RICHMOND HOUSE
INVESTMENT MANAGEMENT

Investment commentary

September 2022

Market overview

The market sell-off in August continued into September, driven by the damaging combination of persistent high inflation, hawkish rhetoric from central banks and downward expectations for economic growth. Global equities fell over 9% in US dollar terms over the month.

It was a particularly tumultuous month in the UK. The new government's 'mini budget', which set out plans for a larger than expected fiscal package and further substantial government borrowing, caused a sharp spike in gilt yields and dramatic fall in sterling to an historic low of $1.03. The size of the rise in gilt yields was such that the Bank of England ('BoE') stepped in to buy longer-dated issues in an attempt to stabilise prices, while the controversy around the proposed measures was heightened by the fact that the International Monetary Fund took the unusual step of criticising some of the policies put forward. The BoE's action did lead to a modest recovery in gilts by the end of the month, however mortgage holders (and businesses) now face significantly higher repayment rates and additional uncertainty in terms of refinancing. Consumer confidence also fell to an all-time low in September.

The continued hawkish backdrop pushed bond yields significantly higher (and prices lower down) with the Global Aggregate Bond Index down a full 5% in US dollar terms. As has been much reported, 2022 has so far been a year where conventional fixed income assets have not provided investors with any protection against equity market weakness. Both the US Federal Reserve and the European Central Bank increased rates by a further 75 bps in September and expectations of peak rates are now 4.5% in the US, 3.5% in continental Europe and 5.75% in the UK.

While inflation remains substantially above target in most developed regions, we have recently seen some easing in pressures from commodities, as the oil price has declined quite sharply, and from food where overall prices fell back to pre-Ukraine conflict levels during September. To date these declines have not been sufficient to alter the hawkish stance of central banks who will also point to the continued strength in labour markets as evidence that it is too soon to change tack. Wages in the US for example have risen by nearly 5% in the last year.

On a potentially more positive note, the resilience to date of corporate earnings may suggest that equity markets have priced in much of the bad news while the same can potentially be said of some areas of the fixed interest markets if inflationary pressure are indeed set to recede.

We also note that a further 4% fall in sterling versus the US dollar in September has once again provided the strategies with significant currency gains given our exposure to dollar-denominated assets. We are likely to see an uptick in corporate activity in the UK market as potential acquirers look to take advantage of sterling weakness.

Strategy positioning

We are maintaining our commitment to equities, with all strategies remaining towards the upper end of their corresponding Dynamic Planner risk profile. Equities have historically provided the best defence against inflation in the shape of earnings and dividend growth and exposure is skewed to regions of relative economic and corporate strength, namely the US and Asia.

While some UK companies have benefitted shorter term from the US dollar profile of their earnings streams, we remain concerned about the outlook for the UK, which still faces acute inflationary pressures and considerable policy uncertainty. The weak economic backdrop and continued oil and gas supply concerns in the eurozone also lead us to have minimal exposure to the region.

Commitments to global infrastructure assets and businesses exposed to important environmental and climate change initiatives (such as the US Inflation Reduction Act) continue to feature prominently in our stockmarket positioning.

Volatility remains extremely high in fixed interest markets and we are continuing to take a very active approach to managing assets in the sector. Our specialist shorter-duration vehicles have largely done their job, and opportunities are now appearing in government bond markets after significant reactions to higher inflation and policy. Where appropriate, we are making changes to lengthen the maturity of fixed interest exposure to take advantage of what we consider to be more attractive value further along the yield curve.

At some point the coast may become much clearer for fixed interest markets, but until then allocations to highly liquid alternative investment funds, exhibiting low levels of volatility, are being maintained. These funds continue to act as an effective risk management tool and replacement for fixed interest exposure within the strategies.

Risk warnings