MERRION INVESTMENT MANAGERS | CANTOR Fitzgerald

Strategy & Outlook

MARKET UPDATE

ARPIL 2022

March: A month of extreme asset price volatility driven largely by Ukraine-Russia headlines and Federal Reserve hawkishness, but global equities nevertheless finished the month higher by 3.3% in euro terms, having been down 4% in the early part of the month. US technology ended the month higher (+3.2%), having been down 7% in the early part of the month, European equities were marginally higher (+0.4%), recovering from a 9% drop, whilst bonds fell precipitously, 10-year yields in Europe and the US rising by more than 50 basis points and 2-year yields in the US rising by almost 100 basis points. The recent drawdown in US treasuries ranks as the third-worst in a century.

The Federal Reserve hiked rates by 25 basis points mid-month alongside a hawkish statement, but equity markets have rallied significantly since then. The initial rally was fuelled not by the Federal Reserve but by a volte-face from the Chinese authorities regarding the regulatory framework towards their own technology sector and the policy framework for growth in general. This saw some of the largest rallies in history for Chinese equities, and in particular their large technology platform companies. These moves spread to the west and have so far been uninterrupted by the hawkish Federal Reserve statement, press conference or subsequent speeches. The rally in US technology from the trough in early March is over 11%, confounding extreme bearish sentiment and expectations that currently exist within markets. Although markets rallying after the first hike in rates seems counter-intuitive to some it is consistent with history.

Pockets of hope have appeared regarding a lasting cessation of violence in Ukraine, but the oil price remains above $100. Governments around the world, from Germany to California, appear to be organising further fiscal transfers to remove the burden of higher energy prices from the consumer, thereby alleviating somewhat the recession fears that are lingering globally. A general expectation of an increase in fiscal spending in the EU in particular because of the conflict is keeping GDP expectations higher than they otherwise would have been. The US employment picture is as robust as ever with the weekly initial jobless claims this month falling to the lowest level since 1969.

Corporate commentary has been robust with Nike reporting no impact to their consumer demand profile thus far and indicating far-eastern supply chain issues are normalising. A capital-markets day from Nvidia highlighted further the structural investment themes that are still ongoing.

Positioning Changes

MIM funds were active over the month with the recent volatility providing many opportunities for the genuine active manager.

We used the sharp rally in copper to take profits on the holdings in the multi asset funds, investing the proceeds into attractive equities that had recently underperformed including high-quality European cyclicals and financials and European renewables that look to benefit from an even faster transition toward renewable energy given the recent Russian-driven energy crisis.

Within our alternative funds (a key part of the multi-asset strategies), we took some profits in long dated bond holdings in the early part of the month and added to a number of high-quality EU cyclical equities. The fund also owns downside protection on the equity markets as shorter term risks remain.

We are currently positioned near the upper end of our allocation to growth assets, those growth assets being skewed towards quality/ structural growth themes rather than cyclical/value.

Outlook

The invasion of Ukraine threatens the post-cold-war order, Germany announcing a sizeable increase in its defence spending, something which would have been considered almost impossible a few weeks ago. Other countries will follow. Financial markets have, since the beginning of the year, been pricing ever-increasing interest rate hikes from central banks, the Federal Reserve in particular, but also the ECB. This has led to a significant outperformance of "value" over "growth" year-to-date. As the mix for future economic growth swings back towards the structural themes of digitalisation, defence, decarbonisation and de-globalisation, this outperformance must now be questioned and in the very short-term at least this trend should be interrupted. Interest rates are inevitably going to rise – from extraordinarily low levels – and much of this has been priced in by financial markets over the last quarter. Central banks are however in a difficult situation: inflation is well above their targets, and the oil price spike is likely to make this worse in the short-term. However, more medium-term indicators suggest supply-side constraints are easing, and that inflation will eventually dissipate.

Meanwhile, equity market sentiment is extremely bearish, with some measures of market pessimism at GFC levels, cash at Covid levels, and positioning heavily skewed towards commodities and defensives. Much of this could be attributed to the war, the oil price, inflation, the flattening of the yield curve and associated recession fears, but consumers balance sheets remain very healthy, the oil price impact on consumers is much lower than it was in the 1970's, fiscal policy should alleviate short-term concerns and inventory rebuild will counter recession fears.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

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