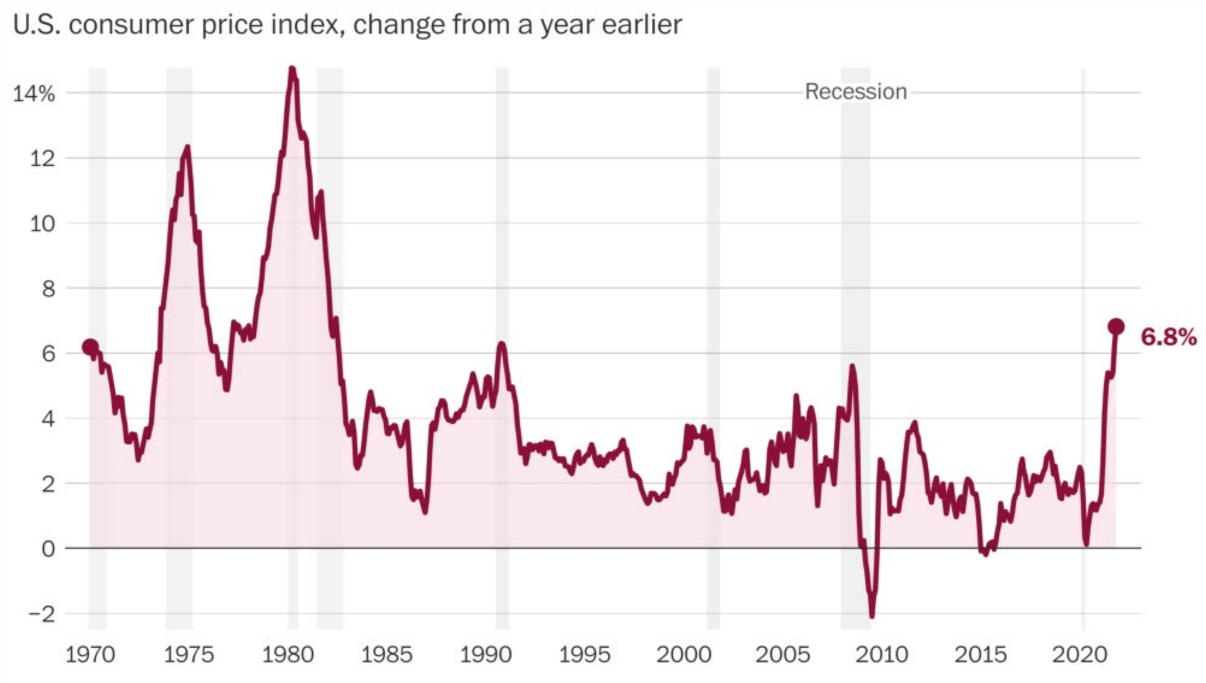
MPL WEALTH MANAGEMENT
MPL Wealth Management Limited
45 Doughty Street London WC1N 2LR
Tel: 020 7831 4711
Fax: 020 7831 3137
enquiries@mplltd.co.uk
www.mplwealthmanagement.co.uk

When the Fog Clears

As we enter 2022, the markets have seen significantly increased volatility, this was caused primarily by price inflation and altered expectations surrounding the next steps in central bank monetary policy, creating considerable uncertainty and sometimes seemingly irrational fears on the part of market participants, which continues to blight global financial markets.

THE CAUSE



Source: US Bureau of Labor Statistics

Attention-grabbing headlines heralded the 6.8% year-on-year rise in the US Consumer Price Inflation number for December 2021, as the largest increase in inflation for 40 years. This inflation number has been spurred on by the ongoing pandemic which has roiled the global economy, displacing large elements of the workforce and severely disrupting established supply chains. The very extensive stimulus responses from global governments and central banks have created an environment where too much cash has chased too few goods, prompting this sharp increase in the inflation number, although it is off an admittedly low base.

From food production to house-building for the consumer, and labour and transportation costs for companies, every industry sector has been impacted by the inflationary impact of the pandemic and its effects on markets and supply chain structures.

THE PROBLEM

In the summer months of 2021, the belief within and narrative from the US Federal Reserve was that rising inflationary trends would prove to be transitory. The Fed dropped this mantra during December 2021 as rising prices became more persistent, rising well above the Central Bank's 2% annual inflation target. One cannot blame the Federal Reserve for wanting to cool the problem; as always with inflation, the more it is potentially allowed to become entrenched within an economy, the harder it becomes and the longer it takes to bring it back under control, and the greater the resulting damage to the overall economy as a result.

CENTRAL BANK RESPONSE

In mid-December of last year, the US Federal Reserve indicated that it would end its pandemic-era bond purchases (the so-called Quantitative Easing measures, which involved the Fed making monthly purchases of $120 billion in a mixture of sovereign and asset-backed bonds) in March 2022, and thereby pave the way for around three quarter-percentage-point interest rate hikes by the end of this year, as the economy nears full employment and the U.S. central bank copes with a surge of inflation. It is widely seen that the Fed can only commence raising rates once the Quantitative Easing measures have been ended, and thus by accelerating the reduction or 'taper' in the monthly bond purchases so that these end in March rather than the originally-intended end-date of June, so the Fed can commence raising rates earlier than previously anticipated, and it is this that has rattled investment markets.

THE MARKET REACTION

After a prosperous 2021, presently and in the short term at least, financial markets have reacted negatively to these Federal Reserve-driven developments. On the one hand, the Fed is expected to increase rates because the economic environment in fact appears quite strong, what with strong consumer demand and household balance sheets, coupled with relatively low unemployment and generally strong corporate balance sheets – which are all factors which bode well for positive financial markets. In the short term however, raising rates creates a drag on the economy by making capital harder and more expensive to access. In tandem with this fear of pricier capital is the fact that the Fed has not acted as yet, hence the uncertainty of not knowing whether there will be one, two, or three rate increases in the US by the end of 2022. Markets usually react badly to the anticipation of uncertain future events, and often react better when the uncertain future event becomes actuality.

As market participants value financial assets by utilising bond yields, which are by definition heavily influenced by interest rate movements, the current uncertainty surrounding the number of potential rate increases has led to a worst-case scenario being priced in very quickly by markets, with the resultant falls being seen at present in the high-valued areas of the said financial markets.

LOOKING AHEAD

Peering through the current fog and looking ahead, as Omicron subsides and pandemic-related supply bottlenecks ease, it is possible (if not already somewhat in evidence) that we have already seen the peak in year-on-year increases in the inflation numbers. If this proves the case and the inflation numbers start to decrease from here or at least quite soon, it could very easily temper the pace and number of interest rate increases by the Fed for this year (and beyond), which would be undoubtedly positive for financial assets. This is in tune with recently revised economic projections from the Fed, with its policymakers forecasting inflation running at 2.6% this year, but then falling to 2.3% in 2023, and 2.1% in 2024.

This appears also to be mirrored in the forward Swaps market, where the '5-Year, 5-Year Forward' inflation rate expectation is seen falling in mid-November from 2.35% to a current level of 2.09%. The Swaps market is in effect a type of insurance available (for a price) to investors so as to be able to mitigate or hedge against future inflation risk.

YOUR PORTFOLIO

Referencing the changes made to your portfolio during the last quarter, we are firm in our belief that when the current fog clears and we have more certainty with regard to the development of central bank policy, the themes specific to the investment areas we have targeted will begin to develop, as ongoing growth in these areas should justify current and projected valuations in this investment environment.

With Kind Regards

Mark Kitson
INVESTMENT DIRECTOR

Simon Weighell
SENIOR INVESTMENT MANAGER

Richard Dawes
INVESTMENT MANAGER