Global equities: Where next?

by Peter Rutter

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Peter is Head of Equities at RLAM as well as the Global Equities team, and a Senior Portfolio Manager with over 19 years of experience. Prior to joining Royal London Asset Management, Peter was Head of Global Equities at Waverton Investment Management, where he worked alongside Will Kenney and James Clarke under the same team construct. Prior to this, Peter was a partner and global equities fund manager at IronBridge Capital Management for six years, where he co-managed the £3bn IronBridge Global Select equity strategy.

Previously, he worked in the Global Equities team at Deutsche Asset Management. Peter graduated from Christ's College, Cambridge University, with a starred double first-class degree in Geography, is a CFA Charterholder and a chartered management accountant (CGMA). Peter has also achieved the CFA Institute Certificate in ESG Investing.

What challenges did global stocks face in 2022?

Rising interest rates, bond yields, inflation and threats of a looming global recession have been significant challenges for stocks globally in 2022. This formidable set of headwinds has seen global equity markets post significant losses in US dollar terms.

With the 'transitionary' inflation pressures of global supply chain disruption that first appeared in the aftermath of Covid being exacerbated and prolonged by the escalation of Russian aggression in Ukraine, an inevitable tightening of monetary policy globally in order to try and control this has resulted in interest rates rising sharply over the course of the year.

With this rise, the present value of future company cash flows, upon which stocks are valued, painted a very different picture for many of the previous market leaders. As a result, traditional higher growth areas, such as technology stocks, saw sharp sell-offs over the course of the year and, as inflation pressures took hold, those companies with less pricing power also began to come under pressure.

What worked well in Global Equities in 2022?

As expected with hindsight, those sectors that tend to do well in rising inflationary periods were the best places to be over the year. Both energy and commodities sectors were especially strong during the year as prices rose on the back of strong demand for weaker supply.

Currency movements had a notable impact over the year with the Federal Reserve's early and more aggressive approach to raising interest rates pushing the US dollar higher against the world's other main currencies. For sterling investors in global overseas assets, this dollar strength provided a boost to returns over the year.

When researching and building portfolios of global equities we tend to look at the world though a proprietary Corporate Life Cycle classification lens. This is based on the belief that corporate returns on productive capital and growth tend to progress along a Life Cycle and every company can be located economically in one of five Life Cycle categories.

Over the course of 2022 we observed that those companies at the front end of the Life Cycle, which we term Accelerators and Compounders, came under significant pressure against the market backdrop. It is here that you would expect to find early-stage technology companies together with some larger, more established, traditional growth business which have been the market leaders for so long. In contrast, the later Life Cycle stages of Mature and Turnaround companies, where we tend to find much more representation of the traditional Value sectors, were much stronger overall performers than in previous years.

What were the biggest challenges when manging Global Portfolios in this market environment?

The volatility of 'style' and 'factor' performance in financial markets, which first started to pick up around six or seven years ago, increased significantly over the period. The deviations in performance between different types of stock and manager 'styles' over the period are strong evidence of this elevated risk.

This has made it increasingly challenging to build portfolios with absolute high stock specific risk, which is our traditional 'edge'. In response to this challenge, we have continued to spend much time and effort evolving our measurement of style and factor risks and also the tools we have at our disposal to build portfolios in these types of environments. We have for example continued to benefit this year from a proprietary toolset using over 20 fundamental risk factors which allows us to understand and balance top-down risk across our portfolios in multiple planes to ensure we remain in balance.

Are you positive on the outlook for equities in 2023?

The significant falls in equity markets along with the resilience of long-term wealth creation in equities means that stocks are likely more attractive now than 12 months ago which does provide some comfort in the face of a challenging and still uncertain outlook within which a pretty deep and prolonged recession seems to be priced in.

There are large swaths of the equity market that are likely to be relative beneficiaries should inflation moderate, in a way that cash and fixed income assets cannot be. The cyclical nature of parts of the equity market are also likely to rally in the event of a more moderate recession once the growth outlook improves.

It's never possible to predict the market for the next 12 months but current lower priced markets, areas of inflation protection and areas that have become particularly cheap all create pockets of opportunity that were not as evident at the beginning of the year.

What themes will be prominent next year?

The rate and magnitude of rising interest rates and bond yields have signalled a global recession as likely given how much consumer financing and disposable incomes are set to be squeezed. How deep, long and widespread this recession is will likely dominate analyst and earnings forecasts for the near term and there is much uncertainty around this. What happens next with the Chinese economy, Covid and geopolitical policy are issues that will all likely be front and centre to sentiment and moves within global equity markets.

We tend to avoid making any top-level sector or thematic predictions, as experience tells us that this can be very challenging. However, we can make observations based upon bottom-up insights and more long-term observations. We believe our approach of investing in a broad range of companies who are in control of their own fates, irrespective of market conditions is the right one. As well as looking for durable businesses, a willingness to look through short-term extremes of sentiment and buy stocks when they are out of favour, or take profits when sentiment becomes exuberant, should, in our view, deliver longer-term performance.

In this respect, for stock pickers like ourselves, the biggest challenge with global equity investing also provides its biggest opportunity: the fact that there are over 5000 investible stocks to choose from. We are advantaged in this approach at RLAM by our comprehensive data-layer and technology toolsets, built up over 20 years, which covers every stock in this broad universe and these form the basis for our comprehensive idea generation, research and stock selection.

In terms of portfolio positioning, we continue to invest broadly across this Life Cycle which, alongside our tight region and sector relative exposures, ensures that we continue to seek stock specific risk as our main performance driver.

We continue to be convinced in our belief that companies pursuing the right wealth creating strategy for their position in the Corporate Life Cycle will be very fruitful long-term opportunities for shareholders. Beyond that, and like 2022, we would note that relative valuation opportunities across the Life Cycle continue to be in abundance.

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Ref: AL RLAM PD 0155

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