



Markets Bulletin 1st July 2022

Market Review - Year to Date Performance

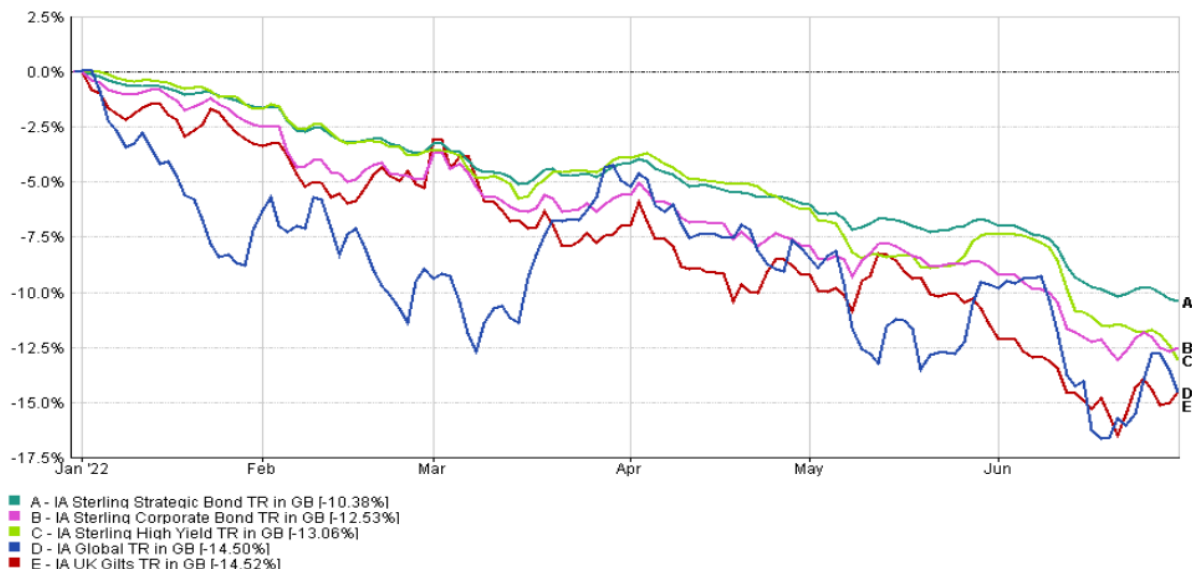
The first six months of the year have been an extremely torrid time for both equity and bond markets. From the U.S. to China, developed economies to emerging markets most equity markets are down over 15% so far in 2022 with many down over 20% putting them into bear market territory (a fall of over more than 20% from recent highs).

During times of volatility in equity markets, portfolio allocations to bonds have historically benefitted and reduced the downside performance of portfolios. The reason for this being that investors tend to move out of

equities, away from risk, into the safety of treasuries and bonds. This in turn increases the demand and the price for bonds. This time however both equities and bonds have seen significant declines due to rising inflation and interest rates.

The chart below compares the performance of global equities (blue) to that of the main sterling denominated bond sectors.

Global Equity V Sterling Denominated Bonds - Year to Date Performance



31/12/2021 - 30/06/2022 Data from FE fundinfo 2022

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.

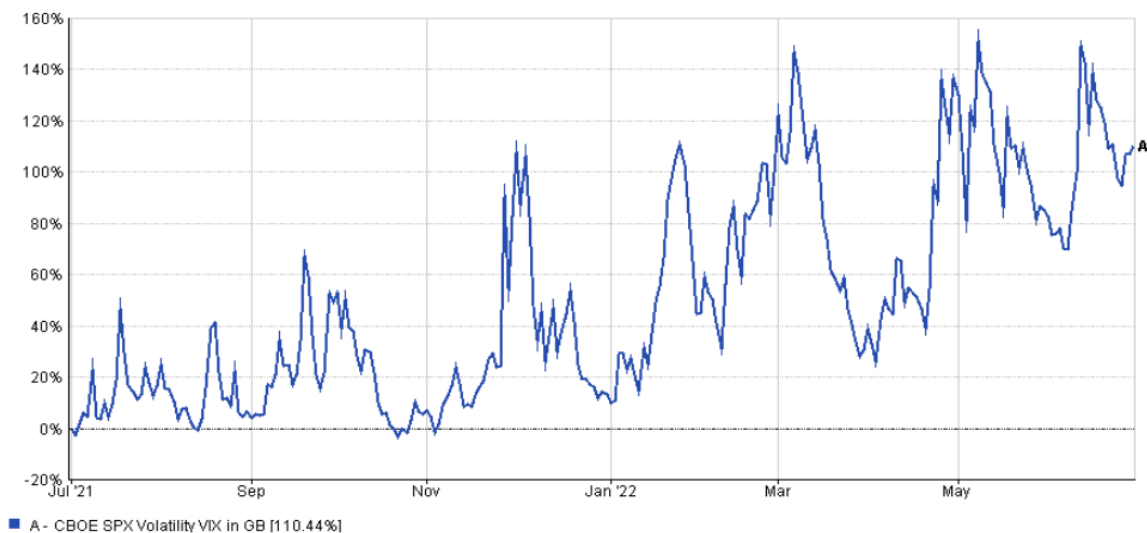


Bringing down the level of inflation continues to be a priority across central banks, with the Federal Reserve taking a particularly aggressive approach. Last month the Federal Reserve raised the benchmark rate by 0.75% to a target rate of 1.50 – 1.75%, which is the largest rate hike since 1994. Until a few days prior to the announcement the expected increase was 0.50%, however May's CPI inflation rate of 8.6%, which increased by 0.3% from the previous month, was unexpected.

The Federal Reserve chair Jerome Powell advised that this jump in inflation needed an appropriate response and that an increase of either 0.50 or 0.75% at this month's meeting was also likely. The aim of the Federal Reserve now is to increase interest rates at pace over the next few months to a level which they see appropriate for the current level of inflation. This they expect shall then lead to a period of declining inflation readings; at which time a reduced pace of interest rate hikes would be appropriate. The U.S. economy is currently expected to continue to grow this year and next, however the risk of a recession in the U.S. is increasing.

The Bank of England has also increased interest rates by a further 0.25, bringing the interest rate to 1.25%. In contrast to the U.S. however they have warned that higher energy prices shall push inflation above 11% in the final quarter of the year. The Bank of England expects minimal growth in the UK economy over the next three years, and therefore does not believe that rate hikes at the level seen in the U.S are appropriate for the UK, as raising rates quickly could bring further pain to the economy. There are however concerns that the Bank of England is raising interest rates too slowly which is negatively affecting the value of sterling and pushing up the cost of UK exports.

Market Volatility - Twelve Month Period



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As the previous chart shows, there have been periods when market volatility has fallen back over the last twelve months, but it has just as quickly returned. This volatility in markets is expected to continue with significant rallies likely at certain times, depending on news flow and the economic and political environment.

Inflation is the key driver of market sentiment at this time, however a further escalation of the Russia-Ukraine war continues to be a risk that could further dampen prospects of a market recovery. If tensions continue to ramp up between Russia and Europe, Russia could cut off supplies of both gas and oil to Europe, which could result in stagflation across Europe, as well as higher commodity prices globally. This would result in a further upward movement of global inflation and weaker global growth. Bearing in mind that the EU has already planned to end purchases of oil by the end of the year and has banned the import of Russian seaborne oil, this is a scenario that could materialise later in the year.

Inflation maybe the key driver of sentiment, but the Ukraine war is a variable that could either send inflation higher over the remainder of the year as stated, or if there is a de-escalation in the war commodity prices and inflation could fall back, reducing some of the pressure on central banks.

The second half of this year will see the midterm elections take place in the U.S. with Joe Biden's Democratic party currently being projected as underdogs. Approval ratings in the U.S. have historically tracked inflation readings, and with inflation in the U.S. currently standing at a multi decade high, it does not bode well for the Democrats chances of retaining control of Congress. The closer that we get to the election date, November 8th, the greater the prospect of additional market volatility.

China has had a difficult first half of the year as it has struggled to cope with the highly transmissible Omicron variant. Lockdowns have been imposed in many areas including Shenzhen, Shanghai and other cities. China has continued with its zero-tolerance approach to the virus and these lockdowns have impacted Chinese economic activity. Restrictions have been reduced over the last few weeks, however with a lower level of infection-induced immunity, lower vaccine take up among the elderly and questions over the efficacy of the domestic vaccines, some form of restrictions could remain in place for the remainder of the year.

On a positive note, June saw China's stockmarket record it's largest monthly rise since July 2020 with the CSI 300 index climbing more than 8%. In addition to this, recent manufacturing data does show that the sector is starting to recover from the lockdowns. There is an expectation that if policy makers show that they have a medical solution to Covid, growth in China could rebound during the second half of the year, driven by a combination of fiscal and monetary measures.

There are many factors that could affect stockmarket performance during the second half of this year and into next year, with inflation being the dominant driver. Economies are expected to slow over the coming months, as the interest rate hikes from central banks start to cool demand and inflation readings should start to fall back. This assumes however that the war in Ukraine does not escalate further, the monetary tightening being implemented by central banks is not overzealous or insufficient and that no other geopolitical event occurs along the way.

We expect markets to remain volatile for the remainder of this year and into next year, and as previously advised, we would expect to see minimal growth in our portfolios until stability returns to the global economy. It is worth remembering that volatility in markets is part of investing in equities, and at this time it is usually best not to make changes to your long term investment strategy.

If you anticipate that you will need access to the monies held within your Advisory Portfolio Service portfolio during the next 12-18 months, or if 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



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