SEASPRAY PRIVATE
Creating Investment Solutions

Monthly Investment Update

June 2022

Introduction

We have seen significant movements in equities year-to-date, with strong commodity price movements, some company earning weaknesses, the ongoing war in Ukraine, and further clarity on changes to central bank policy continuing to drive markets lower during much of this period. During May we did see a bounce in prices as markets attempted a 'risk-on' move. This came after there was some more positive news out of China with regard to the easing of its Covid-19 restrictions, also along with what was perceived as a set of less hawkish minutes from the Fed's May meeting. This short-lived rally has since been undone after higher-than-expected inflation results have come through for both the Eurozone and the US, leading investors to price in more aggressive monetary tightening this year.

Interest rates are on the rise, and are inevitably going to increase further – from extraordinarily low levels – and much of this has been priced in by financial markets over the last quarter. Central banks are however in a difficult situation: inflation is well above their targets, with the elevated price of oil keeping inflation high in the short-term. However, more medium-term indicators suggest supply-side constraints are easing, and that inflation will eventually come back down. It is important to note that the current bout of inflation is different to historical inflation ...this time it is supply side constraints...in the past it was driven by rising labour costs and demand side issues. Meanwhile, equity market sentiment is bearish, with some measures of market pessimism at levels last seen during the Global Financial Crisis, cash at Covid levels, and positioning heavily skewed towards commodities and defensives.

Much of this could be attributed to the war, the oil price, inflation, the flattening of the yield curve and associated recession fears, but we would like to point out that consumers' balance sheets remain very healthy, the oil price impact on consumers is much lower than it was in the 1970's, fiscal policy should alleviate short-term concerns and inventory rebuild will likely counter recession fears.

We would also like to remind readers that markets are always forward-looking and have already embedded most available information into the prices of assets. After a period of loss such as we have seen in H1 2022, many market participants are beginning to ask whether all or nearly all of the bad news is now reflected in prices and if we can look forward to a recovery. While the bottom may not be in yet, buying opportunities continue to emerge in the coming weeks and months and for the value-for-money minded long-term investor, things are beginning to get more interesting.

	1 Month	3 Month	YTD	1 Year
Equity Indices				
S&P 500	-5.6%	-9.4%	-20.6%	-10.5%
DAX	-3.1%	-2.8%	-14.8%	-13.8%
EuroStoxx 50	-3.9%	-5.3%	-17.6%	-14.7%
ISEQ	-6.7%	-7.9%	-21.5%	-19.7%
FTSE	-2.2%	1.6%	-1.1%	1.7%
Nikkei 225	-0.8%	4.0%	-8.6%	-10.1%
Multi-Asset Funds				
Aviva Cautious (Risk 3)	-1.9%	-4.3%	-8.9%	-6.2%
Irish Life MAPS 3	-2.8%	-3.6%	-8.9%	-4.8%
New Ireland iFunds 3	-1.7%	-2.9%	-5.1%	-3.6%
New Ireland PRIME 3	-1.9%	-2.7%	-6.2%	-1.5%
Zurich Prisma 3	-1.2%	-2.4%	-6.3%	-2.5%
Aviva Strategic (Risk 4)	-2.8%	-4.3%	-10.3%	-5.5%
Irish Life MAPS 4	-3.0%	-3.3%	-9.7%	-3.4%
New Ireland iFunds 4	-2.0%	-2.8%	-6.3%	-2.2%
New Ireland PRIME 4	-2.6%	-3.1%	-8.8%	-0.6%
Zurich Prisma 4	-1.6%	-3.3%	-9.6%	-2.1%
Aviva Dynamic (Risk 5)	-3.4%	-4.0%	-11.1%	-4.7%
Irish Life MAPS 5	-3.2%	-3.3%	-11.6%	-4.6%
New Ireland iFunds 5	-2.4%	-2.4%	-7.1%	-0.3%
New Ireland PRIME 5	-3.3%	-3.3%	-10.3%	0.6%
Zurich Prisma 5	-1.8%	-3.5%	-12.6%	-2.1%
Currencies				
EUR/USD	-0.1%	-4.7%	-8.3%	-13.1%
EUR/GBP	1.8%	2.4%	2.6%	0.6%
GBP/USD	-1.9%	-6.9%	-10.7%	-13.6%
USD/JPY	4.1%	13.8%	16.8%	21.5%
Fixed Income				
US 10yr	0.46	1.25	1.89	1.91
German 10yr	0.68	1.29	1.80	1.85
Irish 10yr	0.71	1.33	2.04	2.10
UK 10yr	0.71	0.88	1.49	1.70
Commodities				
Gold	0.2%	-7.4%	-0.7%	-2.6%
Brent Crude Oil	4.8%	11.9%	54.0%	61.0%

Global Economy & Inflation

Investors began 2022 on an optimistic note that economic growth would be strengthening as consumers began to spend the stack of savings built up during the Covid-19 period. The war in Ukraine and resulting inflation pressures have changed that landscape and delivered the biggest commodity shock seen since the 1970's. Now the concern has started to turn to the growing risk of stagflation, i.e. lower growth and higher inflation - a phenomenon last seen in the 1970's and one which is very difficult for central banks to resolve.

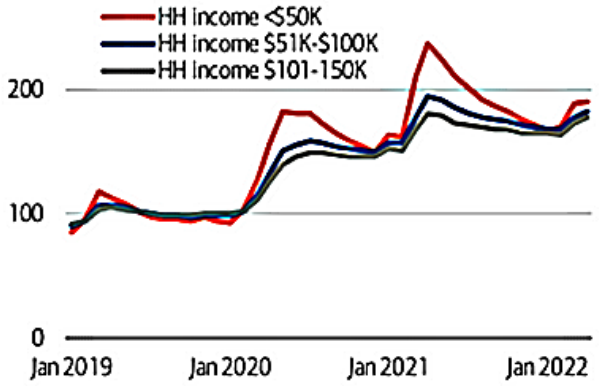
A significant slowdown is expected in global activity after a still quite resilient Q1, due to end of pandemic restrictions in several countries. We believe the combination of higher inflation, enduring Russia-Ukraine conflict, extended lockdowns in China and tighter global monetary policy should lead to weakening global demand over the coming quarters. As it stands, Europe appears to be the most exposed to recession risks due to geopolitical uncertainties in the short run and fears of major energy shortages. It is also worth noting that the Chinese growth story could be severely hit during Q2 as a direct result of the Zero-Covid policy and the costs of the related lockdowns in several major Chinese cities. US activity is challenged in the medium term by the Fed's willingness to engineer a significant slowing and quite possibly a recession. External shocks combined with more aggressively tight monetary policy may potentially push the post-pandemic high-growth cycle into a much lower growth scenario by 2023.

In this regard, it is important to point out that last week saw both the OECD and World Bank make noteworthy cuts to their respective growth forecasts for the world economy this year, largely on the back of the fall-out from the war in Ukraine. The OECD is now projecting global growth of 3% for this year, down from its previous estimate of 4.5% made at end 2021, and also said it is expecting inflation to reach 9% this year. The World Bank has cut its 2022 forecast from 4.2% to 2.9%. "The war in Ukraine, lockdowns in China, supply-chain disruptions, and the risk of stagflation are hammering growth. For many countries, recession will be hard to avoid" stated World Bank President David Malpass.

Global Economy & Inflation

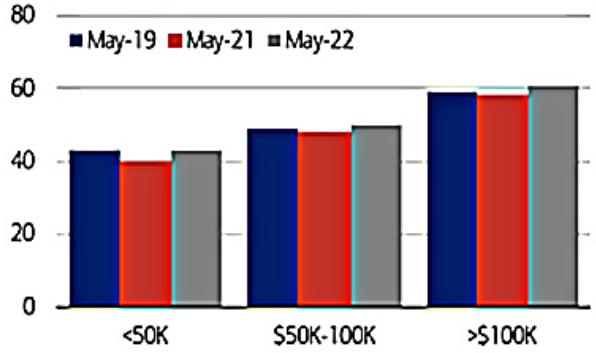
Taking a closer look at the US consumer; household borrowing, by most measures, remains far from a point of concern. As a share of disposable personal income, consumer credit is still below its pre-pandemic position at just around 25%. Furthermore, many measures of consumers monthly or quarterly debt obligations as a share of income remain near record lows. According to Bank of America's internal data, savings and checking account balances continue to be much higher today than they were before the pandemic. Credit card spending as a share of card spending are right where they were before the pandemic. This is across all income categories.

Exhibit 8: Median household savings and checking balances (index, 2019 avg =100 for each group) for a fixed group of households (HH)[2] between 2019 to April 2022
Households' savings remain well above 2019 levels.



Source: Bank of America internal data

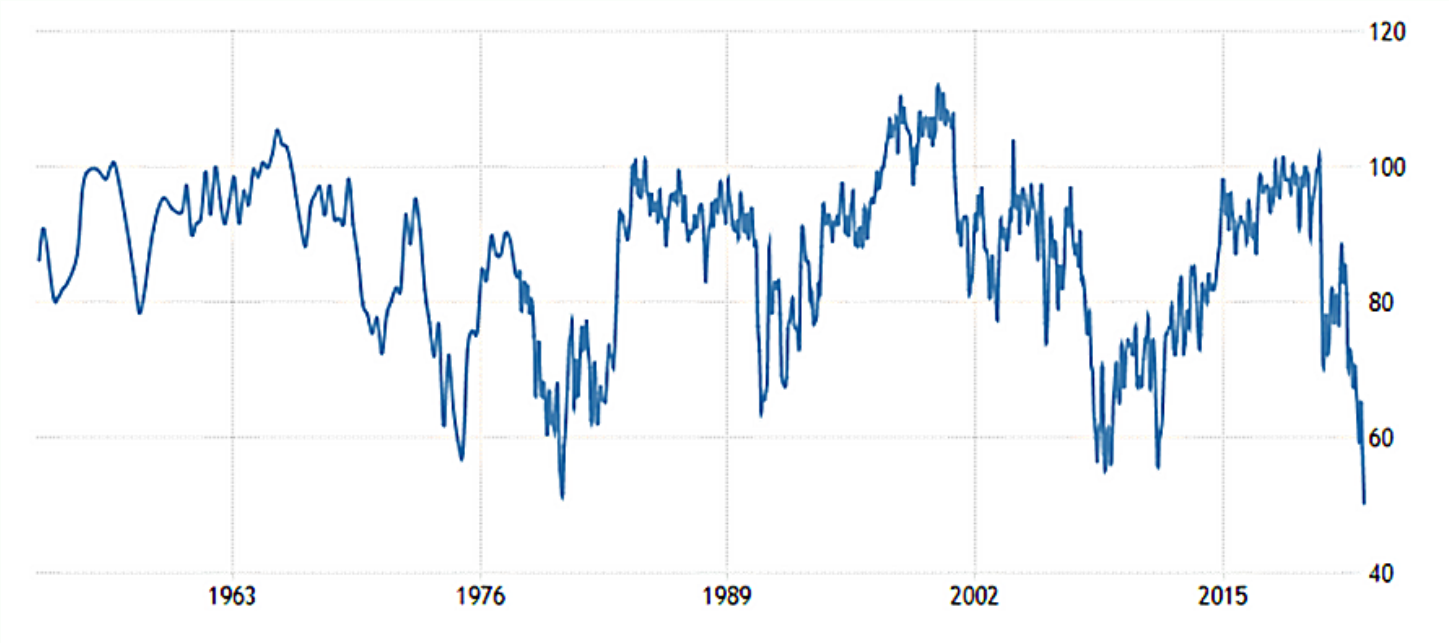
Exhibit 9: Credit card spending share of total card spending for households with at least one credit and debit card since 2019 (%).
Credit card spending relative to debit card spending is little changed versus May 2019.



Source: Bank of America internal data

Source: Bank of America

However, just because consumers' strong finances are enabling them to pay up does not mean they are liking it. In fact, the latest Consumer Sentiment figure from the United States last week tumbled to a record low amid concerns over inflation, as can be seen below.



Source: University of Michigan, tradingeconomics.com

"The war in Ukraine, lockdowns in China, supply-chain disruptions, and the risk of stagflation are hammering growth. For many countries, recession will be hard to avoid."

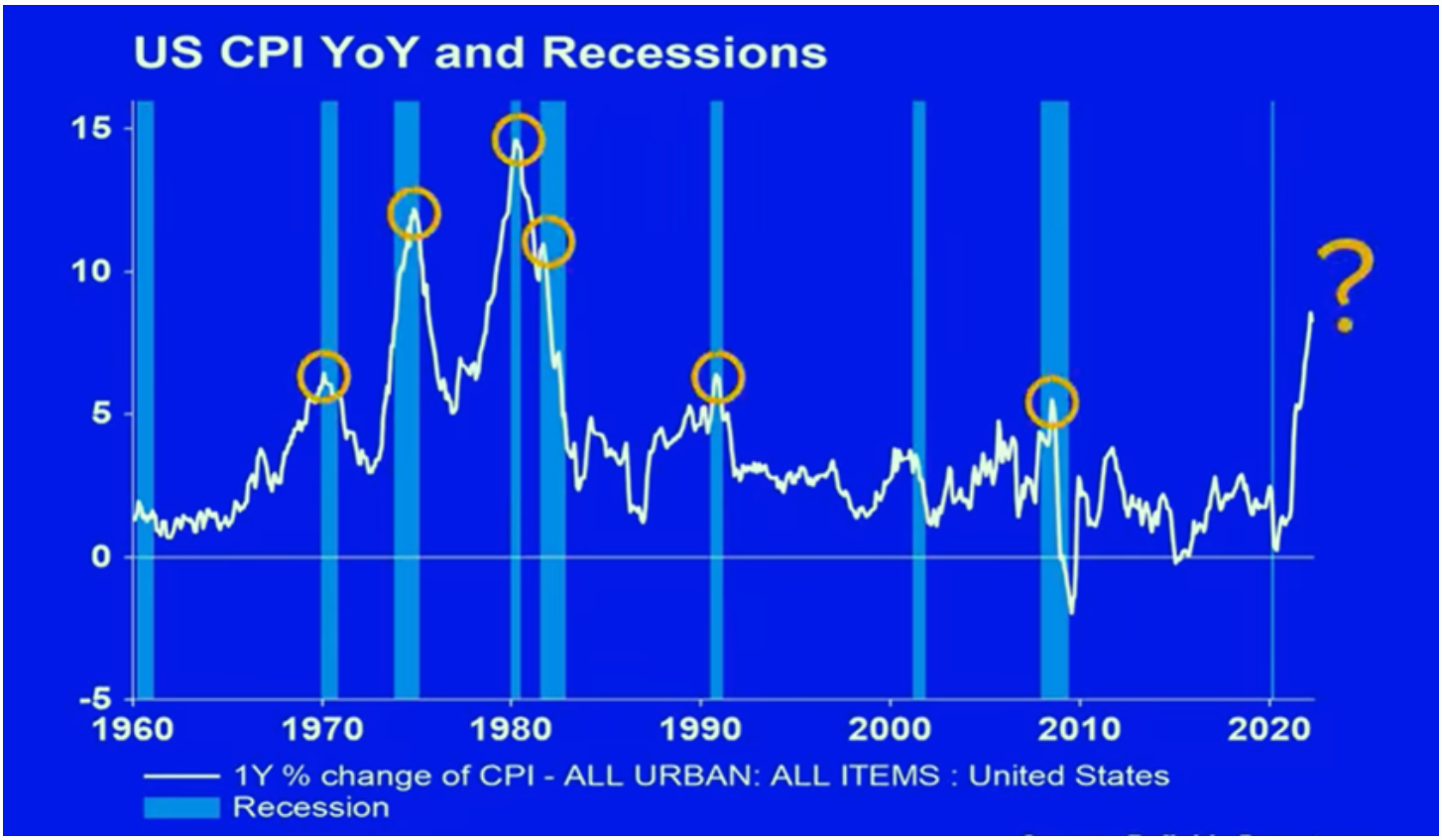
World Bank President David Malpass

The most important thing to remember about sentiment is that it has been falling sharply for a full year now, a period which has seen consumer spending only trend higher. This is a bullish contradiction, which will likely continue to hold as long as consumers can afford to pay these higher prices.

There is undoubtedly quite a bit of tension in the US economy right now. On one hand, you have a Federal Reserve aggressively tightening monetary policy in its effort to cool inflation by slowing the economy. But also, you have an economy bolstered by massive tailwinds that wants to keep growing. Supply chains, meanwhile, remain stretched for now while the war in Ukraine continues to put upward pressure on food and energy prices. So, while economic growth has been showing signs of deceleration and labour markets have been getting less hot, it is quite clear that none of this has changed enough yet for inflation to move decidedly lower.

It is often said in economics that the antidote to high prices is in fact high prices. The idea is that when the price for something rises too far, fewer people will be willing or able to pay for it. Therefore, demand will inevitably come down, and in turn the price comes down. But while inflation has indeed been running hot so far this year, one of the main problems this time around is that consumers and businesses in developed regions are in unusually strong financial positions. While this may prevent any economic slowdown from becoming economic calamity, it is also a curse in that it has enabled consumers and businesses to pay the higher prices. And so, inflation continues to climb.

This complicated scenario was on full display late last week, when we learned that the consumer price index (CPI) for the US in May rose by a new 40-year high of 8.6% year-over-year (vs expectations for 8.3%). The Euro area inflation rate now stands at a record 8.1% (and this is again ahead of the consensus forecast which had been 7.8%). In Europe, a great deal of this arises because of supply problems that can be traced to the Russian-Ukraine war. Energy prices (which were c.39% higher year-on-year in May) in particular were a significant source of the inflation to begin with.



Source: Refinitiv Datastream

While we are addressing the topic of inflation, we feel it is important to point out that when we have experienced inflation at these levels over the past 50 years, we have usually been within a recession, as can be seen on the above chart. This would suggest that the possibility for lower prices in the very-short term is there, even if it is a brief move lower that is relatively quickly bought. We would not encourage clients to attempt to time such a move. At Seaspray we are of the firm opinion that 'Time in the market' has proven to be a much more effective method down through history than 'timing the market', even for highly sophisticated investors.

Markets

We continue to prefer equities as an asset class, as well as certain commodities, although their relative appeal versus bonds has slightly diminished recently as yields have surged. At present, we are neutral developed market equities due to a higher risk of central banks overtightening policy and a deteriorating growth backdrop in the US and Europe. The short-term risk has risen that central banks' focus solely on inflation without fully acknowledging the high costs to growth and jobs. Should we see the likes of the Fed and ECB overtighten, and then subsequently make a dovish turn at some stage next year, we would likely look to move back towards an overweight positioning in equities. This situation would likely make for some attractive medium and longer-term opportunities and entry points throughout the second half of this year and into next.

We reiterate our underweight positioning with regard to nominal government bonds, with a preference for shorter-dated maturities over long-dated bonds. We see yields broadly climbing higher from here. We stay firmly underweight the long-end as we see investors demanding higher compensation for holding government bonds amid rising inflation and debt levels. We prefer inflation-linked bonds as portfolio diversifiers in the higher inflation regime. We are also underweight corporate debt, against a backdrop of rising interest rates.

So, what does this all mean for your investments? The volatile macro and market landscape is likely here to stay, at least for now, and this in itself will create some opportunities for us throughout the summer and into Q3. When all is said and done, it is very possible that central banks this time around will ultimately deliver a historically muted response to inflation. This would underpin our core view of preferring equities over government bonds. We are continuing to look for signs that central banks acknowledge the trade-off of living with some inflation for the sake of preserving growth.

We understand that the recent volatility may give clients a sense of anxiety in relation to their investments. In equity bear markets, where we see drawn-out declines, investors can sometimes worry and wonder whether or not the markets will bounce back like they have always done before. While nobody knows for sure exactly how long the current bear market will last, we would like to point out some statistics from volatile periods in the past.

Markets

TIME Magazine publication date	TIME Magazine publication title	Market event description	Cumulative % return 10 years later ($ terms)
Dec 3, 1984	America's Banks. Awash in Troubles	US banking crisis	289%
April 14,1986	Good news! Cheap Oil! Bad News! Cheap Oil!	1980's oil glut	267%
Nov 10, 1986	Is it Good for America?	Electronic trading begins	303%
Nov 2, 1987	The Crash	Aftermath of Black Monday	379%
Oct 15,1990	High Anxiety	US Economy nosedives	469%
Jan 13, 1992	How Bad is it?	Layoffs and US debt crisis	150%
Sep 28, 1992	The Economy Is there light at the end of the tunnel?	US coming out of a recession	141%
Sep 14, 1998	Is the Boom over?	Worldwide bear market threatens economy	43%
Jan 8, 2001	How to survive the slump?	Dotcom bubble	19%
Mar 26, 2001	Looking Beyond the Bear	Threat of recession looms	38%
Sep 14, 2001	*No title but a picture of the Twin Towers in flames*	Terror attack on the US	32%
May 26, 2008	Surviving the Lean Economy	Upcoming US election	145%
Mar 9, 2009	Holding on for Dear Life	Global Financial crisis	400%
June 20, 2011	What recovery?	Credit Crunch	299%

Source: Davy, TIME magazine

The table above illustrates the titles of articles published by TIME magazine over the decades during periods of high market volatility. Also included is the description of the event, and then the return in US Dollars which would have been accumulated over 10 years had you invested in the S&P500 on the date of the TIME magazine publication.

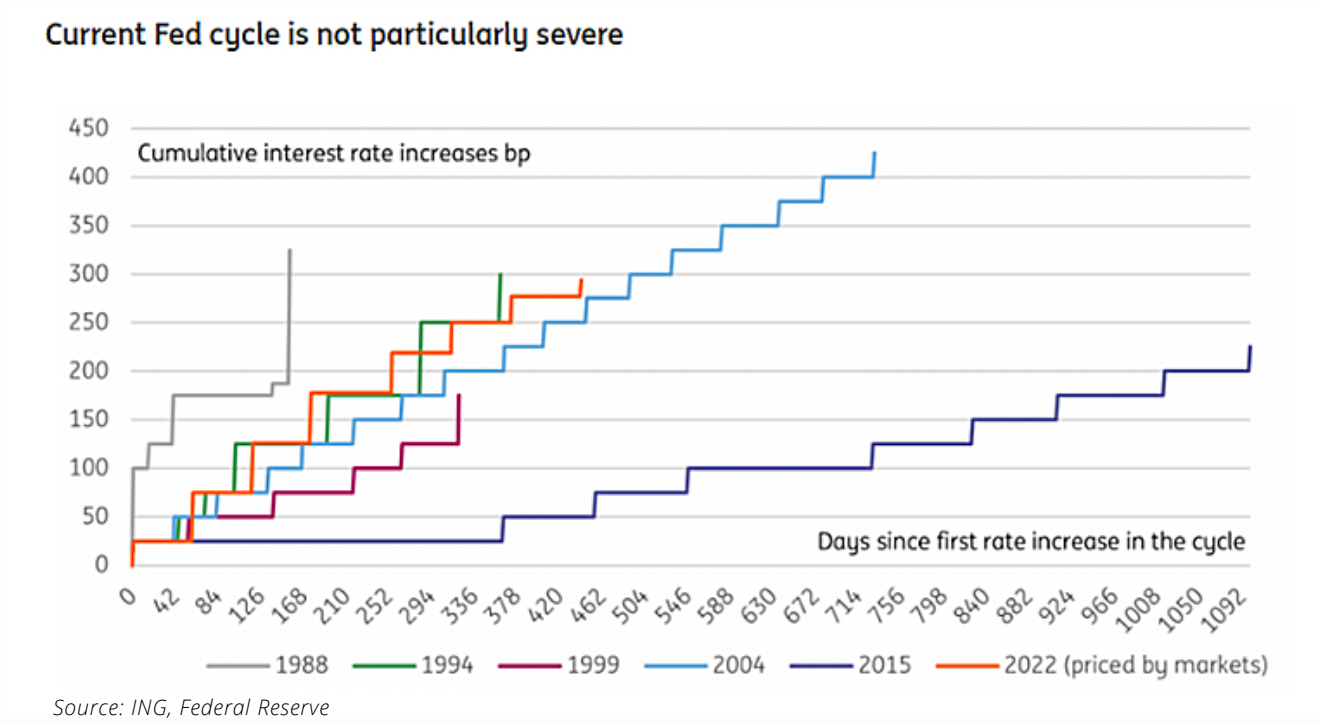
Most investors' time horizons stretch into the decades. It is important to remember that headlines only focus on the day or week that's in it. Your real focus should be on the long-term, not individual days or weeks. Planning for the long term means that you inevitably must endure both markets ups and downs and not lose sight of the bigger picture. Market risk will also decrease the longer you invest for and time after time there have been bounce-backs in the market post a drop with negative scenarios built into prices setting the stage for recovery. It is worth pointing out also that a focus on decades goes for inflation also, rather than taking a short-term view. In fact, higher inflation for longer can mean there is more of a cost to not being invested.

Monetary Policy

Federal Reserve

The Fed this week executed its single largest rate hike in 28 years when it moved by 75 basis points to a new Fed Funds rate of between 1.50% - 1.75%. In the days leading up to this meeting, markets began to come around to the idea that the US central bank would have to be more aggressive in tackling inflation and would do more than they previously did in May. The Fed indicated that one more 75 basis point hike may be required, followed by a couple of 50bp increases before they moderate to more typical quarter-point hikes. Fed Chair Jerome Powell alluded to the fact that "many factors that we don't control are going to play a very significant role in deciding whether that is possible or not", when speaking about the bank's plans for tightening this year.

This week's tightening of monetary policy was accompanied by a downgrade to the Fed's economic outlook, as was broadly expected. The US economy is now forecast to slow to a below-trend 1.7% rate of growth this year, while unemployment is expected to rise to 3.7% by year-end and continue on to 4.1% by 2024. Policymakers see inflation as measured by the Core PCE index at 5.2% this year and slowing only gradually to 2.2% in 2024.



Source: ING, Federal Reserve

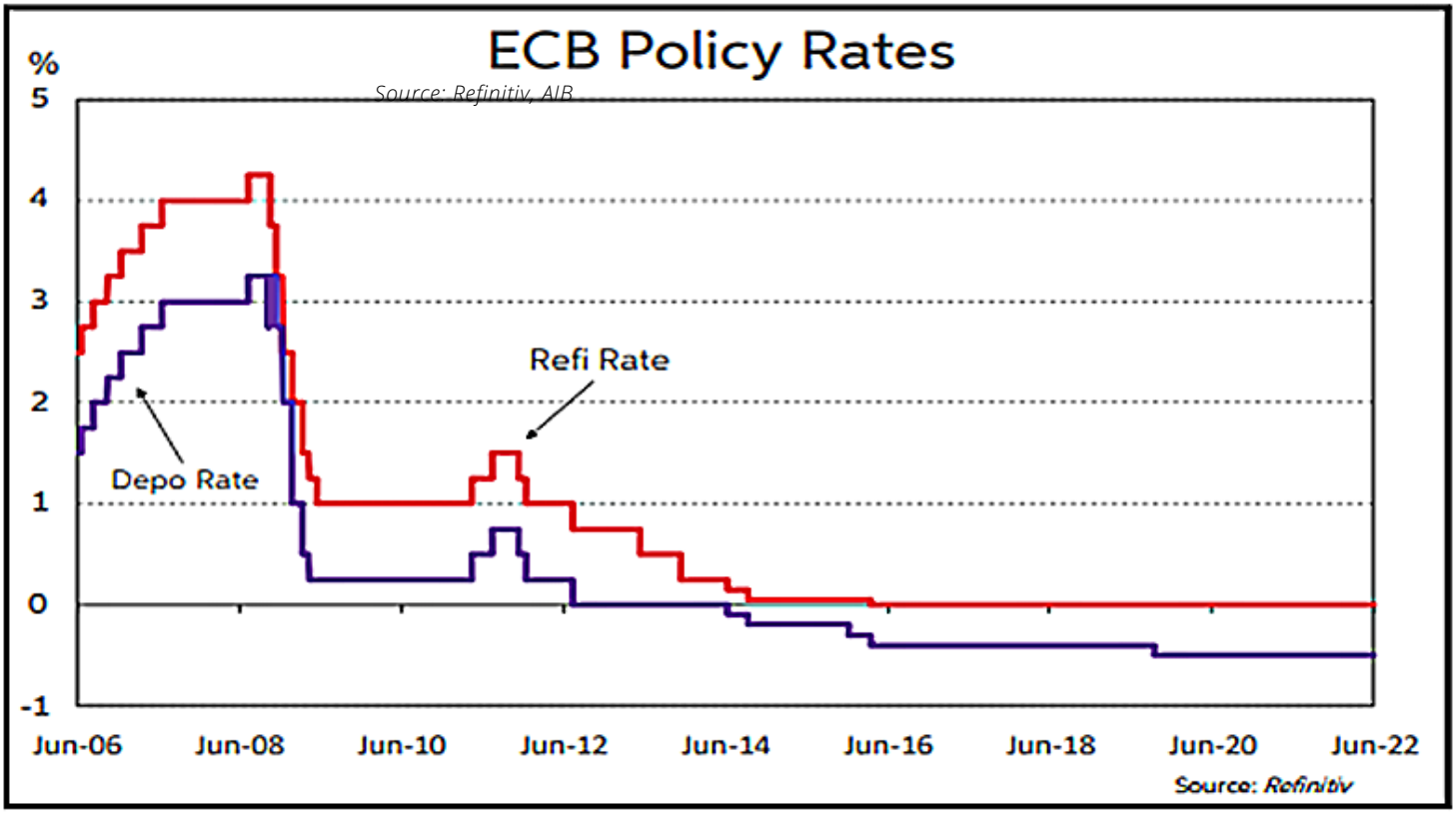
Looking further ahead, we must remember that the Fed does not leave policy in so-called restrictive territory for very long; the average period between the last rate hike in a cycle and the first interest rate cut has only averaged around seven months when we look at data from the past 50 years. The combination of the Fed stepping on the brakes and cooling demand, coupled with supply-side improvements in the form of healing supply chains and increased worker supply should help to get inflation moving meaningfully towards the 2% target through the second half of 2023 and 2024. This is something we will continue to keep a close eye on, and could pave the way for the Fed to consider moving policy to a more neutral or even possibly dovish footing in late 2023.

Monetary Policy

"The June meeting of the European Central Bank marks a major turning point in monetary policy in the region. The ECB announced the end of its asset purchasing programme from the start of July. Rates will be hiked from next month, in the first tightening of policy in over a decade....."

ECB

The June meeting of the European Central Bank marks a major turning point in monetary policy in the region. The ECB announced the end of its asset purchasing programme from the start of July. Rates will be hiked from next month, in the first tightening of policy in over a decade. The ECB stated it would raise its key interest rates by 25 basis points at the July 21st meeting. It then expects to increase interest rates at the following policy meeting in September and indicated that a larger hike than 25bps may be appropriate then, depending on the outlook for inflation. Everything considered, the bar does not appear to be that high for a larger hike in September as the ECB signalled the medium-term inflation outlook would need to improve to avoid such a move. Beyond September, the central bank is anticipating that a gradual but sustained path of rate increases will likely be appropriate.



Source: Refinitiv, AIB

Monetary Policy

ECB

In terms of the ECB's updated macroeconomic projections, growth forecasts were downgraded and inflation upgraded, as was widely expected by investors. Policymakers are now expecting inflation in the Eurozone to average out at 6.8% this year (vs their previous forecast for 5.1%). Inflation is also projected to come in at 3.5% in 2023 (vs previous 2.1%) and 2.1% in 2024 (vs previous 1.9%), while oil prices are forecast to fall back somewhat over the next couple of years. The ECB is now forecasting for the Euro area to grow by 2.8% in 2022 (vs March forecast for 3.7%) and 2.1% (vs prior 2.8% estimate for 2023). GDP is then forecast to grow by 2.1% in 2024 vs the prior 1.6% expectation.

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