Mini Investment Committee October 2022 Rebalance

General Overview

With the recent volatility in markets, particularly sterling assets, an investment committee was held in early October, with members voting for a rebalance at the next available opportunity (given the 30-day rule).

One of the major headwinds this year has been the Ukraine conflict, and there appears to be no end in sight, if anything the situation is deteriorating which raises further questions over energy and food supply. A particular concern as the northern hemisphere heads into the winter months.

The market appears to be back in the thinking that bad news is good news for equities when it comes to economic data, and the recent non-farm payrolls figure didn't help the equity bulls (if there is any at the moment). The eagerly watched data release was relatively positive, although hourly earnings did weaken. Nonetheless, it did see stocks and bonds sell off as it gave no signal that the Federal Reserve would slow in its task to curb inflation.

One US survey highlighted that job openings in August plunged by over 1 million, although this is from a position of strength for the labour market, so at this stage, we are not reading too much into it, but we'll continue to monitor as one potential sign of a slowdown. Elsewhere, the data continues to disappoint.

Global factory output mostly weakened in September from slowing demand due to cost pressures and tighter liquidity conditions, with Europe's problems particularly impacted by surging energy prices. There were some signs of 'catch up' production in China, although new orders index remained in contraction for the third straight month. The continuation of the zero-covid policy has impacted business and consumer sentiment and continues to weigh on the Chinese economy. There have been stimulus measures there (unlike other central banks), however these have failed to have an obvious impact.

Politics continue to command headlines in the UK, with the Prime Minister seeking to rally backbenchers after a dismal start to her tenure. The economy remains in a precarious position, with the renewed rise in oil prices doing nothing to ease the cost-of-living squeeze. Selling in long duration gilts and the pound has continued. The Bank of England has only purchased a fraction of what they could have done in their support for longer duration gilts.

The consumer remains under great pressure, with concerns over house prices, job security and personal finances the main areas of concern from one YouGov poll. Consumer weakness has been evident in the UK sales numbers, and this was also evident in company updates in September, and this has us worried for the upcoming reporting period starting mid-October. This concern is not isolated to UK Plc.'s, with macro events weighing on firms near and far. This has been reflected in the earnings bar being lowered in recent months.

Infrastructure investments had been a ballast in portfolios, and with the sharp rise in government bond yields in recent weeks, we feel there has been an overreaction as the asset class has experienced drawdowns. These assets continue to provide a valuable function in society, whether that's transport infrastructure or renewable assets. The exposure is towards structural growth sectors rather than cyclical, and as the economic situation deteriorates, we continue to feel comfortable holding these more defensive investments.

Our main concern being the determination that the rate hiking cycle will continue, sending economies into a recession in order to tame inflation. Until there is clarity and a pivot in policy, we expect the volatility to continue. As a result, we remain at the lower end of our ranges for allocation to equity investments, a move which took place at our previous rebalance, so there has been no change this time round.

The main reason for the rebalance was to remove the longer duration gilts and linkers from portfolios. We cut back at our last rebalance, but have now taken the decision to completely remove the allocation. The aggressive selling was exacerbated by the UK fiscal event and it wasn't just because of concerns over UK credit and supply, as well as inflation, but also because of forced selling from liability-driven investment funds, or in laymen's terms, pensions funds which are allocating capital based on current and future liabilities.

With this increased volatility, we felt comfortable removing this exposure from portfolios, and taking a more defensive stance with more cash and money market investments in the near term.

Please contact us for specific model changes.

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