RICHMOND HOUSE
INVESTMENT MANAGEMENT

Investment commentary

October 2022

Market overview

Developed market equities staged a strong recovery over October, returning 7%. The US market led the way despite weak manufacturing and services data and despite the US Federal Reserve continuing to stress the need for further rate tightening until inflationary pressures recede. Company earnings announcements during the month were a positive, with three quarters ahead of expectations, and this resilience buoyed sentiment.

In the UK, the appointment of Rishi Sunak as Prime Minister, and Chancellor Jeremy Hunt's reversal of much of the now infamous 'mini-budget', was favourably received by markets. This led to a highly unusual scenario of the UK equity market, UK government bonds and sterling all rising around 3% over the month. Economic data was weak, with a contraction in the economy in August confirmed and evidence to suggest that this trend is continuing.

Economic data in the eurozone also disappointed with the services and manufacturing Purchasing Managers' Indices ('PMI'), both of which were already indicating recession, falling further. There was some brighter news for investors however with the European Commission announcing firm plans to address the energy crisis in the shape of an energy price cap and a coordinated purchase scheme. Support packages were also announced, notably a EUR200bn scheme in Germany aimed at both households and corporates. The European Central Bank raised rates by 75 basis points as it continued to target reducing inflation (now 10.7%).

In contrast to the strength across developed markets, emerging markets fell 3% in October. Much of this was driven by the weakness of the Chinese market where investors were disappointed to see no let-up in the zero-covid policy and the re-election of Xi Jinping whose economic policies are perceived as restrictive to growth for companies with an international reach. The technology sector was particularly weak in the face of newly implemented component supply controls from the US.

There was a wide divergence of returns across fixed interest markets. As noted, the UK market performed very strongly with the 10-year gilt yield falling from 4.2% to 3.6% and the 2-year yield from 3.9% to 3.3%. Eurozone yields were largely unmoved with the 75bps rate rise already priced in while US treasury yields rose slightly (and values fell) as resilient employment numbers and persistent inflation pressures reduced the perceived likelihood of a change in rate policy.

Broad commodity indices rose over the month with higher energy prices only partially offset by some weakness in agriculture and gold.

Strategy positioning

Fixed interest markets remain volatile in the face of acute inflationary pressures and continuing central bank actions across the globe. Our underlying active managers in this space are reacting dynamically to market moves and we have also repositioned some of our exposure away from the shorter end of the yield curve and towards the longer end where we see greater value.

As has been well documented elsewhere, bonds have not behaved like defensive assets so far this year as rate expectations have risen substantially across much of the developed world. Looking forward, and with bond yields having risen very substantially year to date, we believe that some value is reappearing and that we may see a more 'normal' profile of returns from here.

We continue to favour equities as an asset class and all strategies remain towards the upper end of their corresponding Dynamic Planner risk profile. We are comfortable with having significant exposure to the US market given the relatively robust economic outlook versus much of the developed world and the strength and breadth of corporate America. The strength of the US dollar this year has also provided a very valuable tailwind for investors and has mitigated some of the market weakness. The recent shorter-term rebound in sterling may prove to be short-lived.

We have also targeted exposure to two important investment themes, global infrastructure assets, and environmental and climate change initiatives. Given the ever-increasing commitment from governments across the globe to these themes we believe this exposure has the potential to produce significant excess returns over the long term.

Our exposure to alternative assets has been crucial over a period of weakness for both equities and bonds. These funds continue to target absolute returns regardless of market direction and are helping to reduce portfolio volatility.

Risk warnings