McLaren
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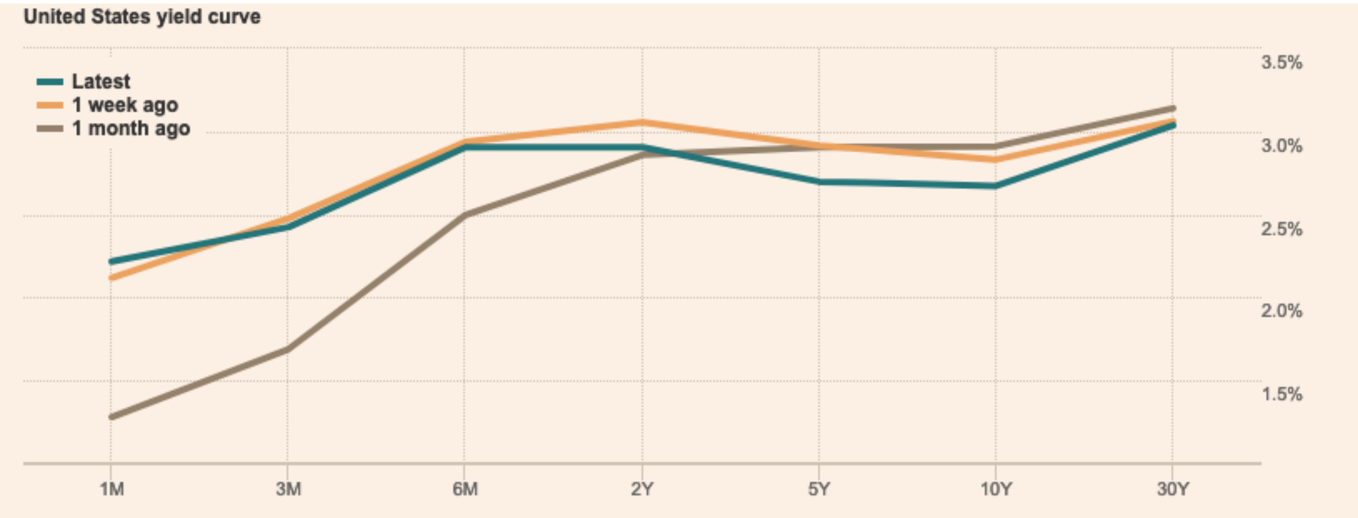
Global Market Strategy – August 2022

Let's talk Goldilocks again

After a first half-year which was the worst for equity markets in the US since 1970, markets rallied off June lows as second quarter corporate earnings beat expectations (Netflix and SNAP were notable exceptions) and finished the month strongly following far better than feared announcements from Amazon and Apple.

Positive trade was helped by the lead from the bond market when the US yield curve began flattening from its recession-predicting inversion to its now modest and more traditional rising trend. This suggests that higher interest rates in the short term may not need to go as high as feared to combat what is increasingly thought to be temporarily high inflation.



US yield curve (Source: ft.com)

As ever, it's a delicate balance. How high must interest rates rise to eliminate inflation without causing a recession? Is it a precondition that jobs must be lost for inflation to be beaten, or will higher energy and food costs be sufficient to curb spending, bring down prices but still allow businesses to thrive?

Although part of the current rally in equities can be put down to relief that inflation may have peaked, part can be attributed to another fear of missing out (FOMO), and a further part to short-covering - the practice of traders realising they are wrong to be bearish and needing to buy equities to cover their short positions.

However, the strong rally at the end of last month (the Nasdaq was up 12% and the S&P500 had its best month for two years) could still be a head-fake. Higher interest rates have already heavily impacted the housing market, and better than expected announcements from corporate America last month are reflective, not predictive, and there was a noticeable tone of caution to guidance for the third quarter. Indeed, unless the war in Ukraine ends before Winter, energy costs in Europe which have already seen some household bills for gas and electricity rise fivefold, will force people to choose between food or warmth. (More people die from hyperthermia than from starvation.) Can central banks walk the fine line between thwarting inflation and encouraging consumer spending? Momentarily, the market thinks they can, or at least the US equity market thinks the Federal Reserve can but there are plenty of analysts who feel equities must test the June lows at least once during the fourth quarter this year or the first quarter next.

One analyst noted for his research and opinion is Tom Lee of Fundstrat who believes the worst is over. He sees lower commodity prices generally, not just energy, and a gently weaker dollar will benefit emerging markets as well as international US businesses. He predicts the S&P500 rises to 4800 by the end of 2022 from its current level of 4160. This would put the price of the market at 19 times next year's earnings, back to being expensive when compared to the long term average and current level of 15 times.

Markets are always a push and pull of opinion but with the continual overhang of war, this is a classic market for phasing new investment over six months into 2023.

S&P500, 1 year showing the high of January 2022 (Source: [ft.com])

Apple common stock, 1 year (Source:** ft.com**). Apple's ecosystem commands strong loyalty and the brand high prices.

While many international markets have rallied in July, the Chinese market has gone into reverse, suffering from new covid outbreaks and concern by international investors over the transparency of Chinese company accounts. Alibaba, among other prominent Chinese companies, has been added to the US's Securities and Exchange Commission (SEC)'s watchlist of companies which the SEC believes are providing accounts which are not full and transparent - a reminder that China is a long term story.

Shanghai Composite, 1 year (Source: [ft.com])

GBP:USD, 1 year (Source: [ft.com](ft.com))

The pound has rallied since Boris Johnson resigned and latterly on expectation of lower than expected rate rises in the US.

<u>Favoured investment plays - **via monthly drip-feed**</u>
Nil risk:
Cautious risk: **Cash**
Balanced risk: **Managed / Multi-asset funds**
Market risk: **Multi-asset funds,** UK equity
Adventurous risk: **Asia,** Europe, Japan, US equity
Speculative risk: **Technology, Energy,** Agriculture, Emerging Markets, **China**

<u>Disclosure:</u>
Nicholas Chappell has the following personal investment exposure: Technology (all US, including fintech & green energy) 37%, (Other) Energy 4%, Pharmaceuticals (US) 2%, China 11%, Asia (ex China) 7%, Global Multi-Asset 10%, UK smaller companies 12%, (Other) UK equity 4%, US smaller companies 1%, (Other) US Equity 3%, Food & Agriculture 2%, Cash 7%