

INFLATED FEARS

Good news in financial markets has been rather scarce of late. In addition to the horrendous daily updates coming from Ukraine, news of surging interest rates, hawkish rhetoric from policymakers and lockdowns in China (of jaw-dropping scale) have painted a grim picture. Volatility is elevated and financial market pessimism is at an extreme. The consensus is not always wrong, but at times like these, identifying positive catalysts that the market is not focusing on can be highly rewarding.

First, it helps to take a step back. Coming out of COVID lockdowns, we anticipated a relatively rapid growth but shorter economic cycle (versus the post-2008 period) to materialize; as pent-up demand and the effects of accommodative monetary and fiscal policy would effectively “front-load” the recovery. In this scenario, a condensed but “typical” business cycle would unfold, as inflationary pressure mounts and central banks step in to squeeze aggregate demand through tighter policy.

Despite the turmoil this year, this economic roadmap remains largely intact. However, the timeline has likely moved forward. With inflationary pressure already building, the commodity price shock that ensued following Russia’s invasion of Ukraine poured fuel on the fire. Furthermore, widespread lockdowns in China (by far the world’s largest manufacturing nation) certainly will not help ease supply chain bottlenecks. Central banks have sprung into action quicker than previously anticipated, with interest rate hikes and hawkish forward guidance. All else equal, this should shorten the cycle.

But fears of imminent recession are wide of the mark. In the US, corporate return on invested capital (ROIC) remains comfortably above the cost of capital,

despite the sharp rise in interest rates. Higher prices will eat into demand, but are offset by wage gains and solid household balance sheets. Per the chart above, household debt-to-disposable income levels have fallen to a sustainable level and delinquency rates are at a generational low. Chinese lockdowns will cause a significant but temporary growth deceleration. But policy conditions had pivoted to an accommodative stance prior to the latest Omicron outbreak and can be ratcheted up if need be. The fact that the world’s two largest economies are still in decent shape provides a reassuring backdrop for the rest of the world.

What could convince investors to shake off the negativity? We would posit that a roll-over in inflation should do the trick. Per our most recent [Ask Forstrong](#) publication, mathematical base effects will begin to kick in shortly, as inflation began accelerating in earnest in the first and second quarter of 2021. Additionally, COVID-related supply shortages are gradually being resolved, despite the setback in China. This is not to say that inflation will quickly return to central bank target levels or that monetary tightening will be abandoned. But an alleviation in the frantic pace of inflation should provide policymakers with more flexibility, ease pressure on interest rates and help quell stagflation fears. Against this backdrop, widespread pessimism and outsized risk premiums provide a fruitful environment for opportunistic investors.

GLOBAL STRATEGY OVERVIEW

CASH

Europe faces numerous challenges with an active war on the continent and a terms of trade shock emanating from an over-dependence on Russian energy imports. With economic uncertainty, a deteriorating trade balance and fiscal stimulus likely to balloon, the euro and other European currencies look vulnerable to further downside risk. We have initiated a partial hedge on European currency exposure in client portfolios this quarter.

BONDS

Fixed income assets have offered little respite this year, with longer-dated bond prices falling sharply despite the risk-off market sentiment. Even with the higher yields, real rates remain deeply negative in most markets, offering little compensation to investors. We remain underweight fixed income in client portfolios and have decreased exposure this quarter.

EQUITIES

The distinction between commodity importers and exporters is a key focal point at present. Nations that are large exporters of natural resources are well-positioned to benefit from the constraints emanating from the war in Ukraine and an unfolding commodity cycle. We have increased the commodity factor exposure amongst equity holdings this quarter.

OPPORTUNITIES

Gold and gold-related assets provide an attractive source of diversification; offering an inflation hedge and benefitting from safe haven demand amidst market turbulence. Furthermore, limited capital spending in the gold mining industry over the past decade has left companies lean and profitable. A position in gold miner equities has been initiated 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
GLOBAL SERIES								
Global Income	30/06/08	-2.55%	-7.00%	-3.82%	1.38%	2.37%	6.29%	7.19%
Global Balanced	30/06/03	-5.14%	-8.35%	-5.35%	3.84%	4.49%	7.68%	6.88%
Global Growth	30/06/03	-6.00%	-9.32%	-4.18%	5.86%	6.30%	9.44%	8.07%
CORE SERIES								
Core Income	30/06/08	-2.56%	-5.77%	-2.64%	2.43%	2.87%	5.83%	6.18%
Core Balanced	30/06/03	-4.70%	-4.93%	-1.54%	5.18%	5.06%	6.95%	7.05%
Core Growth	30/06/03	-5.45%	-5.18%	0.98%	7.30%	6.82%	8.52%	8.10%
FOCUS SERIES								
Special Opportunities Focus	30/12/13	-4.76%	-11.24%	-10.88%	0.39%	2.30%	-	5.47%
Emerging Markets Equity Focus	30/01/19	-4.42%	-9.13%	-11.26%	-0.52%	-	-	1.16%
Global Ex-North America Equity Focus	30/12/19	-4.26%	-11.88%	-11.70%	-	-	-	0.21%

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.