IMS Capital

Quarterly Review

Q2 2022

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Market Commentary

We ended our previous quarterly update with a note that said "current levels of volatility could yet be exacerbated if the situation on Ukraine's border deteriorates." Whilst this might not have been the boldest of predictions, it is safe to say that it came true after Vladimir Putin instructed his tanks to roll into Ukraine. Shortly after the invasion began, the VIX index (a measure of volatility commonly referred to the fear index) spiked as investors tried to assess what the impact would be. The index rose to almost 31 which was the highest point since early 2021. However, to put this into context, this is less than half the level it reached during the initial pandemic panic.

This volatility capped a very turbulent first three months of the year, enough that we saw the worst performance from managed portfolios in the UK (as measured by one of the major index providers) since the dark days of March 2020. The situation was exacerbated because both bonds and equities struggled at the same time as a result of the confluence of Russian warmongering, rising interest rates as well as the reversal in popularity of Growth stocks (the likes of the big tech firms that did so well during the pandemic).

Russia's attempt at a limited "special military operation" has clearly not been as successful as they had expected but they are not showing any signs of remorse as they continue to send missiles and troops into Ukraine. Ostensibly the West is seeking to bring about an end to the war through peaceful means, but they also appear to want to use it to essentially teach Putin a lesson in an apparent attempt to dissuade him from future escalation by sending large amounts of military hardware to Ukraine.

Alongside the supply of howitzers and anti-air rocket systems, efforts are (perhaps belatedly) being made to reduce or entirely remove dependence on Russia oil and gas supplies. Some European countries are exploring the possibility of fuel rationing and are resisting demands to pay for deliveries in roubles. All of these serve to massively worsen the rise in inflation that began earlier last year as supply chain issues reduced supplies just as demand was starting to pick up.

Inflation remains a persistent pressure around the world: in the UK the CPI rate hit 7% in March with an expectation that it could move above 9% in April. In the US the figure was 8.5% and in both cases this is the highest level seen since the early 1980's. The central banks in the UK and US have already embarked upon a new rate rising cycle to combat this, although there has been doubt expressed about how much power they have to materially influence prices, at least without risking cooling the economy so far it leads to a recession.

As we enter the next quarter it would be easy to succumb to doubt about the near-term outlook but it is important to remember that remaining invested has invariably proven to be the best strategy through history (on the assumption that one's time horizon is suitable). As HSBC put it recently, "to paraphrase Winston Churchill, equities are the worst assets to own during periods of rising prices, except for most of the others."

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Performance Update

As mentioned in the commentary above, the first quarter of the IMS year has seen a series of challenges that have disrupted the growth rally that emerged in the spring of 2020. Since the initial bounce back from the lows of February that year, expensive companies, often those with low profits but high future growth expectations, became increasingly more expensive as investors first sought out oversold opportunities and then doubled down for fear of missing out.

This trend has reversed this year and the last quarter began as the one before it had finished, with markets moving downwards as investors began to reassess the investment outlook on the back of expectations for interest rates to begin to rise. This saw further falls in the share prices of high value companies in favour of those that offered more steady rates of growth along with dividends that would help to counteract some of the impact of rising rates.

This meant that the income focused portfolios performed well over the quarter (and in fact are now positive on a relative basis over every period) while those at the higher end of the risk spectrum did not fare as well. The impact was exacerbated in the Future Focused models which have an inherent bias towards growth-focused companies as well as less potential for diversification due to the screening process which seeks to remove funds which do not meet our ethical or sustainable requirements.

Portfolio	**3 month performance**	**12 month performance**	**36 month performance**	**60 month performance**	**12 month historical yield**
IMS Defensive Income	-1.97%	-0.22%	8.18%	14.07%	2.31%
Benchmark	*-2.59%*	*-2.97%*	*5.20%*	*8.86%*	n/a
IMS High Income	-0.81%	2.70%	16.06%	23.90%	2.86%
Benchmark	*-1.49%*	*-0.73%*	*13.13%*	*20.96%*	n/a
IMS Cautious	-1.76%	0.08%	11.44%	20.12%	1.65%
Benchmark	*-1.97%*	*-1.24%*	*9.55%*	*15.18%*	*n/a*
IMS Balanced	-1.95%	-0.58%	15.75%	26.31%	1.41%
Benchmark	*-1.00%*	*-0.22%*	*16.79%*	*26.99%*	n/a
IMS Growth	-1.90%	-1.11%	18.25%	32.17%	1.16%
Benchmark	*-0.83%*	*-0.24%*	*18.49%*	*29.14%*	n/a
IMS Future Focused Cautious	-3.90%	n/a	n/a	n/a	1.35%
Benchmark	*-1.97%*	n/a	n/a	n/a	n/a
IMS Future Focused Balanced	-3.41%	-3.60%	20.97%	37.81%	0.97%
Benchmark	*-1.00%*	*-0.22%*	*16.79%*	*26.99%*	n/a
IMS Future Focused Growth	-3.23%	n/a	n/a	n/a	0.85%
Benchmark	*-0.83%*	n/a	n/a	n/a	n/a

All data are to 30/04/2022. Source: Financial Express Analytics

Portfolio Change Summary

It is important to bear in mind that the war in Ukraine is not the cause of the challenges we face today, but it has amplified them. Inflation was already on the rise as the world economy emerged from lockdown and Russia's invasion has furthered price rises by making commodities like oil, gas, and grain much more expensive. The changes we've made this quarter reflect our views on the medium term impacts of inflation including how these might be exacerbated by central bank moves to raise interest rates.

The analysis of how our funds have performed over the quarter was again complicated by a number of strong trends that clouded the returns from individual funds. It continues to be important to understand how funds work both individually as well as a part of a portfolio, and to ensure that appropriate latitude is given to holdings to take account of their future potential rather than solely looking at past performance.

From an asset allocation perspective, the main changes made this quarter were to reduce our weighting in European and Emerging Market regions. Whilst equities broadly remain our preference over bonds, we felt that the combination of potential contagion issues from the war in Ukraine and China's ongoing structural problems warranted a reduction in these areas. The proceeds from these sales were reallocated to US equities which, outside of the issues facing the high growth technology sector, remain an attractive option.

We have made a number of fund changes at a fund level, both to incorporate the points above and also to reduce or replace underperforming holdings. The main change sees Jupiter UK Mid Cap taken out of the Capital Growth portfolios in favour of a passive alternative. The former fund has struggled in the face of challenging conditions for its underlying holdings and we have elected to replace it with a passive alternative which has the benefit of reducing the overall cost. Elsewhere we have implemented a number of changes with the intention of better diversifying the models including adding two new funds to the Future Focused range.

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