INVESTMENT UPDATE

MARCH 2023

FOR PROFESSIONAL INVESTORS ONLY

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Investment Update

The road to Damascus is never a straight line – this seems particularly true when it comes to economics and investment trends. Disinflation proudly reported by Jerome Powell, the Federal Reserve Chairman earlier in February soon converted to irritating increases in PCE inflation just a short couple of weeks later. CPI inflation fell less than expected whilst prices continued to rise in France, Spain and at home in UK food inflation hitting a high point of 17%. The expectation for rate rises accelerated as a consequence with terminal interest rate projections 0.25% to 0.5% higher at the end of February than at the beginning of the month. We will seek to unpack this issue and other important trends in this update, whilst endeavouring to do so in relatively concise fashion – you're welcome! Let's dig in...

Equity markets enjoyed a positive run-up during the first part of February powered by growing sentiment that a recession might be avoided, and the ubiquitous "soft landing" would be delivered. UK stocks reached a high point last witnessed in 2018, a warmer winter and much reduced dependency on natural gas in Europe added to the optimistic mood. A rebound in sticky inflation (quoted above) snuffed out positive traction as February ended.

The confusing "hokey-cokey" nature of data flow and market reaction is not entirely surprising and explains our portfolio positioning. To quote Voltaire, history never repeats itself, but people do. Economies are effectively being starved of liquidity, a form of economic oxygen.

Source: Bloomberg, as at 12 Feb 2023.

When oxygen is delivered economies accelerate and when deprived they retard. So, with quantitative tightening and higher rates slowing things down and liquidity injections coupled with a post Covid reopening in China and a reduced affect of natural gas weaponisation in Europe, markets and data have reacted in the ways witnessed during the month.

The US economy remains strong but is slowing as expected. Rate rises take time to filter through the system and inflation remains on a downward trajectory – the services component of the inflation data will lag. Goods inflation is sharply lower, and housing is turning down.

The collection of credible indicators still point squarely to an economic slowdown which is likely to meet the recession definition, albeit a modest one. Treasury yields are notably higher at 3.9% for the 10-year stock which of course makes equity valuation harder to justify – as we have seen, any ripple of bad news stimulates price action. The Dollar Index has likewise aligned with news flow, lower then back higher.

Unemployment remains low and job creation remains strong. We do expect this to weaken as the cycle plays out and as higher rates exact their toll on corporate cashflows. Simultaneously the latest earnings announcements from America's largest companies have delivered more patchy results than the long-term trend – 67% of firms beating earnings forecasts rather than the average of 77% or more over the past few years. Hardly disastrous but the slowdown is clear. US rates are still likely to peak this year and remain "higher for longer" before pivoting lower.

PROPRIETARY RESEARCH FROM REFINITIV
S&P 500 EARNINGS SCORECARD

FEBRUARY 24, 2023

S&P 500: EARNINGS

Exhibit 2. 2022Q4 Earnings Scorecard

Sector	Above %	Match %	Below %	Surprise Factor	Reported Total #	Index Total #	% of Mrkt Cap
Consumer Discretionary	68%	4%	28%	8%	47	56	10.6%
Consumer Staples	67%	11%	22%	2.8%	27	33	6.8%
Energy	62%	5%	33%	1.7%	21	23	4.8%
Financials	62%	5%	34%	1.6%	65	67	11.6%
Health Care	79%	2%	19%	4.8%	58	64	14.5%
Industrials	70%	6%	25%	0.2%	69	70	8.4%
Materials	55%	3%	41%	2.8%	29	29	2.7%
Real Estate	57%	7%	37%	-8.0%	30	30	2.7%
Technology	83%	3%	14%	1.2%	71	76	27.4%
Communication Services	45%	9%	45%	-7.5%	22	22	7.6%
Utilities	58%	12%	31%	-10.3%	26	30	2.9%
S&P 500	**67.5%**	**5.2%**	**27.3%**	**1.1%**	**465**	**500**	

Source: I/B/E/S data from Refinitiv.

Europe's rapid switch away from Russian gas has been extraordinary and this coupled with a warmer winter on the continent has improved the investor mood no end. Economic activity has picked up, as reported in the Purchasing Managers Index report during the month and equities moved ahead. Mrs Lagarde and the ECB remain intent on tackling inflationary pressures by hiking rates and removing liquidity, in-sync with the Federal Reserve and the Bank of England. UK stocks pushed higher driven by likely higher demand for commodities from a reopening China and robust oil company results. Banks pushed higher too, and results pleased investors – such is the concentration and skew these days for the UK's largest listed firms.

The Bank of Japan will have a new Governor, an experienced economist Mr Kazuo Ueda is expected to reduce dependency on yield curve control and a gentle rise in rates is expected over time, making Japan more in tune with western type polices. As stated here previously, the net effect of higher yielding domestic stock is likely to incentivise local investment rather than international speculation.

China has injected $162 billion liquidity into her economy to help stimulate a smooth transition from the protracted Covid related lockdown. The halo effect from this and the reopening has been felt positively throughout global markets. Chinese Purchasing Managers Index reports are expected to support the notion of a pick-up in activity. The fact China is no longer economically synchronised with the West will deliver positive and negative drivers as the cycle works through. However, for now the news here is net positive and provides a counterbalance to the slowdown experienced elsewhere.

Of course, geopolitics cannot be modelled but continues to play a critical role in the value of investments. We now inhabit a multi-polar world where US hegemony is increasingly less apparent. A settlement in Ukraine would benefit humanity and portfolio valuations and we maintain a vigilant watch on other potential flashpoints around the world such as Taiwan. The regression towards an expensive cold war across a broad front seems to be underway. The weaponisation of commodities, information flow and technology is escalating.

The above narrative will contextualise the portfolio changes implemented during the month. We have sought to secure upside potential from the reopening Chinese economy and to benefit from the easing of the energy pressures in Europe. Allocations to these regions and their beneficiaries have been increased across appropriate portfolios. We remain cautious around markets which could be impacted by the cyclical downturn in US earnings which could well provoke a downward revision with stocks priced to perfection with the support of earnings robustness beginning to ebb away. We do not expect any correction to be long lasting,

but a strong recovery from today's valuations and earnings yields is perhaps unlikely. Likewise we have seized the moment to apply a hedge to around 30% of our dollar holdings – as the Greenback will inevitably revert from its all-time high against other currencies. Cash levels remain elevated for the reasons explained but are now benefitting from sensible yields of 3.5% or more as we are "paid to wait" for the right reinvestment moment. Cash will be deployed back to risk assets when markets provide the stimulus, we anticipate not too far distant.

As ever, we thank you for ongoing support. We are well positioned to add more risk when the moment arrives.

Written by the Alpha Beta Partners Investment Team

All sources Bloomberg unless otherwise listed.

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