IMPERIUM CAPITAL

momentum

Data, data everywhere and not a number to guide

(with apologies to Samuel Taylor Coleridge)

Global Matters Weekly

3 October 2022

– Richard Parfect — *Portfolio Manager*

All through life our brains like to use "general rules of thumb" when dealing with problems. These rules may come through personal experience or maybe they are more prescriptive and laid down by doctrine.

When dealing with problems I have sometimes found it useful to use a "factor of three". For example, if I plan to do a DIY job in the house, bitter experience tells me it will take three times as long as I might expect. Similarly, in my distant past, my military training followed the doctrine that when attacking a defended position, your force would need to be at least three times the size of similarly equipped defenders; events on the ground have shown that Russia overestimated its forces and underestimate those of Ukraine (and its Western support) thereby putting itself on the wrong side of this golden rule. Such a guide can help avoid the shock of a gross under-estimation of outcome.

The Bank of England (BoE) publishes its expectations for inflation 12 months hence. Looking back at the Bank of England's Monetary Policy Report of August 2021, the Monetary Policy Committee's own 12 month forecast for the Consumer Price Index (CPI) inflation we are experiencing today was only around 2.2% (with little difference between including or excluding energy and VAT); indeed, external (to the Bank of England) forecasters were also only expecting 2.2% in Q3 of 2022. Fast forwarding 6 months to February 2022, (the report was written prior to Russia's invasion of Ukraine, but with other post COVID-19 inflation forces already on the loose) the Bank of England had increased its Q1 2023 inflation expectation to circa 5.3%, whereas the average of external forecasters was somewhat behind at 3.1%.

Even in May this year, with much more relevant information available to all parties, the Bank of England in that report was projecting CPI to be (only) 6.5% in Q2 2023, more surprisingly there were no external forecasters predicting it to be over 6% and their average forecast was for just 3.7%.

Humans like to have a number to hold onto as it feels tangible and brings confidence.

Last month, Citi, the investment bank, issued a headline-capturing warning of UK CPI likely to exceed 15% in the first quarter of 2023 (around three times what the BoE was predicting for Q1 2023 back in February 2022); even the Bank of England's report of that month was predicting Q3 2023 inflation to be almost 10%. Clearly, the forecasts as recently as February were in "gross error" territory.

What does this tell us apart from the folly of attempting to predict macro-economic data? Answers on a postcard; however, I would contend that it is a perfect example of the danger of anchoring. After many years of official and (optically at least) succeeding in achieving inflation of around 2%, there was a classic case of group think and anchoring at play in the minds of economic forecasters. Personally, it reinforces the fact that in circumstances that are not particularly unusual (war, pestilence, and famine) there is a high risk of underestimating things by a factor of three, even when the forces at play are known.

With such uncertainty and variability of outcome being an almost inevitable result of numerous known and unknown factors, it often baffles me how the forecasting industry garners so much attention and apparent credibility from observers. Perhaps it is the inevitable result of a lucrative machine who's vested interest is to convince people that they need their services.

The folly of blind faith in forecasts was illustrated even more starkly last week as a result of the fiscal event or "mini budget" (indeed the government did not even publish any forecasts to accompany the policy announcements). Gilts have been regarded as the benchmark "risk free" security, providing little volatility and a measured reflection of future interest rate "normalisation". Therefore, how shocking it

Sources: Unless stated all figures are from Periodic Monetary Policy Reports of the Bank of England.

was to see the quiet backwater of the 30 year UK Treasury Index Linked Gilt fall from around 118p in early September to around 53p on Wednesday 28th September (it has since recovered to 101p).

Humans like to have a number to hold onto as it feels tangible and brings confidence. Gross Domestic Product (GDP), inflation, and employment figures are only as good as the data fed into them; they are the measurements of the immeasurable. The reality of course is that the economy is far more ethereal than that. Furthermore, who is to say that doubling GDP is a good thing, if it comes at the woefully underestimated cost of climate change and catastrophe?

That desire to measure and have a number to point to is understandable, however it can be misleading, especially when used to compare things that are not actually directly comparable. My colleague Gary Moglione wrote about the subject of fees back in August (read Gary's thoughts here) and how the new rules on the disclosure of total look through costs, while laudable in principle, can run the risk of false comparisons in practice. As these rules are now having to be applied across the funds industry, it is essential that investors take time to appreciate what is actually being disclosed, what services are being provided by whom, and how they are being charged. We would welcome any questions from investors on this matter to explain the recent changes.

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The **Marketplace**

- Global equities fell 2.6% last week
- The UK's 'mini' budget continued to cause carnage across financial markets. The International Monetary Fund urged the government to change the course of action
- Brent crude rose 2.1% over the week to $87.96 a barrel
- Gold rose 1.0% to $1660.61 per ounce

Market **Focus**

US

- US equities fell 2.9% last week
- Ten-year Treasury yields touched 4% for the first time since 2010
- The Organisation of the Petroleum Exporting Countries Plus will consider cutting crude output by more than one million barrels a day when it meets in Vienna on Wednesday to increase prices. A larger-than-expected reduction would reflect worries over slowing global growth

UK

- UK equities fell 1.7% last week
- The IMF called the mini-budget excessive and likely to increase inequality
- GBP/USD tumbled to a record low, and Gilt market volatility caused pension schemes to panic, resulting in the Bank of England stepping in to purchase Gilts of up to £5B per auction
- The British Retail Consortium said shop price inflation accelerated to 5.7%, topping the previous 5.1% record set last month, as retailers increasingly pass on their surging costs to consumers. Food bills are rising the most, with inflation hitting 10.6% in September, quickening from 9.3% the previous month. Prices for non-food items, such as gardening and home products, rose 3.3%

Europe

- European equities fell 0.6% last week
- Credit Suisse Credit Default Swap (CDS) contracts rose last Friday, causing fear over the bank's liquidity and capital position

Asia/Rest of The World

- Global emerging market equities fell 3.3% over the week
- Chinese equities fell 2.6% over the week, ahead of a week of closure
- Japanese equities fell 3.2% over the week

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Asset Class/Region	Currency	Currency returns			
		Week ending 30 Sep. 2022	Month to date	YTD 2022	12 months
Developed Market Equities					
United States	USD	-2.9%	-9.2%	-24.1%	-15.9%
United Kingdom	GBP	-1.7%	-5.0%	-1.3%	3.8%
Continental Europe	EUR	-0.6%	-6.2%	-20.7%	-14.6%
Japan	JPY	-3.2%	-5.5%	-5.5%	-7.1%
Asia Pacific (ex Japan)	USD	-3.6%	-12.6%	-26.4%	-27.0%
Australia	AUD	-1.5%	-6.2%	-9.6%	-7.7%
Global	USD	-2.4%	-9.3%	-25.4%	-19.6%
Emerging markets equities					
Emerging Europe	USD	-4.4%	-10.5%	-79.9%	-81.4%
Emerging Asia	USD	-3.6%	-13.2%	-28.8%	-29.5%
Emerging Latin America	USD	-3.1%	-3.3%	3.0%	0.2%
BRICs	USD	-2.6%	-11.2%	-27.6%	-31.2%
China	USD	-2.6%	-14.6%	-31.2%	-35.4%
MENA countries	USD	-1.5%	-6.9%	-2.4%	-1.2%
South Africa	USD	0.5%	-8.9%	-18.8%	-19.2%
India	USD	-1.7%	-5.8%	-8.8%	-10.3%
Global emerging markets	USD	-3.3%	-11.7%	-27.2%	-28.1%
Bonds					
US Treasuries	USD	-0.7%	-3.3%	-12.7%	-12.5%
US Treasuries (inflation protected)	USD	-2.5%	-6.9%	-14.4%	-12.3%
US Corporate (investment grade)	USD	-1.9%	-5.3%	-18.7%	-18.5%
US High Yield	USD	-1.4%	-4.0%	-14.7%	-14.1%
UK Gilts	GBP	0.5%	-8.3%	-25.8%	-24.0%
UK Corporate (investment grade)	GBP	-2.7%	-8.9%	-24.5%	-24.0%
Euro Government Bonds	EUR	-1.0%	-3.8%	-16.7%	-17.1%
Euro Corporate (investment grade)	EUR	-0.9%	-3.3%	-14.6%	-15.1%
Euro High Yield	EUR	-1.9%	-3.9%	-14.7%	-14.9%
Japanese Government	JPY	-0.4%	-1.2%	-3.8%	-3.9%
Australian Government	AUD	0.2%	-1.4%	-10.9%	-12.2%
Global Government Bonds	USD	-0.5%	-4.9%	-20.3%	-21.0%
Global Bonds	USD	-0.7%	-5.2%	-20.5%	-21.3%
Global Convertible Bonds	USD	-1.2%	-6.4%	-24.1%	-26.0%
Emerging Market Bonds	USD	-3.1%	-6.9%	-30.7%	-30.9%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 30 Sep. 2022	Month to date	YTD 2022	12 months
Property					
US Property Securities	USD	-3.7%	-12.3%	-28.9%	-17.5%
Australian Property Securities	AUD	-3.0%	-13.7%	-30.7%	-24.6%
Asia Property Securities	USD	-5.7%	-8.3%	-16.4%	-20.4%
Global Property Securities	USD	-3.7%	-12.5%	-28.7%	-22.7%
Currencies					
Euro	USD	0.9%	-2.6%	-14.0%	-15.4%
UK Pound Sterling	USD	2.1%	-4.3%	-17.8%	-17.3%
Japanese Yen	USD	-1.1%	-4.1%	-20.5%	-23.0%
Australian Dollar	USD	-1.7%	-6.2%	-11.6%	-10.9%
South African Rand	USD	-0.6%	-5.3%	-11.8%	-16.4%
Swiss Franc	USD	-0.3%	-0.9%	-7.4%	-5.1%
Chinese Yuan	USD	0.2%	-3.1%	-10.7%	-9.4%
Commodities & Alternatives					
Commodities	USD	0.0%	-6.3%	14.5%	18.6%
Agricultural Commodities	USD	-0.8%	-2.9%	6.7%	15.4%
Oil	USD	2.1%	-8.8%	13.1%	12.0%
Gold	USD	1.0%	-3.2%	-9.2%	-5.6%
Hedge funds	USD	-0.5%	-0.9%	-4.5%	-4.4%

Source: Bloomberg. Past performance is not indicative of future returns

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