INVESTMENT UPDATE

DECEMBER 2022

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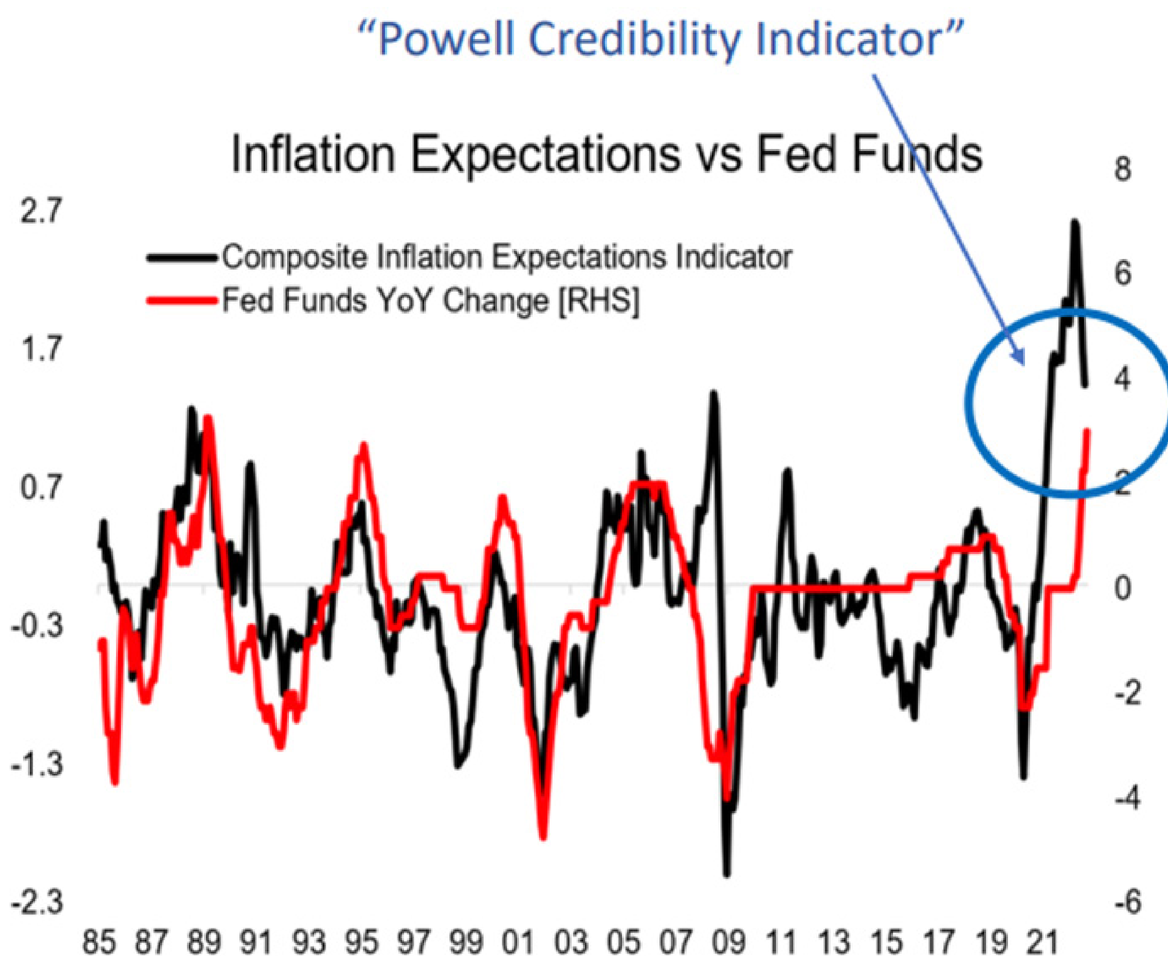
Of course, it is easy to feel glum at this time of year – fewer daylight hours, inflation gnawing at our bank balances and a difficult year in stock markets impacting the wealth effect. Human suffering relatively close to home in Ukraine sits uncomfortably in our minds. In some ways 2022 has proven to be an annus horribilis, however, whilst a recession lies ahead, we are confident at an investment level at least, we can look forwards with some cautious optimism.

The colossal sums of liquidity deployed by the Federal Reserve during the pandemic will probably be looked back upon as a policy error – awakening the inflation dragon from a 40-year hibernation. "Go spend me" stimulus cheques issued to private individuals in the United States whilst furlough payments and other ingenious fiscal measures to support the economy at home all need to be paid for with higher taxation and at a time when monetary tightening is required to resolve the inflation problem that resulted from the excessive stimulus. We would struggle to create such a narrative!



Source:

Topdown Charts, Datastream, October 2022.

In markets, November has been dominated by the US CPI data release which showed inflation now beginning to slow during October (albeit marginally) from the high point we wrote about here last month. Year-on-year inflation in US fell to 7.7% *slightly lower than was forecast. The US monthly inflation rate fell to 0.4% in October stimulating an excitable bear market rally across the board in risk assets. Progress indeed, but unlikely to persuade the Federal Reserve to change course and "pivot" sooner than has been planned as inflation remains higher than the 2% target. As stated last month, we expect US rates to rise 0.5% then 0.25% in December and January respectively before pausing. Jerome Powell, the Federal Reserve Chairman is focused upon eradicating higher levels of inflation and bolstering his personal credibility with markets, in the famous Paul Volcker's footsteps. As such we fully expect to see US rates higher than the prevailing inflation rate and this blunt instrument effectively bludgeoning the inflation dragon into submission. In effect this measure might be considered the "Powell credibility indicator".

The mid-term US elections proved to be more positive for the Democrats than many had forecast with the Republican "red wave" of Trumpism failing to materialise in any meaningful way. The Republicans have taken control of the House of Representatives after they passed the threshold of 218 seats. Democrats have retained control of the Senate by gaining the state of Pennsylvania from the Republicans. The Biden administration has pushed through much of its reform agenda early-on and so we anticipate limited impacts for the remainder of the Presidential term.

The rally in risk assets has been a welcome turnaround with just about all asset classes responding favourably and stimulating the super-strong US dollar to show the first glimmers of receding in several months. As markets perceive the zenith of the rate hiking cycle is within touching distance, there is potential for further progress. Of course, we remain cautious. The impact of higher rates is likely to result in an economic slowdown with the almost inevitable but planned for side-effect of defeating inflation. This will offer a knock-on impact to corporate earnings, which offered some room for cheer based on quarter 3 results but are being marked down looking further ahead. The larger technology firms are exercising what in corporate circles is referred to as "operational leverage", meaning laying off workers when the future looks less rosy, then re-hiring when things improve. Thousands of workers are losing their jobs as technology giants cut back. However, we note new projects are broadly going ahead with Microsoft the latest player to create a Met averse environment. The real excitement is for the "industrial met averse" rather than the public / retail version. The ability for manufacturers to test products and services in a virtual world ahead of a formal product launch is set to save large sums of development budget and reduce "time to market" for product launches. NASA has resumed space exploration – from these developments we take confidence for future innovations and the health of technological advances.

The warm autumn will submit to a colder winter with implications to energy prices. We note Europe and UK are the most impacted regions and gas storage facilities are brimmed full whilst the UK has begun importing coal once again to head off a possible winter energy crisis. In Europe the warmer weather has brought natural gas prices lower and Mrs Lagarde (Head of the ECB) comments around a less hawkish monetary policy pathway as Eurozone economies remain weak have seen stocks firmer during the month. The Russo Ukraine war is bound to bring further unwelcome headlines before it is concluded but for now seems to be grinding into an attrition phase with the onset of winter. The Autumn Statement at home in UK served as a heady reminder that so-called prudent fiscal policies, seemingly demanded by markets, will rely upon cuts in services and tax rises reminiscent of the austerity years. The UK will undoubtedly head into a recession although equity valuations are cheap next to other global markets.

Japan continues controlling interest rates at lower levels at the expense of the yen – although a firmer month in November proved beneficial. In China the zero tolerance Covid policy of the CCP (Chinese Communist Party} continues with lockdowns now creating social unrest. The newly reappointed President Xi Jinping portrays a dominant image across the region which continues to struggle with a real estate crisis and slowing GDP growth. India's momentum remains positive with the stock market reaching new highs late in the month.

At portfolio level we benefited from the risk asset rally and have raised a further cash weighting in the event markets turn down, as they did during the summer. However, the S&P 500 has regained the 4,000 **mark and looks intent on tackling the important 200-day moving average hurdle. With volatility lower in both the equity and fixed income markets and with seasonality to consider, it is possible a rally beyond these levels will continue. Stocks in US offer fair value but are a long way from being cheap. Treasury yields have fallen back slightly from their recent highs sitting now at 3.7% for the 10-year benchmark. We will consider implications for US dollar strength and the relative attraction of value-oriented stocks in our next portfolio moves – more of which to follow. For now, portfolios are well balanced and, we believe, nicely positioned with a sensible buffer should sentiment turn down but likewise with an attractive springboard should positive momentum be accelerated.

This is the last Investment Update of 2022. We would like to thank you for your support during the year – a difficult one in absolute terms but a positive outcome relative to the peer group against whom we are so often judged. We wish you a very Merry Christmas and a happy and peaceful holiday season.

Written by the Alpha Beta Investment Team

Sources: **Bloomberg, ** Investing.com, 28 November 2022.*

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