RICHMOND HOUSE
INVESTMENT MANAGEMENT

Investment commentary

April 2023

Market overview

After a volatile, if ultimately positive, first quarter for markets April has proved to be a quieter month. With limited news flow it is, however, encouraging to see that developed equity markets are proving resilient, rising by 1.8% in local currency terms over the month. Returns were weaker in emerging markets however with geopolitical concerns weighing heavily on China.

Inflation and the likely path of central bank policy remains the key driver of markets. US inflation has fallen to 5% from a peak of 9.1% last year and market expectations are now of one final 25 basis point rise in May before the US Federal Reserve pauses and then potentially begins loosening into next year. While a significant (c2%) step down in UK inflation is expected shortly, driven by a favourable 'base effect' on fuel prices, the UK continues to face more acute inflationary pressures than almost any other developed country – within the G20 only Turkey and Argentina are currently facing inflation above the UK's current rate of 10.1%. Rising food and drink prices are currently weighing heavily on the UK, as is continued strong wage growth, which is impacting the services sectors in particular.

The comparison between the inflation rate trajectory in the UK and US since last summer is therefore a stark one, however markets are anticipating a similar final 25 basis point rise from the Bank of England in May, albeit there is less consensus on how quickly policy may change. The dilemma that the Bank of England (and other central banks) faces is that there is typically a lag in the economic effect of rate rises. It is likely that the full impact of higher rates and tightening lending standards has not yet been seen on either the consumer or the corporate world and this is making the timing of monetary policy decisions particularly challenging.

Markets are also focusing on the earnings outlook as the first quarter results season moves into full flow. On balance these announcements are beating expectations and markets are reacting reasonably favourably. Given recent concerns in the financial sector, and the further collapse of First Republic Bank in the US, stronger than expected results from industry heavyweights such as JPMorgan, Wells Fargo and Citigroup have also been welcomed and the banking sector has been resilient over the month.

Fixed income markets are also going through a more settled period driven by moderating inflation and greater clarity around the end of central bank monetary tightening cycles. Resilience in the corporate sector and reduced fears around recessions are also providing support to credit and higher risk areas of fixed income markets as spreads narrow.

Sterling has strengthened against the US dollar recently. In the short term this has impacted returns from US dollar denominated assets in portfolios however we do not expect this trend to persist given the likely relative strength of the US economy and our view that interest rate differentials will shift against sterling. The reserve status of the dollar also provides another potential layer of protection should we see further periods of risk aversion.

Strategy positioning

Inflationary pressures continue to recede in most areas bringing the potential prospect of an imminent end to the tightening cycle in many developed regions and of a reversal of policy moving into 2024. Inflation expectations has been the key driver of markets for some time and greater clarity around the outlook is providing some support for risk assets. Our base case remains for inflation to fall to more comfortable levels for central banks over the course of this year, potentially allowing them to loosen policy into 2024.

Our view remains that recessions this year, where seen, will be relatively mild and that 2024 will bring quite a strong recovery in both economic and earnings growth. Given that valuations do not look stretched this backdrop leads us to favour equities as the asset class most likely to provide the strongest real returns on a medium-term view. Looking globally there is a good degree of disparity in the likely path of economic growth, and in the likely headwinds posed by inflation and other potential obstacles to recovery. Our assessment of this leads us to skew exposure to the US and Asia, which we expect to provide the strongest and most resilient growth profile going forward. We also believe that specific sectors provide the prospect of superior earnings growth, notably infrastructure and sustainable energy, and we are retaining targeted exposure to these sectors.

A balanced exposure in terms of style and cyclicals versus defensives has served us well over the last year given the swings in market leadership.

Given our expectation of inflationary pressures receding and of key central banks becoming more dovish over the course of this year we see investment opportunities in both government and corporate bonds and we have added targeted exposure to where we see most value in recent weeks.

Numerous potential risks to markets do remain however and, where relevant to the mandate, we continue to believe that low risk, uncorrelated alternatives strategies have an important role to play in portfolios.

Risk warnings