Client Update:
Portfolio Activity

Given the roller coaster ride for financial markets so far this year, we wanted to provide an update to help our clients understand how we actively manage portfolios through difficult market conditions like these, and to provide some insight into how we monitor and react to developments on a daily basis. Before we look in more detail at the actions we have taken so far this year, it is important to stress that financial markets always have been, and always will be, volatile in nature. Whatever happens, the key to achieving long-term investing goals is combining a disciplined and patient investment process, with a well thought out, and regularly reviewed, financial plan. That being said, on any journey, troubles along the way are only easily forgotten once passed. Only the most experienced travellers can resist a little wince when the "fasten seatbelt" light flashes on and the turbulence starts to rock the plane. So, let's look at what is causing the current turmoil and the actions we have taken to make this stretch of the journey as comfortable as possible.

Firstly, we have seen extraordinary changes over the last two years, stretching from the pandemic itself, the response to the crisis and the ongoing recovery. While it may already feel like an eternity ago, we are still feeling the effects. Whether that be the higher-than-expected inflation, changes in working practices and labour markets, or just the lingering bottlenecks in supply chains. It is the inability of Central Banks, and markets, to predict the magnitude of these impacts that has ultimately led to high levels of volatility. We see three distinct phases to markets so far this year. A drop in January, led by fears of rising interest rates; mid-February to mid-March, led by the war in Ukraine; and April through May, led by recession fears. Before looking at our reaction to each development we must also remember that at the end of 2021 three things became clear very quickly: Omicron would not result in further restrictions, inflation would peak higher and stay there for longer, and that central banks needed to withdraw loose policy and start tightening sooner and faster than previous expectations.

During phase one in January, Markets set about "pricing in" up to eight increases in US interest rates in 2022, versus previous expectations of two or three. Global equities fell somewhere between 8% and 15%, with the more expensive growth areas like technology suffering worst. In this period, we still expected inflation to cool more quickly than the market and thus rates to rise more slowly. However, we had to accept the increased probability that we might be wrong and so modestly reduced our risk taking, particularly in growth stocks. We did however take advantage of the volatility to purchase some private equity and technology trusts that had been caught up in the panic selling. While these are still struggling in current conditions, we view them as exciting long-term investments with attractive entry points.

After markets made a modest recovery in early February, the tension in Ukraine rapidly ramped up, ultimately resulting in the tragic conflict we see today. We have written previously about the impact of this on markets but very briefly, the initial shock was subsequently swamped by concerns about inflation and supply chains. This upward pressure on inflation removed any chance of more gradual interest rate rises and in fact accelerated the expected pace of tightening. Through this period, we did an awful lot of research that resulted in very little change to the portfolios. Traditional portfolio insurance such as government bonds remained very expensive in our view, and the long-term risks outweighed short term protection. While equities reached new lows, in many cases we felt there was potentially more pain ahead, and thus resisted adding to risk in a very uncertain environment.

Finally, the most recent phase followed the late March rally and has been driven by the potential economic consequences of tighter monetary policy. Rising costs and falling consumer sentiment has led to speculation of a global recession. Previously we had viewed this as a clear signal for central banks to reduce the pace of tightening. The prevailing view from the US Federal Reserve, however, seems to be that a recession is an acceptable cost to controlling inflation. This commitment to increasing rates in the face of a potential recession saw another leg down in risk assets, with bonds performing almost as badly as equities. At its lowest point, a broad global equity index had now dropped around 15% year to date, with a 7-week losing streak through April and May. UK Government bonds were also down over 10%. This is the point in time where we have been most active.

As prices dropped we started buying conventional government bonds again. While we see further tightening ahead, we believe most, if not all, of this has already been factored into prices. Secondly, we cautiously increased our equity weight with a focus on critical infrastructure. This looks an attractive area both in the event of a slowdown, due to defensive cashflows from things like utilities, but also from a secular growth perspective, as significant investment is required to facilitate a faster energy transition and reduce dependence on Russian energy exports. We funded these trades mostly through reducing diversifiers from within our alternatives holdings, including selling our gold position, as well as trimming some of the winners in the equity component, such as our UK stocks.

Adding risk to the funds is by no means a sign we are calling the bottom of the market. We can see plenty of ways for assets to fall further this year. However, given the scale of the price correction relative to the health of the underlying global economy, we do think a lot of bad news is priced in already. Looking ahead to the next 2 to 3 years, we believe now is a good time to start investing for the next growth cycle, being as selective as possible to limit the potential of further losses in the short term. Ultimately it is this long-term perspective that rewards patient investors. It can be hard to zoom out and take the long view, especially with so much volatility in the world, but this is exactly when disciplined and methodical processes are most important to ensure decisions are made with heads and not hearts.

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2022 markets to date

Performance and Activity

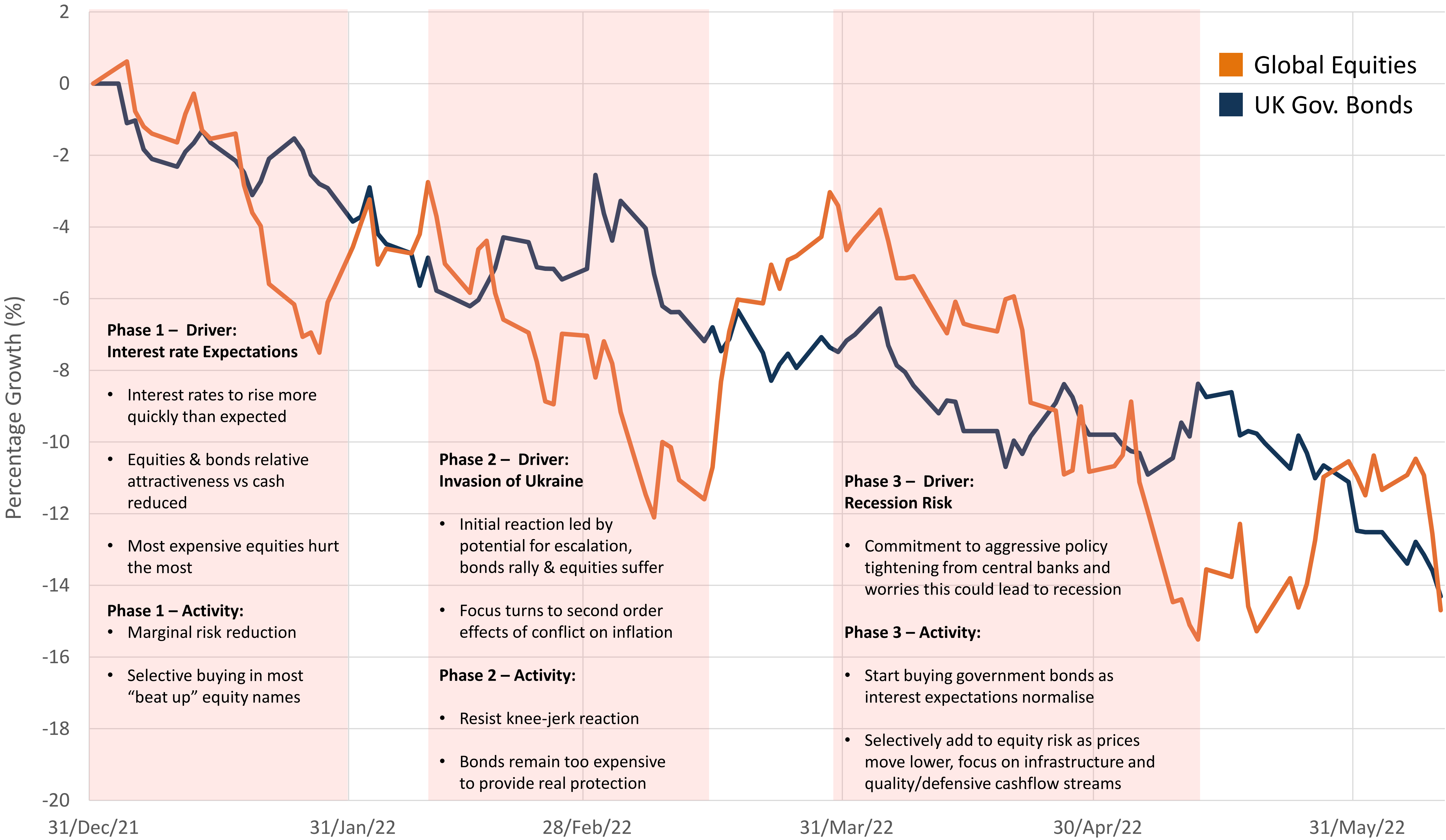

Chart shows total return (including income) for global equities and UK government bonds for the period 31/12/2021 to 10/06/2022 in local currency. Investments can fall as well as rise and you may get back less than your original investment. Past performance is never a guide to future performance. Data source: Lipper for Investment Management. Data collated by Astute Private Wealth. Astute Private Wealth Limited registered in England No. 11365701. Registered Office: 2nd Floor, Vista Building, St David's Park, Ewloe, Flintshire. CH5 3DT. Astute Private Wealth Limited is authorised and regulated by the Financial Conduct Authority.

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