MAS
Investment Update

22 April 2022

JBWere

Navigating a complex world

After a volatile start to the year for financial markets and what can only be described as less-than-positive news flow, we haven't altered our base case for the economic and markets outlook. We expect inflation to fall from current elevated levels as global supply chain disruptions improve and energy prices stabilise, allowing central banks to remove monetary policy stimulus at a more measured pace. Global growth is expected to continue decelerating from last year's break-neck pace but settle around trend, with support from pent-up household saving, increased business capex spending and modest policy stimulus from China. It is a backdrop that should support reasonable corporate earnings growth and therefore modest equity market upside, especially following the derating in valuations that has occurred from recent market highs.

But while our base case for the outlook hasn't changed, the distribution of risks around it certainly has. Risks to the outlook have increased recently, and unfortunately largely to the downside. They include heightened geopolitical tensions, China's ongoing attempt to eliminate (or at least contain) COVID-19, which is exacerbating global supply chain disruptions, and the increasingly hawkish behaviour of central banks as they look to rapidly remove emergency monetary policy stimulus and get on top of elevated inflation pressures, creating downside growth risks. The investment landscape has become increasingly complex, which sounds extraordinary considering the unprecedented events we've all experienced over the past two years.

By highlighting all of this, our intention is not to spark alarm or fear. Far from it. Just because there is increased risk and uncertainty, that does not necessarily mean it is also the time to make a major asset allocation change or adopt a more defensive portfolio stance, as tempting as that may feel. We are not at that point yet in our view.

Sustained equity market weakness rarely occurs outside of major economic downturns or recessions, and a recession is not our expectation over the coming year. While some regions of the world are facing into different risks, in general economies are still benefiting from reopening tailwinds. Private sector balance sheets are in good health and labour markets are strong. That provides economies with momentum and resilience.

Looking forward through, central banks are clearly trying to get on top of elevated inflation and the only realistic way they can do that (even if a big part of the inflation story is due to constrained supply) is by cooling demand. So, while global recession risks look low for this year, as central bank tightening cycles progress, those risks will naturally increase as interest rates rise. Whether a recession occurs over the next few years will hinge on the success that central banks have in bringing inflation down to more tolerable levels. It will be no easy task, but we still believe they will get a big ‘assist’ by an eventual easing in global supply chain pressures. Admittedly, there is little evidence of this yet.

It is important to remember that markets are reasonably efficient at quickly re-pricing shifting risks too, and they have. Global equity market valuations have fallen to levels where they are now looking reasonably attractive for longer-term investors. Of course, the corporate earnings picture needs to hold together, and we are watching that closely (especially the current reporting season in the US). But as mentioned, we believe it is too early to say a recession is imminent and so this should support ongoing corporate earnings growth – a key driver of equity markets over the long-run.

Despite the complex landscape, we haven’t made any major changes to the strategy we adopt when managing the funds within the MAS KiwiSaver Scheme and the MAS Retirement Savings Scheme (the MAS Funds). That should not be interpreted as paralysis or bewilderment. Rather, it is because we believe the MAS Funds are appropriately positioned for the current backdrop. Elevated levels of volatility speak to highly diverse portfolios, and that is a hallmark of JBWere’s investment approach. JBWere's ethos is to always behave as owners of businesses, not as short-term traders, and always consider the longer-term objective of the portfolio. Our investment philosophy is to seek high quality, long-term investment ideas, and we think this focus on quality will serve the MAS Funds well in what is likely to be a turbulent and tricky investment backdrop for some time yet.

Relative to strategic asset allocation targets, the MAS Funds sit at broadly neutral levels, which is a position we have maintained for a while. That continues to feel appropriate to us and leaves the MAS Funds well positioned in our view. At some point we may need to tactically tilt away from growth assets (equities) and more towards defensive assets (fixed interest and cash), as well as make more defensive shifts *within* asset classes. But we don’t think now is the time. History suggests there is a cost to positioning portfolios (much) too defensively too early.

Ultimately, our focus continues to centre on actively managing and positioning portfolios, and assessing the investment attributes that we believe will help the MAS Funds achieve their return objectives over the medium to longer term. Investing always contains a level of uncertainty and risk. At times when those risks are heightened, and the outlook is uncertain, as investors it is often tempting to lose sight of your investment goals and do something rash. We would again stress the importance of remaining invested according to your chosen risk profile, as this provides the best chance of investors achieving their investment objectives over the long-term.

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