Alpha Beta PARTNERS

INVESTMENT UPDATE

AUGUST 2022

www.alphabetapartners.co.uk

The somewhat surprising market rally in July saw the technology focused Nasdaq +12.6% and the broader S&P 500 +9.1% as the market interpreted what would normally be bad news as good news – insofar as persuading a hawkishly minded Federal Reserve to raise rates perhaps a little slower and a little less aggressively. Of course, investors will have welcomed the arrested equity market falls and reassuring bounce with warm applause. The question remains, whether the bounce in equity values represents "fools gold", a classic bear market rally or something more substantial and deep rooted? Let's take a closer look...

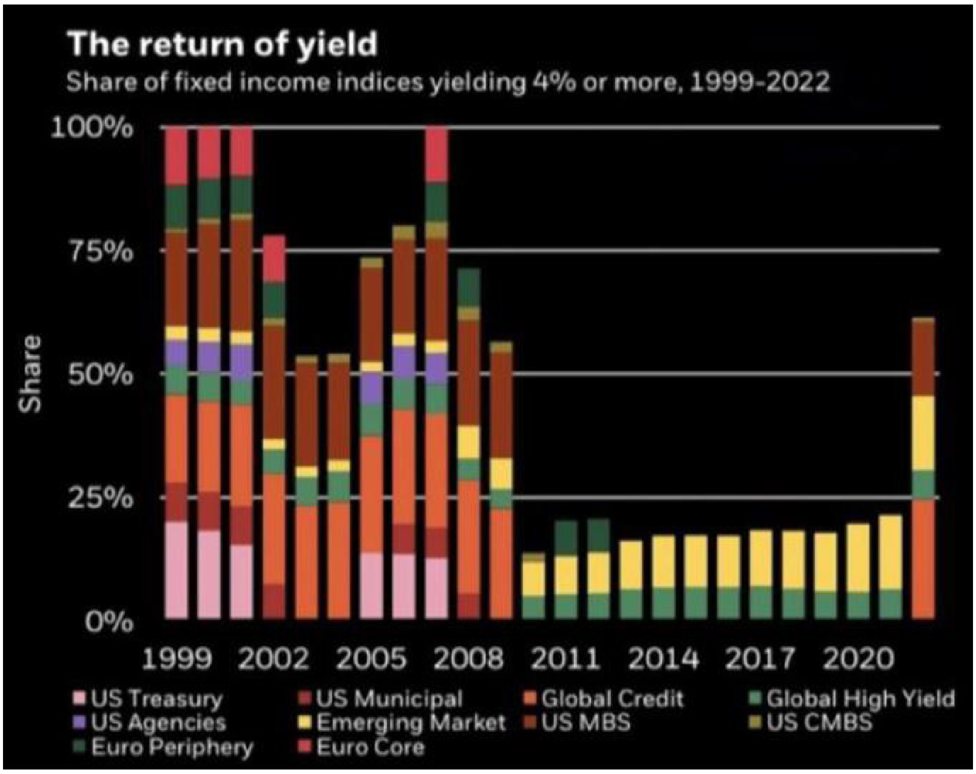
We know some of the inflationary leading indicators have begun to soften from previous highs. Certain commodities are sharply down in price, such as copper which is recognised as a key industrial metal, present in a broad and growing number of products. Likewise the oil price fell to sub-$100 during July, despite an unsuccessful Presidential trip to Saudi Arabia which majored on a plea to increase production. Transportation costs have weakened too – the cost of shipping a 40 foot container from Shanghai to Long Beach is down 38% and the Baltic Dry Index, which measures the cost of shipping bulk raw materials around the world has fallen 60% from its highs. The mighty US economy slipped quietly into a technical recession in July following 2-consecutive quarters of GDP contraction. The Federal Reserve hiked rates by an additional 0.75% (a large real terms increase) to 2.25% - 2.50% yet stocks rallied as traders interpreted Chairman Jerome Powell's comments to be more doveish than previously expected. A confusing picture.

The geopolitical issues in Ukraine remains unresolved and the knock-on impacts to food and energy prices remain acute. Europe in general but Germany in particular remains directly in the grip of Putin's gas weaponisation strategy. The knock-on consequences to Europe's manufacturing base should not be trivialised, particularly as autumn and winter lie ahead. The exogenous nature of these scenariois means central banks are powerless to control them. Central banks face a particularly difficult task of defeating inflation using interest rates and a strong currency (particularly in the United States) whilst avoiding a real recession as the economy naturally slows. History is instructive, showing an economic soft landing under such conditions is rare indeed. Interest rate rises have been front-loaded so far and with the yield curve steepening at the short end still further markets antipate an additional 0.5% and perhaps a final 0.25% from the Federal Reserve in September and November respectively. However, should inflation data ease significantly over the next 3 months (and it may well do so) there is a good probability rates go on hold by December. Thereafter a short period of stability before rate pressure can begin to be eased. We consider a "pivot" unlikely until central banks are confident inflation is contained.

Consumer Price Inflation in US hit a 40-year high at 9.1% in July and the Federal Reserve's favoured measure of PCE (Personal Expenditures Price Index) inflation remained significantly elevated at 6.8%, way above its 2% target, also at a 40-year high point. Chairman Jerome Powell remains confident, as does Janet Yellen, Secretary to the Treasury, that the economy can be brought down to a safe and soft landing on what amounts to an increasingly short and narrow runway. We are scepitcal, at the point of writing.

Following broad criticism Jerome Powell decided to abandon so-called forward guidance to markets and will rely increasingly on technical data to inform policy decisions. Quantitative tightening will pick up tempo as we head into the autumn. The labour market at home and abroad remains tight – more jobs available than workers willing to fill them. Of course, this pushes wage inflation higher in the face of a period of difficult pay settlements, agitated by unions bolstered by renewed bargaining power. Importantly the Federal Reserve now considers rates are at a neutral point, at around 0.25% above long run inflation – meaning any further tightening will bring greater control, more quickly. However, this is a big call and means the Fed' still considers long run inflation to be around the 2% mark and does not consider economies, post pandemic, have broken out into a new longer run economic regime. Again, we are a little sceptical underpinned by our well stated view of inflation remaining higher for longer.

The chart shows the longer run trend in yields, depicting changing economic regimes.



Source: Bloomberg
As at 30 July 2022.

At home our unique form of party politics saw a serving Prime Minister effectively removed from office whilst markets and the pound sterling looked-on without emotion. In fact domestic markets have performed relatively well over the period. We expect to see a 0.5% rate rise by the Bank of England during early August. The European Central Bank raised rates 0.5% during July whilst fighting their own acute battle with inflation, Eurozone fragmentation which is heightened in Italy particularly and Spain, whilst the afore mentioned reliance on Russian gas has created a lesson for all future history students on the pitflls of an inappropriate energy security strategy. The Bank of Japan continues to fend-off inflation of any magnitude whilst defending low interest rates at the expense of severely weakened yen. The weakened Chinese economy has been underpinned by the PBOC (People's Bank of China) and looks a little healthier, although sudden Covid-19 related lockdowns and the vastly over-levered real estate sector dampen enthusiasm. We keep a close eye on tensions in the Pacific region between China and Taiwan. The emerging world generally is struggling to service debts denominated in US dollars, which remains strong and is likely to do so for some time yet.

At portfolio level we have begun positioning fixed income further along the yield curve to take advantage of falling future rates as depicted by the inverted yield curve. This is likely to continue during the rest of 2022. Equity allocations are broadly around neutral whilst markets are pushing higher but we are positioned and ready to reduce allocations if and when the present rally runs out of steam. Cash weightings remain higher, but will increase further at the expense of equities under the above scenario. Infrastructure continues to play a useful role as does exposure to a strong and unhedged US dollar.

Between 1980 and 1982 the stock market fell 27% as Paul Volcker Chairman at the Federal Reserve ramped-up his fight against inflation. As soon as he "pivoted" during quarter 3 1982, it took only 4 months to erase the entire bear market losses. So, for us the change in rate setting policy by the Federal Reserve will be the critical turning point in markets, and we are perhaps not there just yet. In the meantime we remain vigilant with a laser beam focus on markets and your portfolios.

Written by the Alpha Beta Investment Team

CONTACT

Andrew Thompson

Tel: 020 8152 5117

Email: at@alphabetapartners.co.uk

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

Important Information

This is a marketing communication from Alpha Beta Partners a trading name of AB Investment Solutions Limited who are authorised and regulated by Financial Conduct Authority (FCA). Retail clients should not rely on any of the information provided in this document and should seek assistance from a Financial Adviser for all investment guidance and advice.

The information and opinions contained in this document are subject to updating and verification and may be subject to amendment. The information and opinions do not purport to be full or complete. No representation, warranty or undertaking, express or limited, is given as to the accuracy or completeness of the information or opinions contained in this document by Alpha Beta Partners and AB Investment Solutions Limited.

No liability is accepted by such persons for the accuracy or completeness of any such information or opinions. As such, no reliance may be placed for any purpose in the information or opinions contained in this document.

Please remember that you should not base decisions on past performance and that prices may fluctuate, and you may not get back your original investment. Past performance is not a reliable guide to future performance.

defaqto EXPERT RATED DFM MPS on Platform 2022

defaqto EXPERT RATED DFM MPS (Platform) Family 2022

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