TALARIA

CERTAINTY EMPOWERS YOU

Don't predict, prepare

May 17, 2022

NOAA, The US National Oceanic and Atmospheric Administration forecasts weather, and as such it has spent many years trying to help communities prepare for storms – such as tornados and hurricanes. It makes sense. Even if you know something is coming you never know how long it will last or the impact it will have. The crucial thing for citizens is to prepare in the best way.

This is also true of how we think about investments in the current market. Since 2021 we've been arguing that investors need to prepare for more inflation, but now there's also a slowing global economy.

US inflation is currently at over 8%. 50% of shares in the S&P are down more than 10% so far this year. We are bottom-up equity investors and therefore don't engage in market forecasts, however it is noteworthy that institutions such as Morgan Stanley have recently commented that: "The US equity market is not priced for this slowdown in growth from current levels. In fact, based on our fair value framework, the S&P 500 is still mispriced for the current growth environment."

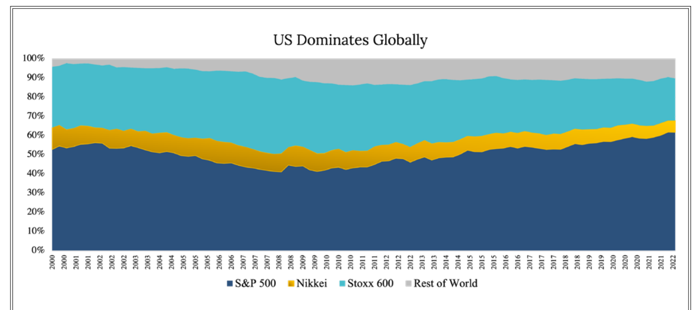
If this is true, then there is likely more pain to come.

What is the upshot of all this?

> *Despite the poor returns many investors have suffered in the last six months – it is not at all too late to embrace the change we have witnessed in markets. Indeed, it is imperative to prepare for this potential future.*

So, what does enacting change as a saver look like within equity markets?

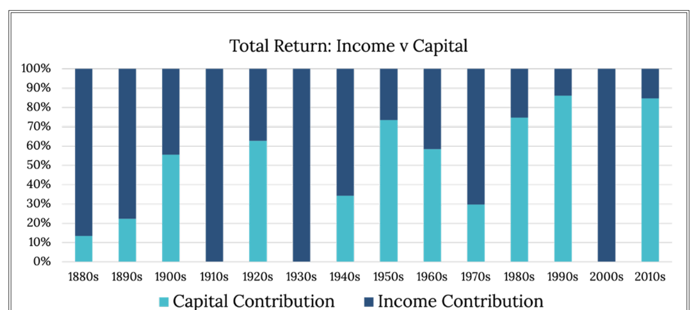
By geography – since the GFC, US equities have been one of the few games in town and they now make up nearly 70% of the MSCI world index. US equities are both over-owned and over-valued, in which case it makes sense to diversify into more attractive regions such as Europe and Japan.



Source: Bloomberg

By style – as we've demonstrated elsewhere, many of the most popular equity investments are highly correlated to Nasdaq and, by extension, to US bond yields. If you haven't already, it's time to move into factors uncorrelated with these areas.

By return type. Quality income in its various forms is an excellent diversifier in savers portfolios and dividend strategies have started performing in all regions while equity income flows have turned strongly positive. Leaning on capital growth to drive total returns is dangerous; it's right to look for income and history tell us that income has always played a part, sometimes the only role, in investor's total returns.



Source: Bloomberg

Don’t predict, prepare

May 17, 2022

We are almost certainly in the early stages of an economic slowdown – the kind which historically does not end well for equities. Earnings’ forecasts are likely to fall as corporates wrestle high inflation and rising interest rates. These challenges, which are also manifesting in falling disposable incomes, threaten to persist.

In this environment investors should not be asking themselves whether market setbacks are over but how they are set if the weakness continues.

However, it’s not all bad news. Our process is also identifying attractive sectors, regions and individual equities in which to invest. For example, our Health Care holdings evidence all three of these categories. If equity markets were weather, it’s hard rain that’s falling and it’s likely to stay wet. Our advice is to adapt and not just stand around waiting for the sun.