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Portfolio Review *July 2022*

On the whole July was a much more investor friendly month and it is pleasing to be able to write for what seems like the first time in many months that the majority of global equity markets staged a rebound from recent lows to deliver positive returns. That is not to say the issues that have dominated investor worries for much of the year – persistently high inflation, slowing growth and aggressive monetary tightening – have gone away. In fact, these were all very evident over the course of the month however, there was a change in the expectation of the path of future interest rates that allowed both equities and bonds to advance and recover some of the ground they have given up so far this year.

A slew of economic data and corporate earnings reports were released during the month giving investors much food for thought. On the growth front, US GDP declined by 0.9% on an annualised basis in Q2, following a decline of 1.6% in Q1. While two consecutive quarters of negative growth means the US is now technically in recession, the ongoing strength of the labour market means that the National Bureau of Economic Research (NBER) is unlikely to formally declare one at this stage.

In contrast, it was revealed the UK economy enjoyed a strong month in May, with output growing by 0.5% month-on-month after shrinking in April. The resilience of the UK economy in May suggests GDP is unlikely to have contracted in the second quarter, despite the impact of the extra Jubilee bank holiday in June. Meanwhile the collapse of Boris Johnson's premiership triggered a leadership contest for the Conservative Party and race to be the next UK Prime Minister. The field quickly narrowed to two candidates, Rishi Sunak and Liz Truss, and the victor will be announced on 5 September. While there are key differences on fiscal spending between the two candidates, thus far investors do not seem to be affected by any uncertainty and, ultimately, the UK economy and markets will be more sensitive to global forces than the actions of the next occupant of No. 10.

Russia and Ukraine remained in stalemate on the Eastern front but managed to strike a deal on reopening ports for grain exports, which was a relief for many emerging countries where political tensions over high food prices are running high. There were heightened concerns over the security of gas supply to Europe after the Nord Stream 1 pipeline, which supplies gas from Russia to Germany, was closed for maintenance and then reopened at reduced capacity. To shore up domestic supplies, the European Commission requested that countries look to reduce their consumption by 15%, although this was met with disagreement from several members of the bloc, raising the risk of European disunity in the months ahead.

Inflation continued its trend of unwelcome surprises as it accelerated across the world and the "peak inflation" narrative again failed to materialise. Year-on-year inflation readings in the US, UK and Eurozone reached multi-decade highs of 9.1%, 9.4% and 8.6% respectively. These figures were cause enough for central banks to continue tightening monetary policy with interest rate increases in all major economies, with the exceptions of Japan and China. Notably the European Central Bank (ECB) delivered its first interest rate hike in 11 years, raising rates by a larger than expected 50 basis points (0.50%), ending the era of negative interest rates, which began in 2014.

But it was the US that caught investors' attention. With inflation again surpassing expectations, the Federal Reserve (Fed) raised rates by 75 basis points (0.75%) for a second month. Chairman Powell noted in his commentary that the Fed funds rate is now close to the Fed's estimate of a neutral rate. Markets began to speculate as to whether this change in tone and language signalled a Fed "pivot" away from aggressive monetary tightening. Whilst it still feels likely that the Fed will move rates higher again when it meets in September, the pace of increases is now largely expected to be slower.

Despite the deteriorating economic picture, volatility declined sharply in July and risk assets staged a strong recovery rally. Global equity markets began to recover during the second half of the month to end with substantial positive returns that were enough to lift a number of indices out of bear market territory. The decline in long-term interest rate expectations appears to have been the most likely catalyst for the recent turnaround in performance.

All sectors advanced but the mid-month rally saw a pivot in market leadership. Growth stocks were the main beneficiaries, recouping some of their heavy year-to-date losses and outperforming value stocks by a wide margin. With its strong growth tilt, the US outperformed all other major countries with the S&P 500 returning 8.97% while the Nasdaq had its best month in over two years. Economically sensitive parts of the market led the way with double-digit gains for the information technology, consumer discretionary and industrials sectors, areas which have performed poorly since the start of 2022. In contrast, some of the outperforming large-cap areas of the market – such as healthcare and telecommunications – performed poorly over July. These more defensive sectors had previously contributed to the UK's relatively strong year-to-date performance. The UK's FTSE All Share rose 4.36% in July, while stocks in Europe also gained 5.09% as measured by the FTSE World Europe ex UK index.

China was the only country with significantly negative returns, down around 9.5%, dragging down emerging market indices. China's reopening last month had lifted sentiment but renewed talks of restrictions returning, including to Shanghai, dampened sentiment. In addition, further signs of China's deeply troubled property market emerged including news of 'mortgage strikes' by buyers who had pre-purchased their homes. This casts doubts on Chain's economic trajectory, at least in the short term.

There were also positive returns for bond markets as falling yields supported fixed income assets. Bond yields recorded their biggest one-month decline since March 2020, alleviating some of the intense pressure seen year-to-date. Corporate bonds in particular enjoyed a strong rebound, outperforming government bonds as yields ended the month down sharply lower from their highs reached at the end of the last quarter.

It seems then that investors have breathed a sigh of relief after getting through July's economic events and earnings reports without too many upsets. However, markets may not be able to mount a sustained rally until we see notably lower inflation and a bottoming in fundamental data. We must remain mindful that markets are likely to exhibit further volatility in the months ahead, particularly as economic and earnings growth continue to slow and as yields rise as central banks continue to raise rates. That said, markets have so far this year moved to price in a lot of bad news and many stock price declines now look consistent with a modest downturn in profits and a softening of economic growth.

Portfolios

The Beckford James portfolios delivered positive returns across the board in a welcome change to the year-to-date trend. With the US and growth stocks in particular having an exceptionally strong month, those portfolios with the greatest exposure to these areas naturally performed the strongest. However, with bonds also exhibiting positive returns, those portfolios at the lower end of the risk spectrum with a greater exposure to this asset class also performed well.

Growth 10 was the strongest performing of the Growth portfolios delivering a total return of 4.72% whilst at the other end of the risk scale Growth 3 returned 2.96%. All Growth portfolios outperformed their respective benchmarks for the month. As highlighted, some of the month’s best performing funds were those that have underperformed the most year-to-date and vice-versa. Goldman Sachs Global Millennials and Natixis Sayles US Equity Leaders which have been laggards so far this year were the top performing growth funds, both up in excess of 10%. There were also some notably strong performances from their UK counterparts such as UK Buffetology which rose 8.02%. The only funds to deliver negative returns were the previously strong UK direct property funds and emerging market funds, thanks largely to the aforementioned issues in China.

With value stocks underperforming growth stocks, unsurprisingly the Income portfolio did not fare as well as the Growth portfolios, however still delivered a positive return of 2.41%. Again, there were some strong performances from some of the UK equity fund holdings, with Man GLG Income and Unicorn Income the standout performers, up 5.76% and 5.38% respectively. Property funds detracted from overall performance while some of the more heavily skewed value funds delivered positive performance but lagged that of the overall market.

Finally, the Ethical portfolio was the best performing portfolio overall, again due to the rotation in market leadership over the course of the month. The portfolio was up 4.93% with some exceptionally strong performances at fund level from the likes of Pictet Water, Liontrust Sustainable Future Global Growth and Stewart Investors Worldwide Sustainability which all delivered double digit returns. The only detractors were disappointingly some of the recently added funds such as property and some of the more value-biased funds however, we still believe this was the best course of action for long-term diversification of the portfolio.