RIVAL WEALTH

Market Update - October 2022

The reign of Queen Elizabeth II ends with Central Banks batting on a sticky wicket

Adapting to challenges

This quarter ended with a global outpouring of grief at the death of H.R.H. Queen Elizabeth II, the longest-reigning British monarch. Affection for Her Majesty was undoubtedly in part due to her commitment to the work that went with her station in life.

A remarkable aspect of her long tenure is that she will have observed how governments, their policies, and their people come and go. She will have also observed that despite so much that appears to be different on the surface, a lot also remains the same: societies evolve, technology advances, economies grow.

Life goes on and adapts to each new challenge, which is well represented in the following chart. It shows the S&P 500 Index over the reign of Queen Elizabeth II. There are bumps and uncomfortable dips, flatter periods as well as steeper ones, but ultimately markets go upward.

The Investment Team

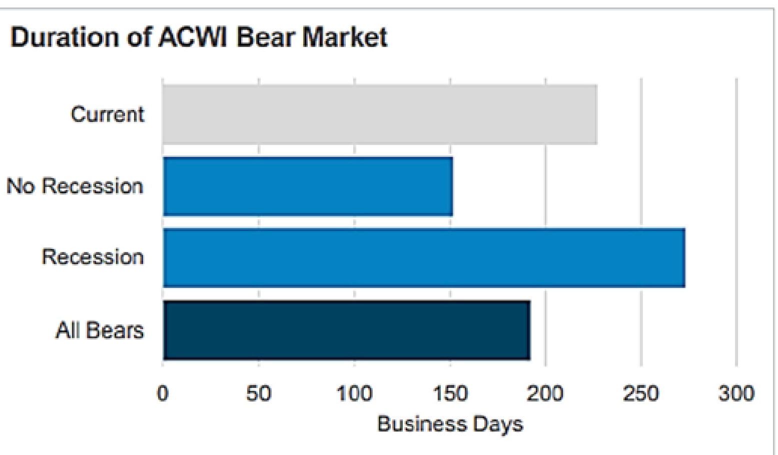
If you have any questions about your investment, just get in touch with the investment team as we are here to help.

Our phone number is:
0800 474 825

Tim, Anna, Rox,
Daryl, Regan, Rennie,
Brett, Nikki & Fiona

Long-term trends will resume... but when?

Global equities' sell-off looks 'long-in-the-tooth' compared to an average bear market. Historically, bear markets tend to last around 9-10 months (or, almost 200 business days) but there is quite a difference between non-recession episodes and episodes accompanied by recessions (as subsequently defined by the National Bureau of Economic Research, the US cycle dating agency) tend to last four months longer. 2022's bear turned 9 months old as October began.



Source: Morgan Stanley Research

The bear market in MSCI All Country World equities has now lasted longer, and been more severe, than in prior episodes over the last 30 years. This latest (September) sell-off looks especially mature outside the US. This indicates that for World equities, the period may be already passed, conveniently the downturn can be dated to the index peak on 4 January this year.

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What's the outlook?

In the short-term, risk remains elevated, and will for the rest of 2022. The main thing to point out is that this is not 2008, where companies are going under.

What is happening is that bond yields are rising as the market has underestimated the policy response to inflation. Earnings expectations are also not fully factoring in the impact of central bank's actions on economic activity.

However, longer-term, interest rate investments are becoming increasingly attractive, and their diversification benefits will reassert themselves.

Likewise, once consumer confidence returns and they start spending again, equities have great long-term prospects. Valuations are at historically low levels, and some of the largest companies are announcing record expected profits over the coming 12 months.

Why do we have interest rates?

Central banks exist for a few reasons, but at the top of the list is combating inflation.

When the current bout of inflation started in mid-2021, central bankers (who have been conditioned to several decades of low inflation), thought that this would be a fleeting encounter. However, rising prices have proven more persistent than initially projected, pushed up by the Ukrainian War. Around the world, multiple jumbo rate hikes of 0.50% - 0.75% have been implemented.

One key objective of monetary policy (interest rates) is to avoid inflation becoming "sticky." This is when inflation becomes embedded in people's expectations and so wage demands increase and price hikes continue, as the cost of production of goods and services rise.

This is what we find ourselves facing at present and is why central banks are resolute in their focus on hiking interest rates until inflation is tamed. They are on a mission to save the economy from inflation spiralling into hyperinflation, but it will come at the expense of the current business cycle.

Over the last quarter, markets have had to adjust their expectations in relation to how determined central banks are when it comes to taming the inflation beast. Just as central banks had been conditioned to inflation being low, so too have investors been conditioned to central banks coming to the rescue of falling markets. The upshot of the dawning realisation that they haven't yet, is that we experienced another quarter of lower markets, both for fixed interest and equities.

No pain, no gain

This is a phrase all of you will have heard before, especially if you have ever engaged in sporting activities. The purpose of training is to force our body to strain and suffer so that the biological response is to grow stronger and cope with this new workload.

During intense workouts, you always reach a point where you want to quit because it is so uncomfortable, but that's the point where the potential for optimal growth is.

The same is true for investing, but the phrasing is slightly different and goes: "No risk, no reward." A key, and foundational, part of our process when taking on clients, is assessing your capacity for investment risk.

During periods of discomfort, it is hard to recall the bigger picture objective and purpose for which you are putting yourself through all this stress.

That's why a plan is put in place from the beginning, to give you a goal. Investors need to focus on this goal in the long term, rather than making short decisions. Yes, prices are down, but value remains.

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