MPL
WEALTH MANAGEMENT

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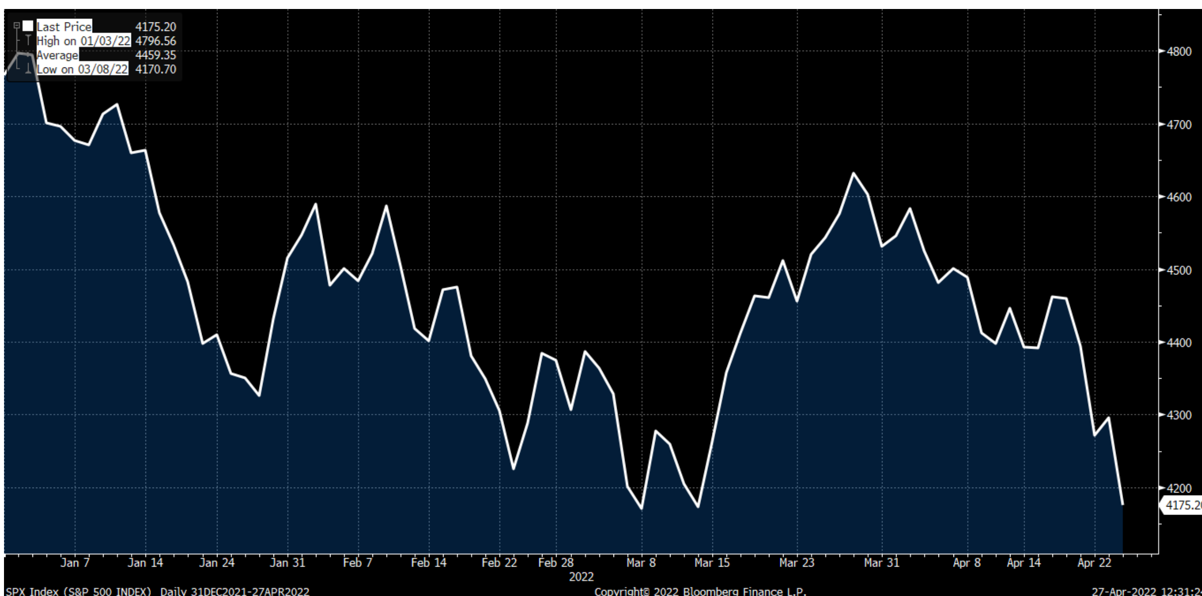
So what now?

Market volatility - whilst having fallen from earlier higher levels – still remains elevated, and there is little prospect of this situation easing at least in the short term. This is due to the inflation adjustment that we were already seeing in financial markets from early 2022 having been considerably aggravated and exacerbated by the emergence of the crisis in Ukraine, which again affords little visibility as to when this might end.

In early January, the US S&P 500 Index corrected by 11% - that is to say an index which had never previously been down by this much just 16 trading days into a calendar year - corrected by 11%.

YEAR-TO-DATE PERFORMANCE OF THE S&P 500 INDEX

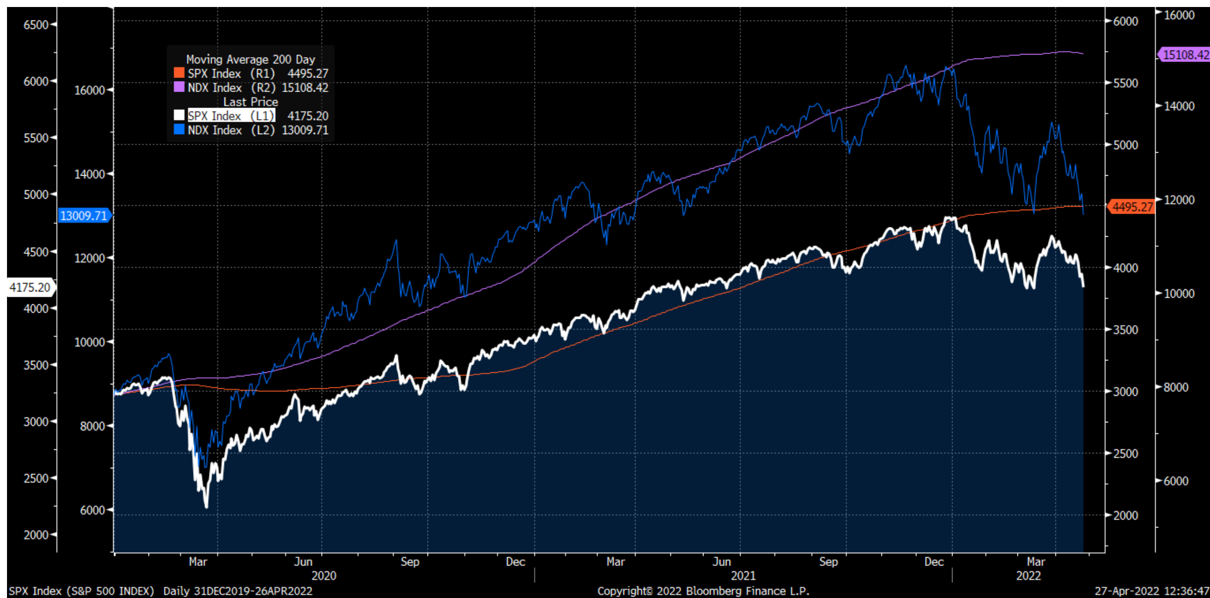


Source: Bloomberg

That was the most on record according to Bloomberg data that goes back over nine decades, although drawdowns had been faster in prior years before quick rebounds then occurred, most notably in 2009.

The downturn has occurred at that point in time mainly as market participants braced for the US Federal Reserve, prompted by rising inflation levels, to tighten monetary policy in the face of a surge in U.S. Treasury yields. This weighed heavily upon the outlook for stocks, with a host of technical signals also suggesting that more volatility could be coming up ahead.

THE S&P 500 AND NASDAQ 100 INDICES BREAK BELOW THEIR 200 DAY MOVING AVERAGES FOR THE FIRST TIME SINCE THE COVID OUTBREAK

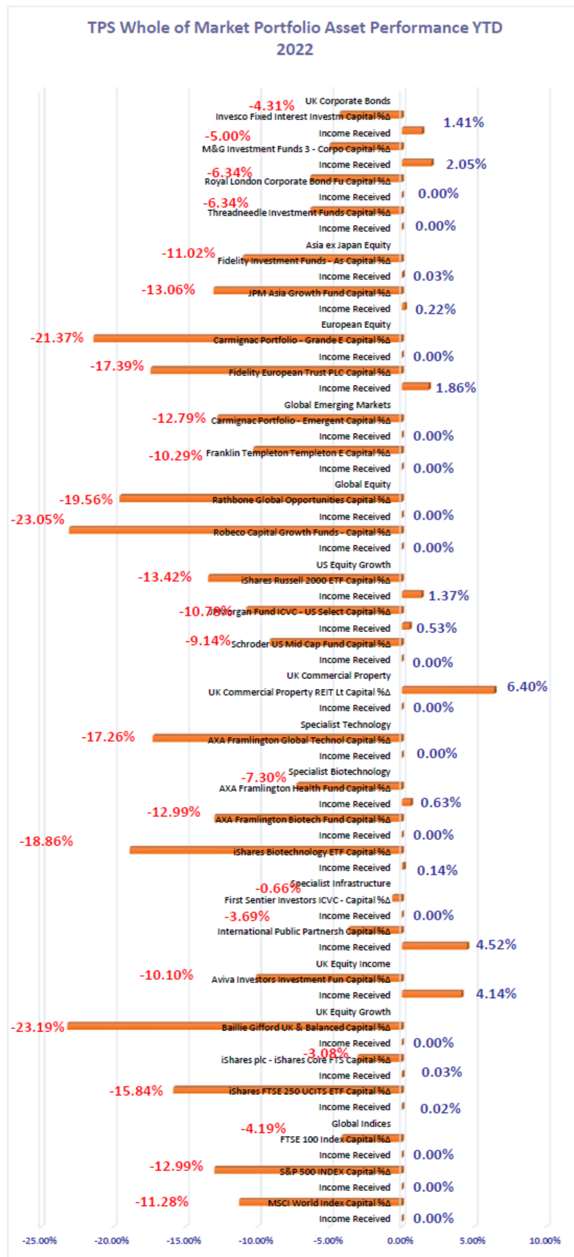


Source: Bloomberg

As the Federal Reserve became more hawkish and threatened to increase interest rates rapidly, liquidity in financial markets lessened considerably, and the S&P 500 and Nasdaq Indices broke below their 200-Day moving averages for the first time since the Covid outbreak in early 2020. This is a technical market signal that can point to markets possibly entering a longer-term downtrend in stock prices. The impact upon MPL client portfolios in the January-to-early March period was quite clear.

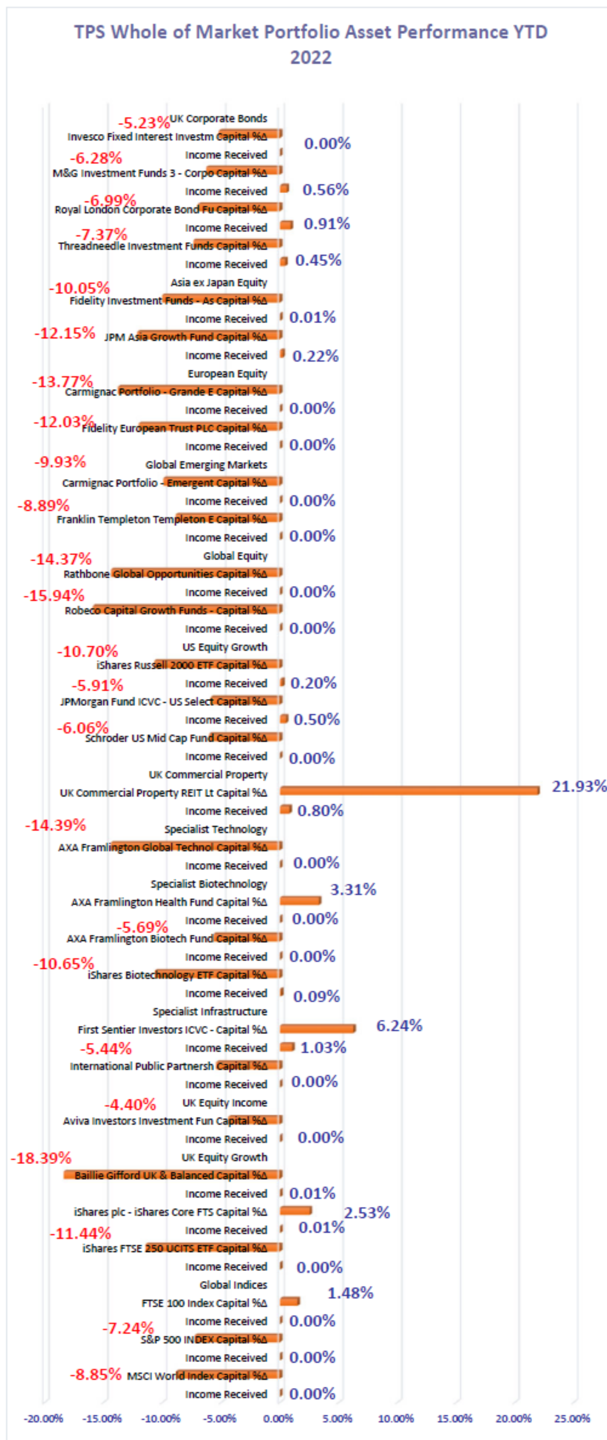
The following performance attribution chart shows the year-to-date position in early February, whereby the majority of asset classes (with the exception of the FTSE-100 Index, FTSE-100 Tracker, and UK Commercial Property positions) were in negative territory, as market participants adjusted forecasted earnings and valuations downwards, to compensate for the higher interest rate and yield expectations.

Unsurprisingly, corporate bonds alongside those growth assets with the highest valuations such as small to mid-cap assets in Europe, the United States and the UK, and global growth assets, as well as technology and biotechnology assets, suffered the full extent of the sell-off, as we raised cash levels to negate some of the volatility and drawdown levels.



Our client portfolios, however, are beginning to paint a well-trodden picture of an environment dominated by inflation and the uncertainty that is associated with it.

With markets having been provided with further information by the US Federal Reserve about their intended approach to tackling inflation in the past month, growth areas such as emerging markets, the UK FTSE-250, global equity growth, and US equity growth, have erased around a third of their losses suffered from their recent market highs of late 2021 and early 2022. That is not to say however that markets are not volatile; they still are and will remain so until such time as greater clarity and certainty as to the outcome of the wars both on inflation and in Ukraine becomes evident.



In tandem, certain indices such as the FTSE-100 (dominated as it is by 'old world' companies in sectors such as energy, raw materials, heath care, utilities, and financials) have outperformed other global indices due to these assets being the prime beneficiaries within an inflationary environment. Whenever there is uncertainty, staple sectors such as healthcare should, as history dictates, remain relatively unaffected by global economic adjustments. With the spectre of inflation now with us, relatively inflation-proofed assets such as raw materials/oil/energy and commodities (albeit severely exacerbated in this instance by the Russia-Ukraine conflict) also tend to perform well, for obvious reasons.

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The current monetary policy objectives of mainly Western central bankers have also benefited the UK financial sector, another influential asset class within our collective portfolio holdings, due to a rising interest rate environment benefiting banks' income via their increased ability to expand their own interest margins, as they fail to pass on higher rates to savers but do pass them on to borrowers. This has the effect of increasing earnings in the sector. Notwithstanding this, two final inflation-resistant asset classes should not go without mention; Infrastructure as a sector with positive inflation-linked cash flows and inflation-accretive assets has performed relatively well during this period, as indeed has UK commercial property, which exhibits similarly attractive income generation with some excellent inflation-linked qualities. Furthermore, due to the structural changes seen globally over the past two years, the commercial property sector has often seen the credit quality of the largely industrial tenant base strengthen significantly.

Current portfolio changes

Whilst current cash holdings were not utilised during the past quarter, we have instructed our custodian TPS, to accept an 'Open Offer' from the International Public Partnerships Infrastructure Investment Trust, to purchase additional shares at below current market value in this asset, for the reasons outlined above. The Open Offer is available primarily to existing shareholders.

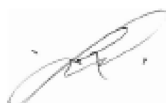
At present we are looking tactically to gain a greater level of inflation protection and total return within client portfolios, by adding asset classes such as commodities/raw materials to the portfolio, both directly and indirectly through the equity and bond asset classes.

We are mindful however, that with some of the technical indicators mentioned above potentially pointing towards a longer-term downtrend in certain equity markets as a whole, we will have to be very selective in our choices here.

If we were to be asked about our main fears for the markets right now, one would certainly be that evidence is emerging of some constrained classes of consumers already beginning to rein in their spending in response to the higher cost of living, while other consumer classes who are perhaps less constrained are nevertheless increasingly nervous concerning the hawkish inflation rhetoric being put out by some key central banks. This could potentially lead to a fall in global consumer confidence and therefore in economic activity, given the pivotal role of consumer spending in supporting most of the advanced economies. Whilst a recession is by no means inevitable at this point, increased consumer nervousness and potentially decreased consumer activity does increase the prospects for a recession, which would be a negative for many financial assets.

We remain closely watchful of the situation and will look to redeploy some or all of the current cash assets once further clarity as to the course of global inflation and growth, emerges.

With Kind Regards



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