CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

May 2022

Coincident Factors

The Russian invasion of Ukraine has been the exception to the generally modest impact that geopolitical events have had on global markets. As such, it has had a catalytic effect on underlying trends that had previously seemed containable. The traditional remedy since the financial meltdown in 2008/9 in the US has been to decrease interest rates and increase money supply. Both strategies have been taken, broadly, to extremes. At the same time, Covid has disrupted supply chains, compounded in the UK by the difficulties of Brexit.

The impact on Ukraine, in addition to human misery for so many, has been to severely restrict the supply of grain from one of the largest exporters. Similar pressure has been felt in the energy market, where the threat of restricted gas supply has sent prices soaring.

In aggregate, tighter monetary conditions, rising inflation and tougher trading conditions are likely to result in narrower margins for the majority of companies. Our task is to find the minority that thrive in these conditions. We will look to include companies that benefit from rising commodity prices, rising interest rates and rising inflation. We have seen in past cycles the emphasis that investors put on immediate returns in these conditions, including some element of yield, strong cashflow with little balance sheet debt and valuations that do not require multiple years of growth to justify current lofty ratings.

As an example of changing trends, it is interesting to note that the previously buoyant rating of NASDAQ has dropped sharply since November, and the apparently more sedate Berkshire Hathaway holding run by Warren Buffet has caught up with it. This seems a clear indicator that in a rising interest rate environment, investors will pay more for immediate certainty and income, and less for long term growth prospects that require a higher valuation discount, as the more distant growth will be curtailed in real terms by inflation.

As we move from an era of Quantitative Easing to Quantitative Tightening, resulting in higher interest rates, this dictates that we need to re-deploy funds to protect your portfolio by seeking out beneficiaries of such changes. The factor that is likely to create some market confusion in the interim is that the year-on-year inflation rate will hopefully slow as we grow accustomed to higher food and energy costs. However, real incomes will have fallen and corrective action has not yet been taken to correct this. The damage that can be caused by ignoring inflation can be seen in Turkey where the central bank was overruled on interest rates, and less than a year later inflation surged to 30%. US and UK authorities are talking about tough action, but already they may be behind events which require prudent action now.

CS INVESTMENT MANAGERS

Important Information

CSFP2 0522

43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com

www.csmanagers.com