June meeting and quantitative tightening (QT) to kick-off around this time but gathering momentum a little later, perhaps by September. The level of QT will be accelerated from $30-60 billion per month to around $95 billion per month. Quantitative tightening effectively sucks liquidity out of the system by draining bank reserves, with potentially relatively minimal impact on interest rates and the real economy. QT was first introduced pre-pandemic in 2017 and so is a new central banking tool. The probability of a central banking policy error tipping economies into recession is rising. Some commentators see the recession risk at 40% likely, we are as ever, slightly more cautious and see the risk a tad higher. Therefore, we are likely to de-risk portfolios ahead of time if this becomes necessary to ensure they remain within allocated volatility boundaries, as required.

The theme of economic slowdown is global in nature. In Europe the ECB is expected to raise rates as German, French and Spanish inflation hit a high point. Japan has seen the yen hit a 20-year low as the Bank of Japan seeks to control borrowing costs at ultra-low levels. In China the slowdown is somewhat more pronounced, although the stringent zero Covid-19 policy appears to be abating with restrictions being lifted in the economically important Shanghai area. At home the commodity rich FTSE 100 has performed reasonably well despite headwinds. It is unlikely inflation will begin

receding until the year end with further energy price rises planned for October. This leaves us with a summer of discontent in prospect with undoubted industrial action across certain industries. A wage/inflation spiral must be avoided with demonstration that lessons from the 1970s have been learned.

The chart shows US 30-year mortgage rates plateauing and beginning to fall.



Calendar	GMT	Reference	Actual	Previous	Consensus	TEForecast
2022-05-18	11:00 AM	13/May	5.49%	5.53%		
2022-05-25	11:00 AM	20/May	5.46%	5.49%		
2022-06-01	11:00 AM	27/May		5.46%		

Source: Tradingeconomics.com
As at 31 May 2022

We know markets are a hugely efficient discounting mechanism, looking forwards and discounting back future probabilities to today's stock and bond prices. This means markets are already pricing in much of the slowdown and potential recession we could see in due course. Therefore, it begs the question – "why would a sensible investor cash in his/her portfolio today?" As higher rates get closer it can be reasonably expected that future, longer term rates are likely to begin falling based upon the expectation of the slowdown passing and a recovery getting underway. We have shifted focus within some of the fixed income allocation towards the longer duration end of the yield curve. The good news is that this shift has already begun to pay dividends with yields already beginning to nudge gently downwards.

In a nutshell, portfolios have performed extremely well when measured against their peer group during the period. We have previously raised cash levels across the board and shortened fixed income duration. We left US dollar exposure unhedged all of which have helped buffer against market headwinds. We are likely to raise cash further in the short term based upon recessionary expectations coming more clearly into focus. We have already shifted some fixed income exposure towards the longer end of the yield curve to protect against short term rate rises and to benefit from the inevitable softening in monetary policy as the slowdown eases. This is already

beginning to manifest. Our focus and attention remain vivid on threats and opportunities. Share prices will be amongst the first indicators to signpost a recovery and resumption of a calmer tomorrow - which will inevitably come sooner than we may think today.

Written by the Alpha Beta Partners Investment

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