May 2022 Rebalance

General Overview

Asset/Region	Current Stance	Previous Stance
US Equities	Neutral View	Neutral View
UK Equities	Neutral/Cautious	Positive View
European Equities	Selective Approach	Selective Approach
ROW Equities	Neutral View	Neutral View
Fixed Income	Neutral View	Negative View
Property	Selective Approach	Selective Approach
Infrastructure	Positive View	Positive View

The Russian invasion of Ukraine has grabbed the headlines and highlighted many shortcomings within the global economy, particularly in areas such as energy and food which pose significant risks to so many people.

Covid infections have taken a back seat in economies such as the UK and US as they look to life beyond the virus. However, this is not the case for China who continue their zero-covid policy, which has posed further supply chain risks as factories shut their doors once again, no doubt dragging on global growth.

As inflation sits around multi-decade highs, there are growing concerns we are heading towards a recession as central banks tighten policy in order to stem price growth. The Federal Reserve tells us the US economy can handle tighter policy; we don't believe this is the case for others.

In Europe, growth is slowing. Consumer and business confidence figures have been plummeting as disposable incomes have been squeezed. Further to this in the UK, National Insurance increases saw workers' take-home pay fall at a time of soaring costs. We remain of the opinion that rate hike expectations in the UK are overdone.

USA

The US economy is more insulated to the troubles in Europe, being more self-sufficient in their energy supply (and other areas of production). Nonetheless, there are concerns over US growth, with higher energy bills and costs of goods weighing on consumer incomes. Evidence is already appearing, with lower demand for new trucks and autos, and a tailing off in freight volumes and prices (although Chinese lockdowns are arguably to blame for the latter).

The Federal Reserve continues its move to tighten monetary policy. This has weighed on risk assets, with the growth focussed US index down just over 15% (in Sterling terms to the end of April 22). We are told the US economy can withstand tighter policy; however past evidence suggests that is going to be hard to achieve.

Biden's build back better plan is all but finished for now. With inflation at its current levels, it's hard to justify further stimulus. This would have supported a number of social investments, from education to healthcare. It looks as though the focus will now move to a severely reduced package, such as expanding the child tax credit as a standalone piece of legislation.

Nonetheless, in comparison, the US economy has less risks than many other countries and inflation could well be peaking. Because of our more bearish views to regions such as the UK and Europe, portfolios exposure to US equities has risen slightly.

UK

As highlighted by The Office for Budget Responsibility, there are high levels of uncertainty, and they cut their growth forecast for the UK to 3.8% from 6% for this year. There was widespread disappointment from the chancellor at the last budget, and with the 'Partygate' scandal hanging over the Tories, their obliteration at the local elections (post committee meeting) was to be expected.

With the uncertainty in the UK economy, we have for some time felt the interest rate expectations have gone too far. We have been near the lower end of our ranges for fixed income exposure, favouring shorter duration assets, however we felt with the move in yields, it was a chance to add to higher quality, longer duration fixed income, with the emphasis on higher quality.

The committee felt the prospect of stagflation was real, we have therefore reduced our UK mid-cap equity exposure. Meanwhile, we have taken the opportunity of the rise in yields to introduce some sterling government debt into portfolios (depending on risk), firstly to add to duration but also to improve the credit quality of portfolios.

Europe

Europe is most exposed to the Ukraine/Russia crisis. On top of this, the continent has still been struggling with the virus, with issues such as staff absences impacting business activity.

Overall, the Eurozone expanded above estimates in 2021 and growth was always forecast to mediate going forward, but this slowdown will be sharper due to the rapid and extreme rise in energy prices and other issues posed by the Russian invasion of Ukraine. The invasion has exacerbated issues for the critical auto sector once more, just as things were looking like they were beginning to ease. So far, what the end game is with regards to the Ukraine conflict is unknown, which alongside the zero-covid policy in China, raises serious growth questions for the region.

Because of the above, Christine Lagarde has been keen to highlight that the Federal Reserve and European Central Bank will be moving out of sync for the foreseeable future. Nonetheless, interest rate hikes have begun to be priced in, and there are growing signs of divergence from the ECB policy committee, with some members publicly critical of the relative ‘dovish’ stance.

In France, Emmanuel Macron beat the right-wing candidate, Le Pen, nonetheless still highlighting the divide in French society. With risks already high in the region, the result does create some stability with regards to the EU (for now).

In general, European exposure has remained largely unchanged, with European Equity exposure reducing slightly in higher risk portfolios.

Rest of the World

China’s zero-covid policy has resulted in a number of city-wide shut downs, with workplaces being told to halt operations or work at home. This has led to many slashing their Chinese growth forecast. However, the supply chain issues the lockdowns will create, will drag on the global economy. A number of retailers have highlighted weaker growth, including luxury goods brands which have for a few years highlighted strength. China’s central bank’s stance is in contrast to other nations, widely expected to ease monetary policy further due to economic pressures. Risk assets also continue to be pressured by the Chinese central bank’s clampdown on areas such as technology. Our Chinese exposure remains limited, still preferring economic exposure rather than country of listing, this remained unchanged at the rebalance.

State elections in India earlier this year were positive for the current leader Modi who remains popular despite Covid and farmer protests. The rise in the oil price for India is a concern, but has become more manageable versus a decade ago. It is expected whilst continuing to tighten policy, it will be more gradual than other EM peers such as Brazil. Business confidence and manufacturing activity continues to rise in the region. There is some optimism built in to the equity market, however we still believe the growth story for the region is positive. The country will also play a pivotal role in climate goals, as highlighted by Rachel Kytem, a member of the UN Secretary General's high-level advisory group on climate action, who said not only can they achieve their own targets, they will be a hub to help others as they expand green hydrogen and green ammonia, on top of their commitment to solar. Our exposure to India remains unchanged at the re-balance.

The Japanese Central Bank continues to favour keeping rates low, and the Japanese Yen has suffered as a result. They continue to seek a relation of the economy, something that has been non-existent for a number of decades. Prices have moved higher, albeit closer to the bank’s target of 2%, tame versus other developed nations. However, there are concerns this is mainly cost-push due to the reliance on imported commodities. Our Japanese equity exposure remains selective through global funds.

Asset Class Comments

Overall equity exposure remains broadly unchanged; however, UK mid-cap exposure has been reduced, reflecting our more bearish view on the UK economy. We are happy to hold large cap UK equity income names, so our holding in Janus Henderson Responsible UK Income was increased slightly in higher risk portfolios where equities form a large part of the allocation. On top of this, we added exposure to global impact funds, particularly in the higher risk portfolios, which broadly led to a slight rise in US equity exposure.

Following on from this, we added to UK government debt. Firstly, we felt the movement in yields was overdone, and therefore we have sort to increase exposure to longer duration fixed income in order to add to an asset class where we had been under our natural weight for some time (based on each portfolios parameter). Secondly, we wanted to improve the credit quality of portfolios, meaning we removed/reduced exposure to the Rathbones Ethical Bond fund to accommodate the move into UK government debt.

Our property exposure continues to have a positive social focus. Whilst the environmental impact of buildings is important as we head towards a net-zero environment, we also ensure they are having a positive social impact, in areas such as social housing, medical property and affordable housing, to name but a few sub-sectors. There were no changes in our property exposure, with the exception of our Mid Green Blended equity portfolio.

With regards to infrastructure, the asset class has provided a ballast in portfolios during the volatile year so far. The asset class is in portfolios to provide a more defensive equity exposure, with underlying cash flows linked to real-assets such as wind or solar farms. The underlying holdings have benefitted from the rise in electricity price, as well as the inflation linkage to many of the contracts. Whilst we still have a positive view on the asset class, we did reduce exposure slightly to lock in some profit, and also to provide the required cash for the changes mentioned above. Changes were also facilitated by reducing allocations to cash and reducing/removing the Royal London cash plus fund.

Company Information

King & Shaxson Asset Management Limited (Reg. No. 3870667) has its registered office at 1st floor, Cutlers Court, 115 Houndsditch, London, EC3A 7BR. The Company is registered in England and Wales and is part of the PhillipCapital Group. King & Shaxson Asset Management Limited (FCA Reg. No. 823315) is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN.