Investment commentary

August 2022

Market overview

After a strong July, developed market equities sold off quite sharply in August. The catalyst was the relatively hawkish comments coming from both US Federal Reserve chairman, Jerome Powell, and from the European Central Bank's Monetary Policy Committee, which implied that greater than anticipated rate rises might be required to tackle inflationary pressures. This is despite economic indicators generally pointing to a continued slowdown and central banks facing the ongoing dilemma of how to mitigate inflation without overly impacting their economies.

Eurozone markets fell most, further impacted by the energy crisis where concerns were heightened by another set of supply issues, notably the closure of the Nord Stream natural gas pipeline between Russia and Germany. The eurozone's composite Purchasing Managers' Index ('PMI') fell below 50 (meaning a contraction of the manufacturing sector) and the euro remains at historic lows versus the US dollar.

The rise in rate expectations led to growth stocks significantly underperforming value, which also weighed heavily on the US market given its heavy exposure to technology and other growth sectors. The UK market also lost ground but fell rather less given its value bias and high exposure to energy stocks, which outperformed over the month, and to traditional beneficiaries of a higher rate environment such as banks. Sterling continues to weaken against the US dollar, providing a boost to UK companies with significant dollar exposure and to our strategies that have significant exposure to dollar-denominated assets.

Emerging markets proved far more resilient over the month, emphasising the fact that much of the region is in a very different economic and policy environment compared to most of the developed world. The Chinese market was flat with lingering concerns over the strength of domestic demand and further COVID-19 restrictions eased somewhat by details of renewed policy support from the People's Bank of China. Markets such as Thailand and India rose on improved macroeconomic data.

The more hawkish sentiment from central banks pushed global bond yields sharply up (and values down). The 10-year treasury yield rose from 2.6% to 3.1% with a similar increase in the 2-year yield. In the UK, the Bank of England raised interest rates by 0.5% to 1.75%, while the political turmoil and the expected fiscal response to the cost-of-living crisis led to even more dramatic rises in yields with the 10-year gilt yield rising from 1.9% to 3% and the 2-year from 1.7% also to 3%.

In his Jackson Hole statement, Jerome Powell cautioned that the US may see slower growth for a 'sustained period' while Bank of England chair Andrew Bailey warned of the possibility of a prolonged recession for the last quarter of this year.

Strategy positioning

Within the equity element of the strategies we are maintaining our skew towards the US where inflation may have peaked and economic indicators such as industrial production and retail sales look relatively resilient versus other developed regions. We also favour Asia, where fundamentals and valuations look relatively attractive, and policy is more supportive for risk assets. We have recently added exposure to the region.

We have substantially reduced exposure to the eurozone, which faces numerous headwinds in terms of inflation, energy disruption and fragmentation risk. We have limited and targeted exposure to the UK, which looks set for a period of heightened inflation and challenged economic growth.

Our exposure to infrastructure assets continues to produce excellent performance across the strategies and provides both an attractive yield and inflation protected cash flows. Within the fixed income element of the multi-asset strategies our strategic managers have protected well against the rise in sovereign bond yields, as has our exposure to shorter duration and inflation-linked bonds. We continue to have no direct exposure to sovereign bonds, albeit our active managers can tactically allocate where they see value.

In such a difficult environment for both equities and bonds we are pleased with how our alternatives exposure has performed. The last few months have demonstrated the importance of having some exposure to funds that are seeking genuinely uncorrelated returns and can eek out positive returns regardless of market direction.

Risk warnings

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