PEAKING OUR INTEREST

As the holiday season rapidly approaches, investors have added "peak interest rates" to their collective wish lists (in addition to the perennial appeal for a Santa Claus rally). While we won't know if major central banks including the US Federal Reserve are truly done hiking rates by the end of December, we should have a clearer indication of what's to come.

There are a number of factors that bode well for peak rates coming to fruition. While still above target in most countries, inflationary pressure has cooled significantly. Despite economic resilience thus far in the US, growth in other countries and regions has sputtered somewhat as the impact of higher interest rates has been felt more acutely and less aggressive fiscal spending has not provided as potent an offset. Oil prices have fallen sharply in recent weeks, shaking off geopolitical concerns and self-imposed OPEC production cuts. In the US, the Federal Reserve is likely to prefer a hands-off approach with a presidential election slated for early-November 2024. While central bank inaction would likely mark the end of this rate hiking cycle, investors have an even more sanguine view. Per the chart below, derivatives markets currently expect 74 basis points of US rate cuts by the end of next year.

Are investors getting ahead of themselves? We believe it is likely so. After all, we have been in the higher-for-longer nominal growth and inflation camp for some time now; arguing that a smooth retreat to 2% target inflation rates in most countries will prove to be elusive. Upwards pressure on wages is becoming entrenched across numerous nations and industries, with news of unions scoring significant collective bargaining victories becoming commonplace. In the US, households are still sitting on excess cash distributed during COVID lockdowns and the multiplier effect of expansionary fiscal policy continues to reverberate throughout the economy. Even China is showing signs of stabilization and a preliminary upturn in domestic activity, after the recovery out of lockdowns was short-circuited by property market stress and badly damaged consumer and business confidence. If the world's second largest economy were able to regain its footing, this would provide a pro-cyclical boost to global growth.

If we are correct that price pressures remain elevated (but do not accelerate meaningfully from current levels), it becomes imperative to gauge central banks' respective tolerance for above target inflation rates. One argument posits that a period of overshooting inflation is acceptable, considering that inflation indices undershot target levels for much of the past decade. But there is a delicate balance. While central banks do not want "hard landings", they must also retain credibility (some would argue that ship has sailed a long time ago!) and prevent inflation expectations from becoming unhinged. Perhaps Fed Chairman Jerome Powell swearing on a hot mic is emblematic of the pressure they're under!

How should investors approach this? Whether rates move slightly higher, hold steady or fall, the key takeaway is that the rate hiking cycle in most major economies is either over or very near to it. Historically, both stocks and bonds have performed well in the years following terminal rate hikes. Additionally, there is an abundance of "dry powder" waiting on the sidelines, as approximately $USD 1 trillion poured into money market funds this year. While jittery investors will continue to scrutinize each CPI print and economic release, the outlook for long-term returns looks promising.

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GLOBAL STRATEGY OVERVIEW

CASH

As near-term recession concerns ebb, money that was sitting on the sidelines should work its way back into risk asset markets. Professional investor surveys show this trend is well underway, with cash positions declining from near-historically high levels. We expect continued flow into global stock and bond markets and have reduced cash and equivalents exposure to neutral in client portfolios.

BONDS

With nominal yields grinding higher in numerous markets during the past quarter, some prominent bond investors have declared an attractive buying opportunity. We disagree that bond yields will quickly revert back to pre-pandemic lows. However, the higher yields are becoming more attractive from an income generation standpoint. Fixed income exposure has been increased this quarter, but remains underweight versus benchmark.

EQUITIES

Market capitalization-weighted emerging market indices are light on “real economy” sectors that should thrive in an inflationary growth environment. Conversely, dividend-weighted indices overweight commodity-centric sectors such as materials and energy, in addition to bolstering portfolio yield. We have pivoted EM equity exposure to a high dividend orientation in client portfolios.

OPPORTUNITIES

Offshore Chinese “H-share” indices are dominated by major Chinese banks (most of which are state-owned) and internet companies. Of these two main components, we currently favour the internet sector, which has been dragged down by general risk-off sentiment towards Chinese assets, despite impressive revenues and a sharp reduction in regulatory hostilities. Broad Chinese H-share exposure has been shifted towards internet companies in balanced and growth-oriented strategies this quarter.

FORSTRONG STRATEGIES	INCEPTION DATE	1 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEARS	SINCE INCEPTION
BALANCED								
Global Income	30/06/08	3.67%	4.85%	3.80%	1.04%	3.38%	5.71%	6.90%
Global Balanced	30/06/03	4.10%	5.75%	4.47%	2.20%	5.18%	6.84%	6.72%
Global Growth	30/06/03	5.19%	7.06%	4.56%	4.15%	6.67%	8.06%	7.83%
Core Income	30/06/08	3.77%	4.43%	3.16%	1.23%	3.67%	4.86%	5.86%
Core Balanced	30/06/03	4.41%	5.38%	3.64%	3.28%	5.79%	6.36%	6.79%
Core Growth	30/06/03	5.40%	5.94%	2.85%	5.02%	6.94%	7.25%	7.68%
GLOBAL EQUITY								
Emerging Markets Equity Focus	31/01/19	4.83%	1.42%	1.74%	-0.68%	-	-	1.62%
Global Ex-North America Equity Focus	31/12/19	5.51%	7.94%	7.56%	2.71%	-	-	3.42%
ALTERNATIVE INCOME								
High Income Opportunities	30/06/22	4.81%	7.35%	6.21%	-	-	-	12.03%

* Performance as of November 30th, 2023

Performance statistics for ETF Managed Portfolios are calculated from documented actual investment strategies as set by Forstrong's Investment Committee and applied to its portfolios mandates, and are intended to provide an approximation of composite results for separately managed accounts. Actual performance of individual separate accounts may vary with average gross “composite” performance statistics presented here due to client-specific portfolio differences with respect to size, inflow/outflow history, and inception dates, as well as intra-day market volatilities versus daily closing prices. Performance numbers are net of total ETF expense ratios and custody fees, but before withholding taxes, transaction costs and other investment management and advisor fees. Past investment results provide no indication of future performance. Future returns are dependent on the general investment environment, the nature of the investment mandate and specific portfolio risks. A rate of return for one year or less is not annualized.