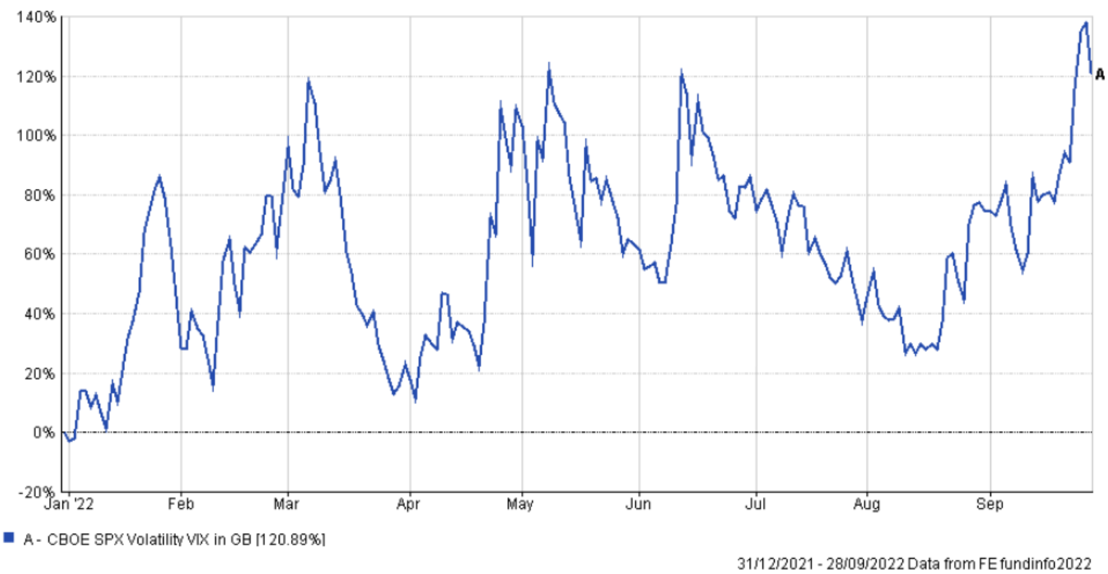
# Markets Bulletin 29th September 2022

As covered off in our previous bulletins markets have been extremely volatile throughout this year moving from positive to negative performance on a monthly basis. The summer did see a level of stability start to return, with markets recovering some of the losses from earlier in the year. The last month however has seen markets once again retreat and volatility has returned. The chart below shows the VIX Index for the year to date, this is a measure of the expectations for volatility in markets over the short term.

As can be seen from the chart below there has been a stark change in sentiment since mid August as markets have become increasingly negative. Investors remain fully focused on the global economy and particularly the path of inflation. Inflation numbers continue to make investors recalculate their predictions for future readings and how central banks shall react, which in turn is driving the volatility that we are seeing. This focus on the global economy and attempting to predict central bank actions is having ramifications for company share prices across all sectors. Investors are ignoring company fundamentals, which we are advised by the fund houses that we have contacted remain strong and resilient.

VIX Volatility Index - Year to Date




**Please note that past performance is only a guide and future yields cannot be guaranteed. Unit prices can fall as well as rise, therefore the value of your portfolios and holdings shall also fall and rise.**

Burley Fox Limited 20 Cathedral Road, Cardiff CF11 9LJ
Tel: 029 2167 9770 Email: info@burleyfox.com

## Regional Inflation & Interest Rate Comparison - Year to Date

| Region | CPI - Inflation Rate | | | Interest Rate | | |
|---|---|---|---|---|---|---|
| | 1st Jan 2022 | 30th June 2022 | 27th Sept 2022 | 1st Jan 2022 | 30th June 2022 | 27th Sept 2022 |
| UK | 5.4% | 9.4% | 9.9% | 0.25% | 1.25% | 2.25% |
| U.S. | 6.8% | 8.6% | 8.3% | 0.25% | 1.75% | 3.25% |
| Eurozone | 5.0% | 8.6% | 9.1% | 0.00% | 0.00% | 1.25% |
| China | 1.5% | 2.5% | 2.5% | 3.8% | 3.7% | 3.65% |

The table above gives breakdown of how the levels of global inflation and interest rates have changed globally since the start of the year and since our last bulletin in June.

As can be seen, the inflation rate across all regions has swiftly risen this year which has left Central Banks playing catch up with interest rate increases. The U.S. Federal Reserve has been extremely hawkish as the rate of inflation in the U.S. rose by 8.3% on an annual basis in August, down from July's 8.5%. Economists were however projecting a fall to 8.1%. In addition to this, monthly prices increased by 0.1%, ahead of a forecasted fall of 0.1%. Markets were hoping that inflation would gradually fall back over the coming months, with the Federal Reserve then reducing interest rates.

This jump in monthly inflation put paid to that vision, as the Fed hiked rates by 75 basis points for the third consecutive meeting. Fed Chair Jerome Powell stressed that his core message has not changed, emphasising that rates will need to continue to rise to a sufficiently restrictive level. "We have got to get inflation behind us. I wish there were a painless way to do that. There is not," Powell said. He went on to say, "Higher interest rates, slower growth and a softening labour market are all painful for the public that we serve. But they're not as painful as failing to restore price stability and having to come back and do it down the road again". He has also refused to rule out the possibility of a recession, reiterating that bringing inflation down to 2% was the prime objective, and that this shall continue to be the priority until the job is done.

Inflation continues to rise in the Eurozone with inflation up 9.1% in August. Minutes from the European Central Bank's (ECB) July meeting indicated that policymakers remain concerned about inflation and that a further rise will come at the meeting in September. Since then the president of the ECB, Christine Lagarde, has confirmed that they shall continue to increase interest rates over the next few meetings until they are at a level that no longer stimulates economic growth.

The ECB is on a similar path to the Fed with their primary goal being price stability. Christine Lagarde has advised that "Our primary goal is not to reduce growth, our primary goal is not to put people on the dole, our primary goal is not to create a recession, our primary objective is price stability and we have to deliver on that. If we were not delivering it would hurt the economy far more than if we do deliver."

The table also shows that inflation rates in China are not at the same level as the developed west and that interest rates have been falling this year. With a relatively normal level of inflation the Chinese government has been able to prioritise growth over inflationary concerns. China's easing measures so far this year have however done little to boost corporate borrowing or revive business activity. With the Eurozone, UK and possibly the U.S. heading for recessions demand for Chinese goods outside of China shall fall. Additional rate cuts in China are therefore expected with increased policy action to try and further stimulate growth.

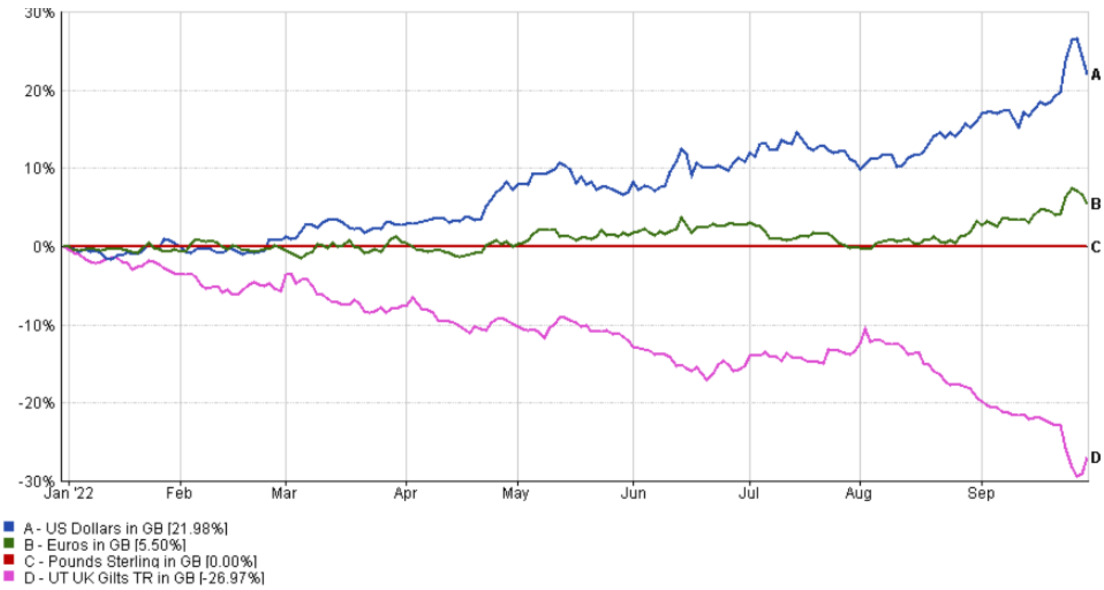
At this time all eyes are on the UK, after the new Chancellor Kwasi Kwarteng announced a tax cutting, growth orientated "mini budget". This contained a reversal of the previous increase in national insurance contributions, a reduction in the basic rate of income tax, abolition of the top rate of tax, and stamp duty cuts. The Office for Budget Responsibility (OBR), which usually provides an independent costing, has so far not provided any analysis of the impact of these measures and this is now not expected to until 23rd November.

Earlier in the month the prime minister announced a substantial package of measures, capping the energy price and providing a short-term subsidy so that in effect households will now see a much more modest rise in utility bills this winter. The exact cost is unknown because of uncertainty about the eventual cost of buying gas, but is expected to amount to around £100bn-£150bn over the two-year duration of the freeze. This energy package plus the additional measures announced by the chancellor are expected to be funded by an additional £90 billion in borrowing, bringing borrowing to an estimated £190 billion this fiscal year.

Since the chancellor's announcement sterling has seen significant falls against the dollar, hitting an all time low of $1.035 on Monday 26th September. This was partly on the back of concerns about the chancellor's announcement, particularly as no plan for funding these tax cuts was provided, but follows a summer of political uncertainty after the resignation of former prime minister Boris Johnson. The dollar has been very strong in this current environment, so a more accurate performance comparison should be made to the euro.

The Bank of England now finds itself in a difficult position. Although the government has made clear that many of its initiatives aim to boost the supply of the economy, in the near-term at least they will merely add to demand at a time when the UK appears to be running at full capacity and inflation is already uncomfortably elevated and persistent.

Currency & UK Gilts - Year to Date Performance Comparison




31/12/2021 - 29/09/2022 Data from FE fundinfo2022

The same concerns which have contributed to weakness in sterling have also been reflected in the UK bond market, where prices of UK-issued bonds (or gilts) have also fallen sharply, pushing up yields. Again, these moves should be seen in the context of broader developments, which have weighed on bond prices across many developed countries this year.

The volatility in the UK Gilt market became so extreme this week that the Bank of England had to take emergency action due to a "material risk to UK financial stability". The bank advised that it would suspend its programme of selling UK Gilts and shall recommence purchasing long dated bonds over the next 13 days at £5 billion a day.

A real concern both inside and outside the UK is that the announced package of tax cuts is going against what the Bank of England is trying to achieve, which is to bring down inflation and stabilise the economy. The International Monetary Fund (IMF) issued a statement advising its concerns and criticising the Government's plans. They stated that "Given elevated inflation pressures in many countries, including the UK, we do not recommend large and untargeted fiscal packages at this juncture. They also advised that "It is important that fiscal policy does not work at cross purposes to monetary policy".

The Bank is not scheduled to meet until November 3rd and they have so far advised that they do not intend to meet prior to this date. There was never a doubt that they would need to raise interest rates at the next meeting, however they are now expected to have to increase interest rates at a greater pace than expected. The problem for the Bank is that failure to act with sufficient force risks undermining its commitment to inflation, a further decline in the currency, further imported inflationary pressures and a need to act with even greater hikes further down the line.

At the time of writing, the market expects the Bank will need to raise interest rates by a further 1.25 percentage points (pp) in November. The following meeting in December is expected to see another 0.75pp increase, taking rates to 4.25% by the end of the year. They are then expected to be 5.5/6% by the end of 2023.

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The prime minister has stated that the government shall not back track on the fiscal policy announcements of last week, as they view cutting taxes as being vital to stave off a recession. This goes against what the Bank of England is trying to achieve and as advised interest rates are now expected to rise quicker and higher than previously predicted. With the Office for Budget Responsibility not now expected to give its independent opinion on the budget statement until late November, and credit ratings reviews due from S&P and Moody's on 21st October, we would expect this UK market and currency volatility to continue for the coming months.

The war in Ukraine has also added to the volatility in global markets, as Putin has escalated his rhetoric with further nuclear threats, announcing referendums in occupied Ukrainian territories and mobilising an estimated 300,000 reservists.

This escalation from Putin came at a time when the war in Ukraine was seeing a significant swing in momentum, as Ukrainian forces regained major strategic cities. They continued with their counter offensive moving east into the Donbas region. With Russian supply lines within range of Ukrainian missiles and Russian forces reported to be demoralized, this could have been a turning point in the war, particularly as winter is approaching.

The partial mobilization announced by Putin will provide Russia with much needed troops, however they will have had limited training and could have low motivation to fight. This move will however mean that Ukraine will need to increase its forces and will need more weapons from the west.

Last weekend Russia held referendums in the Ukrainian occupied territories of Donetsk, Luhansk, Kherson and Zaporizhzhia. Russia has since advised that the residents of these regions have overwhelmingly voted in favour of becoming part of Russia and that they shall be formally annexed on Friday. President Zelenskyy has called the vote a 'farce' and Ukraine's western allies refuse to recognise the results of the referendum and further sanctions against Russia are now expected.

By bringing these territories into the Russian Federation any further incursions by Ukrainian forces could be used as a justification by Russia to retaliate in any way that it deems necessary to protect its territory and citizens. If these forces also continue to be backed by NATO using NATO weapons, then they could also be dragged further into the war.

As we approach the final quarter of the year there are many factors that could bring further volatility to markets. As stated, the economic instability in the UK will bring more volatility both to sterling and the equity and bond markets. The war in Ukraine is escalating and this too will add to the unease in markets. In November the U.S. mid term elections shall take place, the result of which shall shape President Biden's remaining two years in office. The main driver of markets and the global economy shall remain inflation and we do not expect any easing in Central Bank rhetoric or a slowdown in interest rate hikes.

Market volatility can be very unsettling as an investor and can make you question your long term plans and whether you should remain invested. It is worth remembering that volatility in markets is part of investing and at times of volatility it is usually best not to make changes to your long term investment strategy.

Currently we cannot see any significant change in market sentiment or the economic environment until at least the second quarter of 2023. At that time the Federal Reserve may be in a position to start reducing rates, or the U.S. could be on the verge of entering a recession. Markets are finely balanced at this time and are moving positively and negatively depending on the decisions made or the tone of comments from Central Banks and politicians. The last week being a perfect example.

If you are investing for the medium term, approximately 5 years plus, then our advice would be to stay invested, or risk losing out when the market does recover.

If, however you know that you are going to need to access Cash in your portfolio over the next twelve months, then please discuss the options with your Investment Director.

Should you have any queries or concerns, please do not hesitate to contact your Investment Director.

Kevin Hunt Dip PFS, Cert PFS (DM)
Investment Manager
Technical Team

Burley Fox Limited 20 Cathedral Road, Cardiff CF11 9LJ
Tel: 029 2167 9770 Email: info@burleyfox.com

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https://www.burleyfox.com/documents/BFL-Privacy-Notice-2018-V1.pdf

Burley Fox Limited 20 Cathedral Road, Cardiff CF11 9LJ
Tel: 029 2167 9770 Email: info@burleyfox.com