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3Q 2022 Commentary

Financial markets have continued to be volatile during the third quarter of this year. Following relative calm in July, markets were especially volatile in September. We have seen falls in global equities of 26% to the end of September, and the US technology sector has fallen 32.40% over the same time period.

The hawkish Jackson Hole Symposium update in late August confirmed that restoring price stability remains the core priority of the US central bank (the Federal Reserve), despite the inherent risks to growth. The Fed Funds Rate now sits between 3% and 3.25%, a level last seen in 2008, and Fed officials are projecting a rise of at least 1.25% over the final two meetings of this year. The Bank of England has also raised interest rates recently and projections are for base rates to peak at 4.75% in this current cycle.

This tightening of interest rates, together with macroeconomic and geopolitical uncertainty, along with many countries experiencing currency weakness, has contributed to a rapidly strengthening US dollar. This is another headwind for US companies who have foreign profits that now translate back into fewer dollars. And the rest of the world must now pay higher prices for energy and raw materials, most of which are still priced in dollars. A result of the strong dollar could be an increase in US company bids for foreign corporates as well as an increase in US tourists travelling overseas.

A more positive outcome of the continuing high energy prices and resultant elevated inflation numbers is President Joe Biden's introduction of the Inflation Reduction Act which will result in $369bn investment in clean energy and climate change mitigation initiatives.

The bond markets were the key focus in September due to the concerns over rising interest rates. The US Treasury started September with a yield of 3.19% and ended the month yielding 3.83%. For the first time in over seventy years, global bonds are in bear market territory, having seen a decline of more than 20% from their peak. Historically it is unusual to see both equity and bond markets in bear market territory at the same time. To a number of analysts the price moves for fixed income during the third quarter seemed very extreme, and some believe that for the first time in many years certain bonds are now looking more attractive as investments.

Since the end of the third quarter, we have also experienced disorderly markets, especially in the UK, where changed in fiscal policy outlined in the mini budget led to a run on the pound and unprecedented levels of volatility within the UK gilt market. Significant intervention by the Bank of England was required to stabilise the situation and, as we write, most proposed fiscal changed have been reversed; the severe market reaction clearly demonstrates how acutely sensitive it is to change. It is, however, the reversal of past decades' global monetary policy, rather than fiscal policies, that is having the most impact.

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We firmly believe that asset prices will eventually recover, as they have done historically, and that staying invested and maintaining exposure provides the best route to extract the benefits of compounding to enable portfolios to generate good returns over the longer term.

Many assets are now much more attractive than they were at the beginning of the year. Bear market periods are often short-lived when compared to bull market periods, and historically some of the financial markets' best trading days take place both during a bear market and in the first two months of a bull market – catching the timing of these is of course very difficult.

The balance of the year has a number of key international events, including COP 28 (which is being held in Egypt), the November US mid-term elections, and the G20 group of world leaders meeting in Bali in mid-November.

There of course remains the possibility of bouts of extreme volatility in financial markets, and bear market rallies are often very sharp. We will remain vigilant to news-flow.

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