IMPERIUM CAPITAL

momentum

Upside Down

Global Matters Weekly

30 May 2022

– **Gary Moglione**

One of my favourite TV shows is Stranger Things and this week marks the release of the much anticipated fourth season. For those who are unfamiliar with the show, it follows the adventures of a group of young friends as they battle with various creatures that enter our world through a portal into an alternate dimension, which they call the "upside down". Looking at markets right now feels like we may have slipped into some sort of alternative dimension...

If we review the market environment over the past ten years there is a very consistent backdrop in the form of:

- Falling interest rates
- Deflation concerns
- Bull market in risk assets • Growth stocks outperforming value stocks
- Technology sector driving markets upwards
- Huge expansion in valuation multiples, particularly amongst the highest growth stocks
- High levels of speculation resulting in prices for assets such as cryptocurrency and non-fungible tokens (NFT) reaching extreme levels

It seems that we entered the "upside down" sometime around the end of October 2021, the current environment is vastly different:

- Rising interest rates
- Inflation concerns
- Bear markets (NASDAQ is down 24% from peak, S&P 500 teetering on the edge of one)
- Value outperforming growth
- Technology sector pulling markets downwards
- Valuation discipline is increasing as multiples contract, particularly amongst the most expensive stocks
- Lower levels of speculative investments causing a crash in value of assets such as cryptocurrency and NFT's

Effectively, the market environment we are now operating in is some sort of mirror image of the preceding ten years. Investors become conditioned by the environment they operate in, particularly when it has had such success and longevity. Many market participants under the age of 35 have only really witnessed one cycle.

If you have not already reviewed your portfolio, then I suggest you do and continue to do so periodically.

Behaviourally we all take comfort from investing with the herd and find it much more palatable to make investments in assets that historically have performed well. As a result, many portfolios have become more and more skewed to assets supported by a falling interest rate environment. This has resulted in a massive allocation to growth and technology stocks with many portfolios ill-prepared for what has been a pretty sharp inflection point.

If you have not already reviewed your portfolio, then I suggest you do and continue to do so periodically. Ensure your investments have not become overly skewed towards the old environment. Many are not aware of bias in their portfolio when it is performing strongly and then are tempted to "buy the dip" when prices start to fall, compounding their losses. Check that you have plenty of diversification across asset classes, regions, market caps, sectors and styles. You are more likely to be light on value stocks and investments with inflation linkage. Liken it to packing your suitcase for a holiday: you will pack some swimsuits for the beach but you may need a raincoat if the weather turns. The same thought process should apply when constructing your portfolio. Looking through history these style cycles can last anything from 2 to 12 years so there is still time to acclimatise your portfolio.

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The Marketplace

- Global equities gained 5.6% last week
- Most global markets saw positive gains following declines in recent weeks
- Brent crude rose 0.1% last week to $119.4 a barrel
- Gold rose by 0.4% to $1853.7 per ounce.

Market Focus

US

- US equities gained 6.6% last week ending seven weeks of declines. Investor sentiment was improved by several positive earnings developments in consumer discretionary and the energy sector outperforming
- The flash composite Purchasing Manager Index (PMI) slowed to 57.5 in May versus 59.2 in April. The flash services PMI came in at 53.5, down from 55.6 the previous month – both still in expansionary territory
- Freddie Mac showed that the average rate for a 30-year mortgage fell to 5.1% last week, down from 5.25% the week before
- Pending home sales fell by a larger than expected 3.9% (vs. 2.1% expected) in April.
- US durable goods orders in April grew by 0.4% (vs. 0.6% expected), although the previous month was revised down to 0.6% (vs. 1.1% previously)
- Core Personal Consumption Expenditure (PCE) in the US for April printed at 0.3% Month-on-Month, in line with expectations.

Europe

- European equities gained 3.4% last week
- The composite flash PMI of services and manufacturing came in at 54.9 versus 55.8 the previous month
- European Central Bank (ECB) President Christine Lagarde laid out a plan to exit negative interest rates by the end of the third quarter, implying two quarter-point increases in July and September as the most likely scenario, the current deposit rate is -0.5%.

UK

- UK equities increased by 2.5% last week
- The government moved to impose a temporary windfall tax on oil and gas firms' profits at a rate of 25%
- The flash composite PMI for May receded to a 15-month low of 51.8 versus 58.2 in April
- Bank of England (BoE) Chief Economist Huw Pill said he thought more interest rate increases would be needed to curb inflation in the UK, but that too much tightening may run the risk of a deep recession.

Asia/Rest of The World

- The benchmark Global Emerging Markets index increased by 0.9% last week
- Japanese equities gained 0.5% last week
- Chinese equities fell 0.5% last week, though Chinese tech stocks witnessed big gains after Alibaba posted better than expected Q4 earnings
- China's industrial profits (-8.5% year-on-year) shrank at the fastest pace in two years in April, down from a 12.2% gain in March.

Asset Class/Region	Currency	Currency returns			
		Week ending 27 May 2022	Month to date	YTD 2022	12 months
Developed Market Equities					
United States	USD	6.6%	0.8%	-12.4%	0.0%
United Kingdom	GBP	2.5%	1.0%	6.8%	15.3%
Continental Europe	EUR	3.4%	-0.9%	-10.0%	-0.7%
Japan	JPY	0.5%	-0.6%	-4.2%	1.1%
Asia Pacific (ex Japan)	USD	0.7%	-2.8%	-13.1%	-20.3%
Australia	AUD	0.5%	-3.0%	-1.7%	5.4%
Global	USD	5.6%	0.5%	-12.6%	-4.3%
Emerging markets equities					
Emerging Europe	USD	0.9%	-3.4%	-74.7%	-74.3%
Emerging Asia	USD	0.3%	-3.4%	-16.3%	-23.7%
Emerging Latin America	USD	6.0%	9.2%	20.9%	7.4%
BRICs	USD	0.4%	-3.2%	-19.9%	-31.2%
China	USD	-0.5%	-3.4%	-20.5%	-38.1%
MENA countries	USD	-0.5%	-9.6%	5.9%	16.0%
South Africa	USD	5.0%	-1.4%	3.4%	-8.4%
India	USD	1.0%	-5.5%	-9.1%	1.2%
Global emerging markets	USD	0.9%	-2.8%	-14.6%	-21.1%
Bonds					
US Treasuries	USD	0.3%	0.9%	-7.4%	-6.4%
US Treasuries (inflation protected)	USD	0.9%	-1.4%	-6.0%	-1.0%
US Corporate (investment grade)	USD	1.7%	1.4%	-11.5%	-9.7%
US High Yield	USD	3.3%	0.2%	-8.0%	-5.3%
UK Gilts	GBP	-0.6%	-0.9%	-10.9%	-9.6%
UK Corporate (investment grade)	GBP	0.1%	-0.4%	-10.2%	-9.6%
Euro Government Bonds	EUR	-0.1%	-0.6%	-9.4%	-9.4%
Euro Corporate (investment grade)	EUR	0.0%	-0.7%	-8.2%	-8.3%
Euro High Yield	EUR	0.4%	-1.4%	-8.3%	-7.3%
Japanese Government	JPY	0.1%	0.0%	-1.9%	-1.9%
Australian Government	AUD	0.5%	-0.5%	-8.4%	-8.9%
Global Government Bonds	USD	0.7%	1.0%	-10.5%	-12.8%
Global Bonds	USD	1.0%	1.0%	-10.9%	-13.2%
Global Convertible Bonds	USD	1.8%	-3.1%	-15.6%	-19.5%
Emerging Market Bonds	USD	2.8%	1.7%	-20.8%	-21.2%

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

Asset Class/Region	Currency	Currency returns			
		Week ending 27 May 2022	Month to date	YTD 2022	12 months
Property					
US Property Securities	USD	5.5%	-5.3%	-13.4%	4.6%
Australian Property Securities	AUD	1.0%	-9.9%	-16.4%	-0.1%
Asia Property Securities	USD	0.8%	0.8%	-2.6%	-12.3%
Global Property Securities	USD	3.5%	-3.9%	-11.9%	-3.8%
Currencies					
Euro	USD	1.5%	1.5%	-5.9%	-12.1%
UK Pound Sterling	USD	1.1%	0.2%	-6.9%	-11.1%
Japanese Yen	USD	0.4%	2.0%	-9.5%	-13.6%
Australian Dollar	USD	1.8%	0.8%	-1.8%	-7.6%
South African Rand	USD	2.0%	0.9%	2.0%	-11.7%
Swiss Franc	USD	1.8%	1.5%	-4.9%	-6.3%
Chinese Yuan	USD	-0.1%	-1.4%	-5.1%	-4.7%
Commodities & Alternatives					
Commodities	USD	2.5%	3.8%	37.8%	56.8%
Agricultural Commodities	USD	0.5%	0.4%	24.4%	40.4%
Oil	USD	6.1%	9.2%	53.5%	71.9%
Gold	USD	0.4%	-2.3%	1.3%	-2.0%
Hedge funds	USD	0.3%	-1.5%	-3.7%	-3.3%

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

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