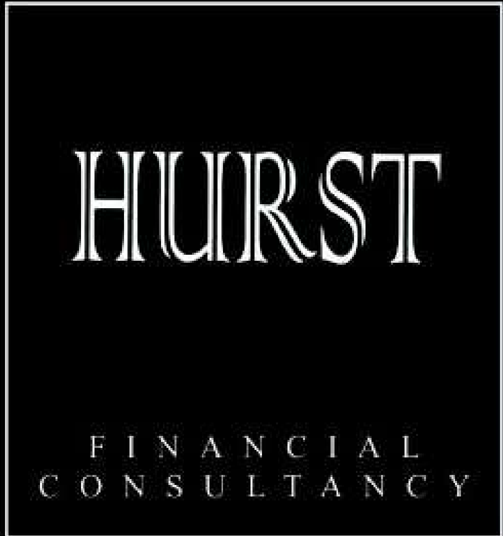

January 2022

Investment Review

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Firstly, a belated Happy New Year to you all!

Over the last few days, we have received an increasing number of enquiries surrounding the fact that the FTSE 100 has been rising and the portfolios have softened. The following will give you some detail explaining the reasons behind this and some outlook for this year.

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It is no secret that inflation has been rising, predominantly in the UK and US (with UK inflation rate now at 5.4%, and the US recently announcing a 7% year-on-year inflation rate). Typically, central banks look to increase interest rates in order to combat inflation but there is currently quite a lot of debate around how far – and how quickly – they might be able to go.

As interest rates rise, we see bond yields also rise, and conversely their prices fall. Another impact of rising interest rates is that high growth companies (in particular, technology) fall in value as the discount rate used to value future earnings to give today's prices, rises.

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As a result, global equity markets have been relatively volatile in the last few weeks (certainly more volatile than they were last year). The largest indices around the world have performed as follows:

Index	YTD Total Return (in GBP)
FTSE 100	2.89%
EuroStoxx 50 (Europe)	-1.26%
S&P 500 (US)	-2.98%
Nikkei 225	-3.16%
NASDAQ 100 (US – tech heavy)	-5.17%

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While the FTSE 100 is one of very few equity indices to have posted positive returns so far this year, all our portfolios are invested on a global basis and usually have only 10-20% invested in UK equities depending upon your chosen risk category.

The FTSE 100 has been driven primarily by the energy and financial sectors, which typically benefit from growing economies and rising interest rates. With the likes of BP and Shell making up a significant proportion of the index, increasing oil prices have certainly helped. However, not all constituents have delivered a positive return this year.

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You will see from the below table that the majority of the FTSE 100 (approximately 52% by sector weighting) has delivered a negative return.

Sector	FTSE 100 Weighting*	YTD Total Return
Energy	10.60%	14.10%
Financials	17.74%	8.94%
Materials	13.77%	5.04%
Communication Services	4.35%	3.09%
Utilities	3.45%	-0.04%
Consumer Staples	17.47%	-0.42%
Health Care	11.37%	-0.90%
Consumer Discretionary	6.49%	-3.23%
Industrials	11.24%	-5.49%
Real Estate	1.27%	-5.96%
Information Technology	1.23%	-10.76%

*does not sum to 100% due to Pershing Square Holdings and Scottish Mortgage Trust (1.02% of the index) not being classified, as they are collective investment vehicles.

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The sectors that typically do not do so well in an environment of rising interest rates have suffered – which is also the reason that global equities markets have fallen. For example, real estate has fallen 5.96% due to the prospect of increasing interest rates potentially reducing the demand for houses (as mortgages would become harder to service).

As previously mentioned, with only a small amount of the portfolios invested in the UK, the portfolios are far more exposed to the movements of global equity markets. The UK funds that we hold tend not to be focussed heavily on the likes of energy and financials as they are very cyclical (although both sectors do appear and have exposure to the likes of Shell and BP). We prefer to predominantly invest in a way that is a little more immune to the business cycle – as much as you can be. Whilst energy and financials have done well so far this year, energy is still 9% down from its January 2020 valuations whilst financials are broadly flat.

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As the world emerges from the pandemic and economic growth looks to be back on the cards, it was to be expected that the sectors that fared worst during the Coronavirus crisis (when interest rates were slashed and the oil price briefly turned negative) would experience a bounce.

However, they are not the sectors that typically consistently do well over the longer-term. We would instead prefer to hold investments in consumer staples and industrials, which have the ability to provide returns through a business cycle and offer a little more protection when markets are falling. Whilst they have not performed as well in recent weeks, consumer staples in the UK have returned 5.39% since January 2020 and industrials have returned 16.89%.

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We are long-term investors and therefore try to look through the short-term movements to ensure that we remain invested in funds that can compound their earnings over time.

Taking a deeper look into inflation, the anticipation is, however, that it is likely to fall this year simply on the back of static to moderately rising energy prices from here, this alone would have a significant dampening effect on headline inflation.

In order for inflation to continue on the current trajectory, energy prices would have to increase substantially from here and it is hard to make a case for that, particularly for the oil price.

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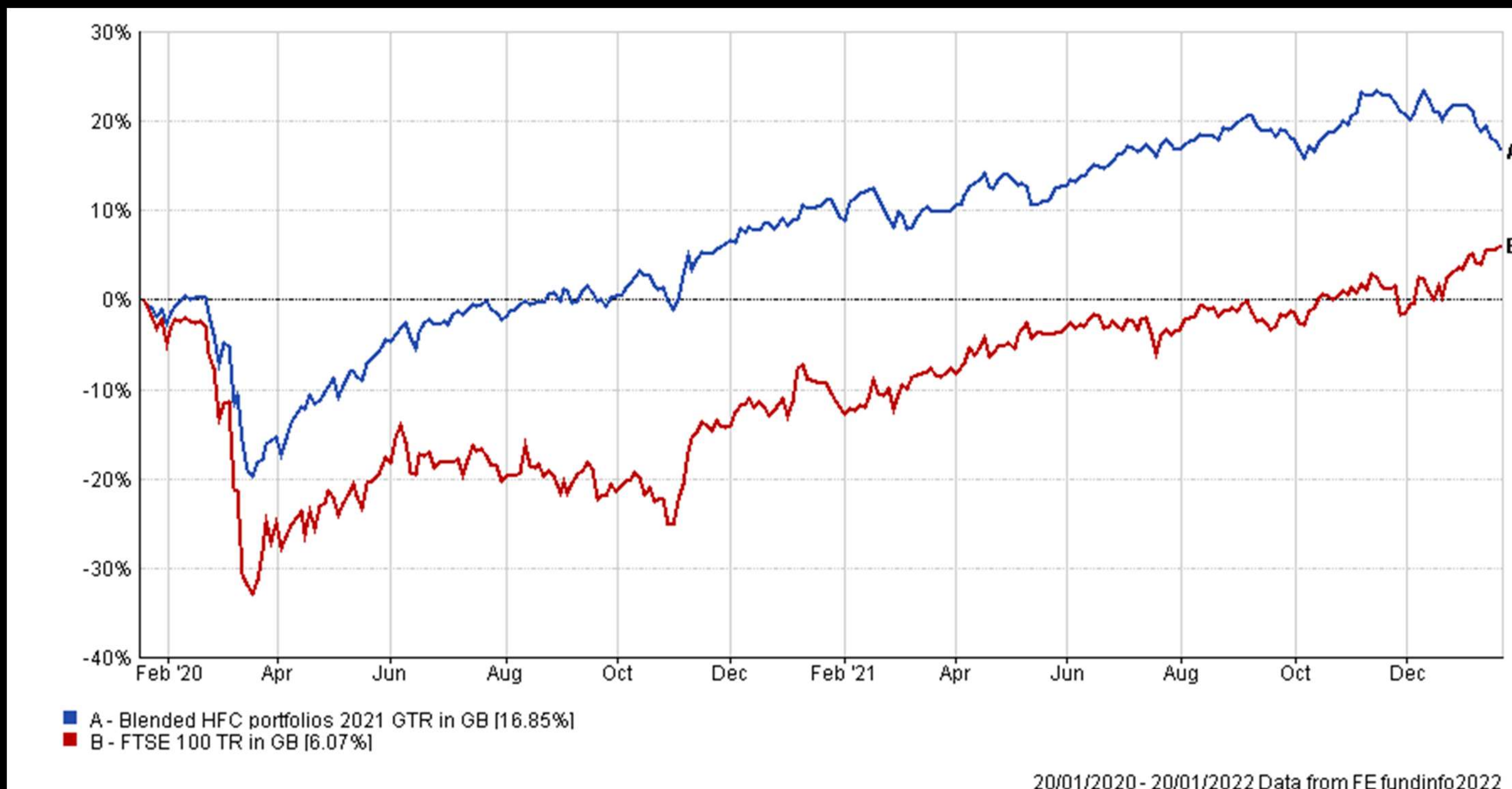
Recent weeks also haven't just been about equity market movements, typically, fixed income investments fall in value when interest rates increase (as bond yields rise) – with longer dated bonds falling further than shorter dated bonds.

Whilst most portfolios are holding a low weighting in fixed income investments, particularly compared to previous years, bond values have still suffered recently and compounded equity losses.

The chart below shows our blended portfolio (an average of our risk portfolios) charted against the FTSE 100.

I am sure you will agree that being invested in your current portfolio versus the higher risk FTSE 100 has proven to be a good choice during the pandemic.



The following chart, to give greater context, over a longer period (9 years) also shows the long term benefits of a diversified asset allocation.

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To conclude, we are happy with our current asset allocation and we must remember that markets do periodically rise and fall.

We aim to ensure that the portfolios' sensitivity to interest rate increases is as low as possible, although this is always a trade-off between giving up additional income or protecting against potential falls in value.

We continue to listen to Central Banks carefully to see how far, and how quickly, they are willing to increase interest rates and will always continue to ensure that the portfolios are well positioned to perform over the long term – as well as protect value if the volatility we have seen continues.

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Keeping in touch

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