Investment commentary

June 2022

Market overview

Continued concerns over inflation and weakening growth led to a further equity market sell off in June, with the MSCI World Index down nearly 8% in local currency terms. Global equities have now fallen over 18% in local currency terms this year, which represents the worst H1 period in over 50 years.

All developed markets suffered over the month with economically sensitive sectors particularly badly hit. Emerging markets proved slightly more resilient, with some support coming from the Chinese market, which bucked the trend and posted positive returns on the back of COVID restrictions being relaxed and some better-than-expected economic activity data.

Consumer confidence continues to fall in most regions and has hit record lows in the UK, which is facing one of the most acute squeezes in (negative) real wage growth. The Bank of England raised its forecast for the peak in CPI in October from 10% to 11% and raised rates again to 1.25%. In response, gilts fell a further 1.8% in June and are now down 14% this year. In the US, the Federal Reserve raised the policy rate more aggressively by 75 bps in response to a higher-than-expected CPI figure (8.6% year on year to May) and also materially lowered its growth forecasts for the next two years. European bond yields also moved significantly as the European Central Bank signalled that it would raise rates once it had ceased asset purchases over the next few weeks. It also announced its intention to come up with an 'anti-fragmentation tool' to address the growing disparity in rates across the region (notably Germany and Italy) and the potential problems created by a broad range of monetary environments across the eurozone.

Corporate bonds, and particularly high yield credit, sold off more significantly as deteriorating economic sentiment pushed spreads wider.

The US dollar continues to strengthen, appreciating by more than 3% against sterling over the month, and this provided a significant uplift to the strategies given our exposure, as indeed it has done during 2022 so far.

Strategy positioning

Investor sentiment is undoubtedly at a low point, but we are mindful that troughs in sentiment have historically created good investment opportunities and that markets can overshoot fundamentals on the downside as well as on the upside. Equity valuations overall look undemanding, positive economic growth is still widely forecast over the next two or three years in most regions, and corporate news flow remains resilient.

We are therefore maintaining our commitment to equities, with the strategies remaining at the upper end of their corresponding Dynamic Planner risk profiles, taking a medium-term view that the current downturn will be relatively short-lived and that the risks of exiting and re-entering markets are greater than riding out this period of adjustment in asset prices. We have positioned equity exposure towards regions or sectors that we feel will be more resilient to issues connected with the Ukraine conflict. Additions to global infrastructure, to gain some inflation protection, and a reduction in European exposure have worked well so far.

Our general reduction in the sensitivity of bond market investments to higher interest rates and inflation has been a worthwhile exercise, helping us avoid some of the worst falls in bond prices. But with attention potentially turning to protecting growth rather than curbing inflation, an opportunity to take a little more risk within bond markets has also materialised. We, along with some of our underlying strategic bond managers, have therefore reduced some of the more defensive biases to fixed interest positioning.

Where appropriate, we have also added to alternative investments at the expense of some fixed interest exposure. Genuinely alternative investments, particularly market-neutral funds, have come into their own in the past few months, and are likely to continue to act as strategy stabilisers and sources of good risk diversification and return if more traditional assets continue to come under some pressure.

We remain comfortable with our commitments to the US dollar – it should remain supported by expected policy moves and we see the US economy performing better than the UK and eurozone, helping the relative strength of the currency versus the pound and euro respectively. The dollar also has the capacity to act as a safe-haven currency should even trickier conditions materialise.

Risk warnings

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