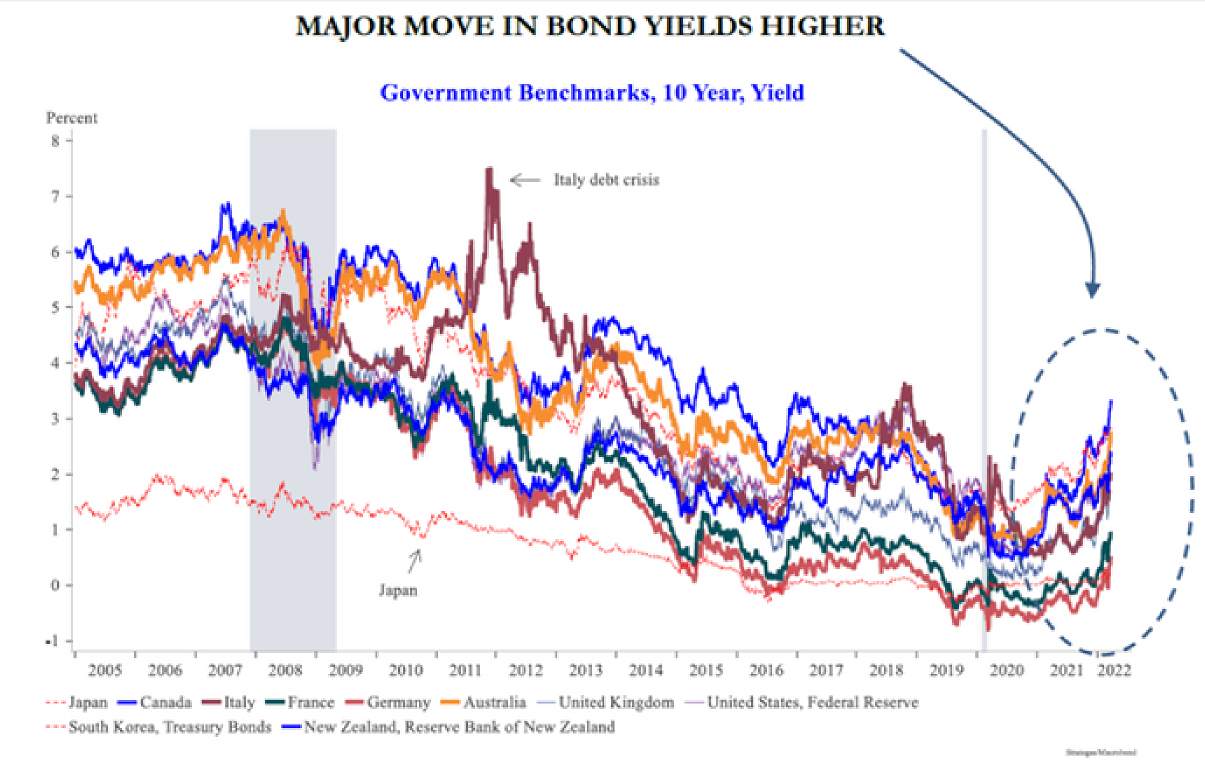
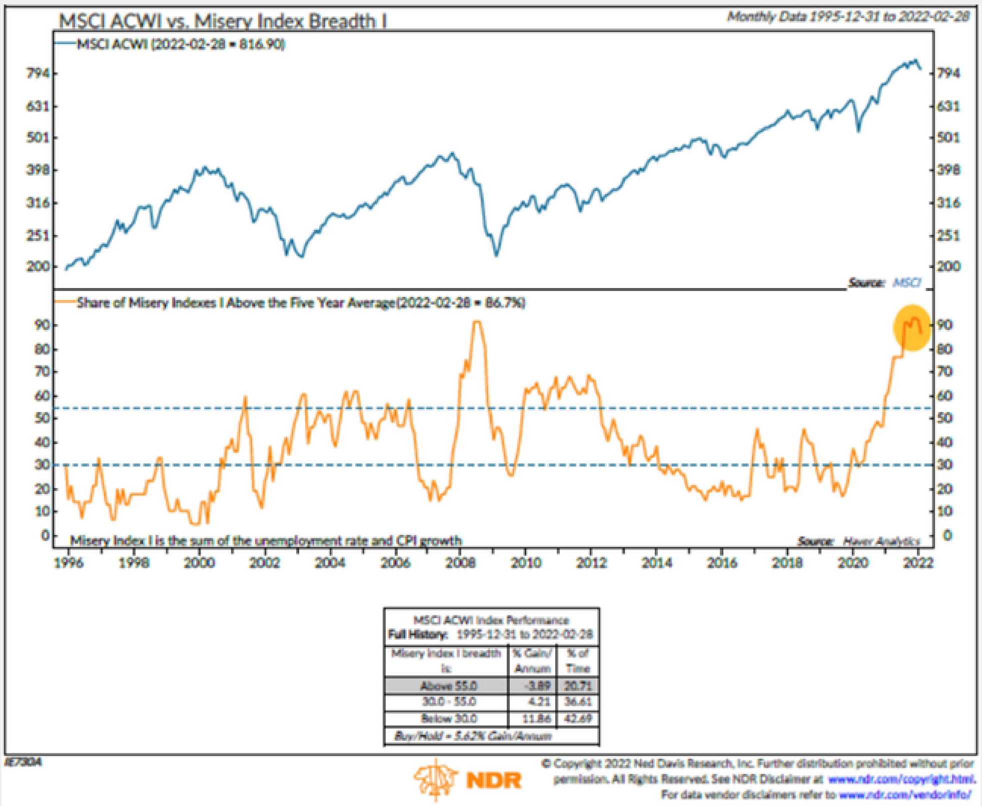
WEEKLY INVESTMENT **UPDATE** 11/12

Global bond yields are responding, without exception, to the specter of higher and longer-lasting inflation. Inflation pressures remain broad based and have only been made worse from the impact of the Russian/Ukrainian war on commodity prices and supply chains.



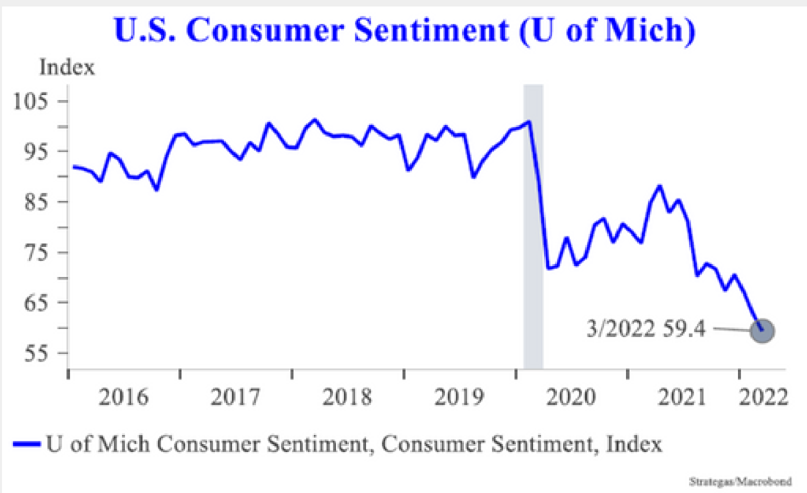
Source: Strategas Research Partners

The chart below, produced by Ned Davis Research, plots the change in the Misery Index relative to its five year average. The Misery Index is the sum of the inflation rate and the unemployment rate and has been a simple yet robust leading indicator of consumer spending. Obviously, any combination of rising inflation and rising unemployment would put a strain on consumer sentiment and finances. The five year change in this index is now at the previous peak reached in 2008 – some feat given how strong labour markets remain.

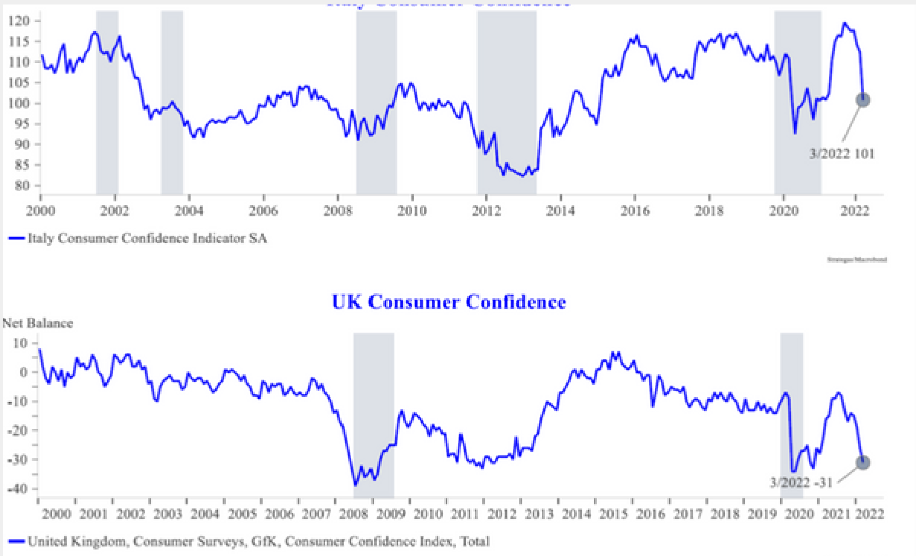


Source: Ned Davis Research

This increasing pressure on consumers is being reflected in the sentiment surveys in most developed countries (charts below). So far, this apparent deterioration in the expectations of consumers across the developed world has not been reflected in weak consumer spending. The reality is that job markets remain healthy, wages continue to increase, and consumers have generally amassed above average savings and pent-up demand due to the extended Covid lock-down restrictions of the past two years. This discrepancy between consumer sentiment and consumer spending cannot continue indefinitely and will be resolved by developments that impact the persistence of future inflation – not least the action of Central Banks in raising interest rates.

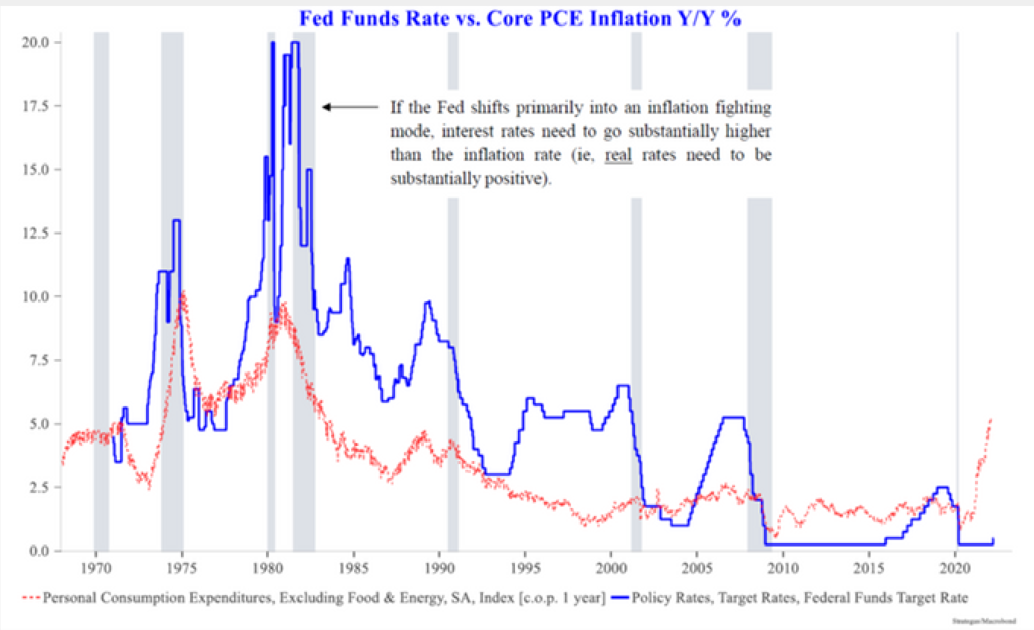


Source: Strategas Research Partners



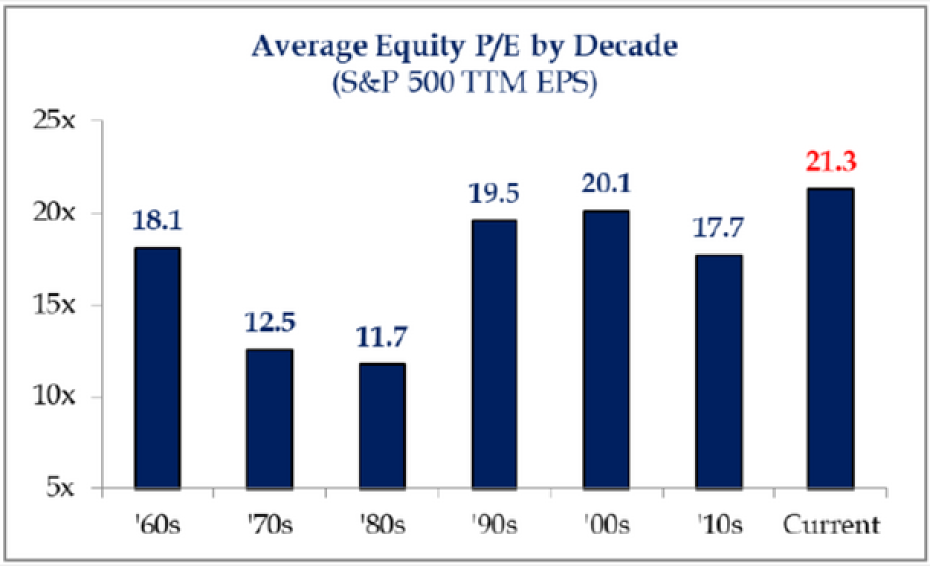
Source: Strategas Research Partners

The chart below plots the interest rate set by the Federal Reserve versus the core inflation rate. Two things from the chart are very apparent. Firstly, the exceptionally loose monetary policy in place since the 2008 financial crisis where interest rates were kept persistently below the prevailing inflation rate in an effort to stimulate economic growth. Secondly, looking back to the 1960s, it was only possible to drive inflation sustainably lower by raising rates to above the level of inflation and keeping them there. If the FOMC decides inflation will not moderate on its own, the first step would be to take the fed funds rate above the inflation rate. The core PCE inflation rate is ~5% y/y currently. That is a big step with some cracks already showing up in the U.S. data. The Fed is now likely in a "tighten until something breaks" mode. The key question remains whether it is inflation or growth that breaks first.

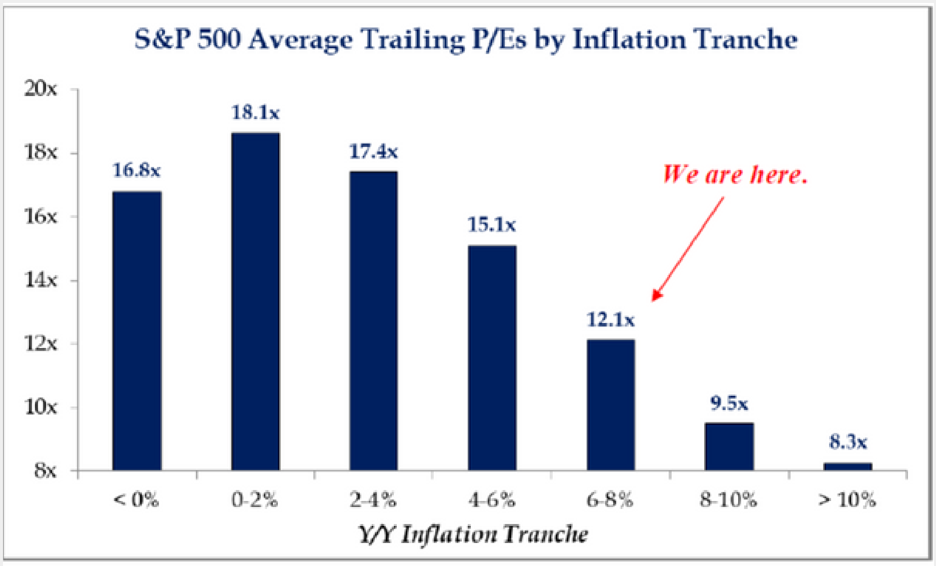


Source: Strategas Research Partners

Persistent high inflation and sharply higher interest rates would not be good news for the most expensive segments of risk assets. Despite the recent market pull-back, U.S. valuations remain high by historical standards (first chart below). However, as the second chart shows, should current elevated levels of inflation become more entrenched and not revert to more recent norms as is currently the consensus expectation, then a vastly different valuation framework for evaluating equity investments will result in pressure on the main equity indices.

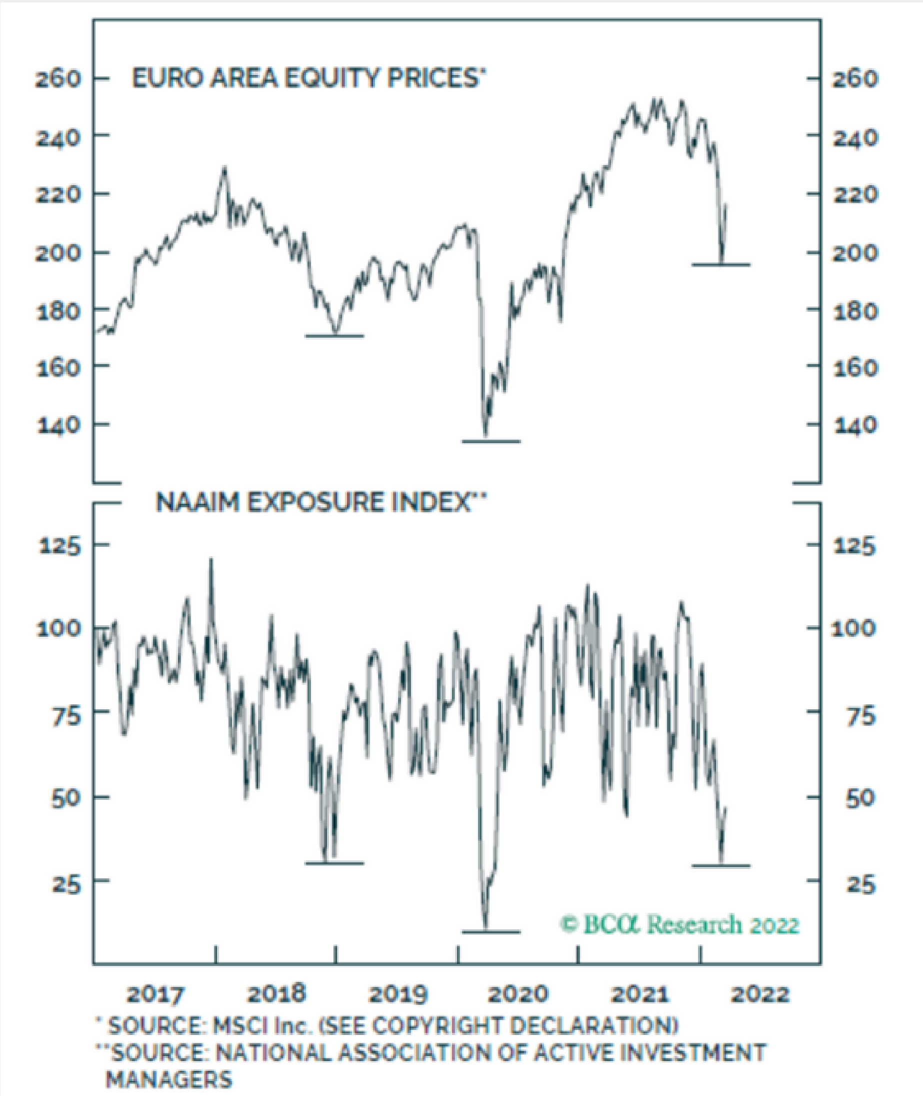


Source: Strategas Research Partners

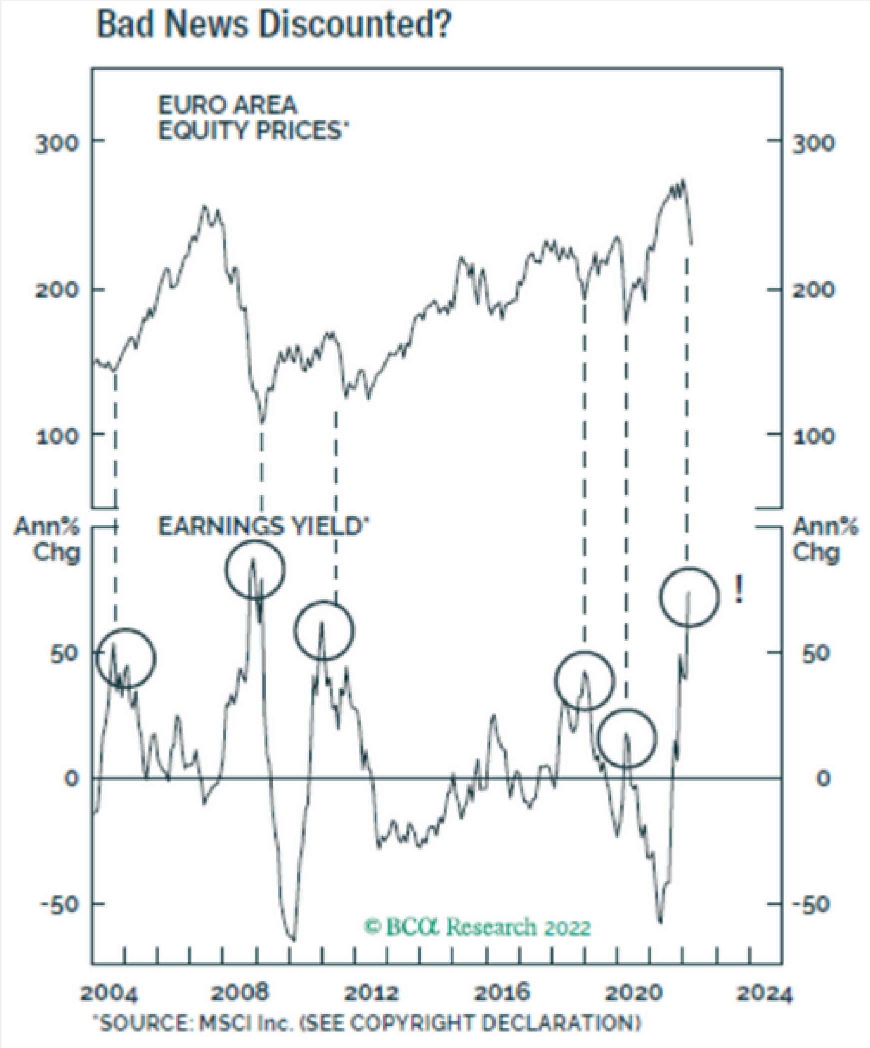


Source: Strategas Research Partners

We expect that this environment will place greater demands on fundamental security analysis and valuation. It seems unlikely that investors will return to the 'winning' strategy of the last few years of just buying the most popular momentum stocks with no regard for fundamental considerations. While acutely aware of the building market dangers, we continue to find attractive investment opportunities in those segments of the market currently overlooked by most investors. Negative headline risks in Europe have resulted in a sharp reduction in European exposure by many global fund managers. The first chart below shows that exposure has been reduced to levels last seen at the 2018 and 2020 market lows. This selling has been largely indiscriminate and has resulted in a sharp improvement in European valuations (second chart below). Again, this rate of improvement in valuations has usually coincided with very opportune periods to increase exposure to European equities in the past.



Source: Strategas Research Partners



Source: Strategas Research Partners

DISCLAIMER

This report, including any attachments may contain confidential and privileged material; it is intended only for the person to whom it is addressed. If you are not the intended recipient (or have received this e-mail in error) please notify us by email (info@m-partners.nl) immediately and destroy this e-mail. Any unauthorized copying, disclosure or distribution of the material in this e-mail is strictly forbidden.The sender cannot guarantee the security of electronic communication and is not liable for any negative consequence of the use of electronic communication, including but not limited to, damage as a result of in or non-complete delivery or delay in delivery of any e-mail.

Mpartners is an investment firm, licensed in accordance with article 2:96 of the Dutch Financial Markets Supervision Act ("FMSA", Wet op het Financieel Toezicht). Based on this licence, Mpartners is permitted to perform investment services as referred to in article 1:1 FMSA, subparagraph a, c and d of the definition of the 'provision of an investment service' (verlenen van een beleggingsdienst). Consequently, Mpartners is subject to the supervision of, and registered with, the Dutch Authority for the Financial Markets (Stichting Autoriteit Financiele Markten) and the Dutch Central Bank (De Nederlandsche Bank N.V.).

Mpartners is seated in Amsterdam and registered at the Amsterdam Chamber of Commerce under number 34389387 0000.