Market update – June 2023

For investors in the Alexander Beard Managed Portfolio Service,
with Albermarle Street Partners Investment Management.

Corporate Comeback

The last few weeks have seen equity markets gyrate in response to earnings and economic data.

The recent earnings season marked a full year since the start of the war in Ukraine. Most US large cap companies exceeded analyst expectations in Q1 2023. While the large cap US index reported a year-over-year decline in earnings of 2.2%, positive earnings surprises in sectors like Information Technology, Consumer Discretionary, and Health Care contributed to a decrease in the pace of earnings decline versus that in the fourth quarter of 2022 (-4.7%).

While earnings have surprised to the upside, economic data has started to weaken. China, the world's largest exporter, has reported disappointing manufacturing data for two consecutive months. US housing and manufacturing indicators remain in recession territory and the wrangling around the debt ceiling and the flight of deposits out of the banking system create additional risks that investors need to be aware of.

When I get back to Blighty

The palpable sense of gloom around the prospects for the UK economy are hard to ignore. UK gilt yields have risen after the latest inflation reading by the office of national statistics. The consumer price index rose by 8.7% in April, down from 10.1% in March. This however is the highest inflation rate among the worlds advanced economies alongside Italy. By comparison, inflation in the US is just under 5% and is 7.2% in Germany.

Underlying inflation (excluding energy and food) rose sharply in April to 6.8% from 6.2% in March. Higher core inflation is seen as a sign that price growth is more likely to remain persistently high. It appears that the Bank of England has a lot more work to do. Expectation of further rate increases have quickly been priced into mortgage rates, forcing further pressure on beleaguered households.

The UK economy faces greater challenges in regaining its footing in a post-pandemic, post-Brexit world. As a result, both fiscal and monetary policy may need to be tighter for a little while longer. While this will suppress growth over the coming months, we do believe it will quell the risk of an inflation mindset taking hold. Inflation will eventually subside allowing a reversal of the policy measures in 2024.

Your portfolios

While there is no escaping the headlines, from an investment portfolio perspective, we have taken steps to mitigate against the risk of UK economic stagnation.

In 2022, we lowered our exposure to UK assets, as we feared a period of sterling weakness. This involved higher allocations to non-UK government bonds. Note that we didn't own linkers in most portfolios and only a third of our fixed income exposure has any sensitivity to UK government bond yields. This varies by the risk profile of the underlying portfolio and has been reduced further in the recent rebalance as we have opted for global corporate bonds in place of a UK centric strategic bond holding.

Unlike many in the industry, we do not have any exposure to UK property, preferring instead to allocate to global infrastructure. Throughout 2022, we took significant steps to de-risk portfolios, which involved the removal of UK mid-cap allocations in low and mid-risk portfolios. UK mid-caps have the highest sensitivity to the fortunes of the UK economy. Larger companies generate most of their revenues outside the UK and would be less affected from an earnings standpoint. 100 % of our UK equity exposure is in larger companies for low and mid-risk portfolios. In our highest risk portfolios, we have allocated to mid-caps in a limited way (less than 10%). As part of the latest rebalance in your portfolios, we have allocated to the Ninety-One UK Equity Income fund within your UK equity allocation. This is a quality-tilted fund which invests in companies that are resilient in the face of economic turmoil.

Conclusion

The start of the year saw a recovery in optimism regarding global growth. While the UK appears to have misplaced its invitation to the recovery party, we believe it is a blip rather than a longer-term shift in our economic fortunes. The sell-off in bonds and parts of the equity market in 2022 has created a good starting point for better than average portfolio returns. We are data dependent and analyse, adjust, and then repeat. We see material risks to economically sensitive assets and have taken additional steps to improve portfolio outcomes.

Change is never painful. Only resistance to change is painful - Buddha.

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