



Markets Bulletin 25th May 2022

Inflation, recession and market timing.

Inflation and recession risks continue to be on the minds of investors, as they continue to watch levels of global inflation rise. Signs are starting to appear that interventions from the Central Banks to bring inflation under control are working, however concerns regarding a global recession are also escalating.

In our last bulletin we focused on the U.S. economy and gave an insight into how markets and the fund houses that we utilise within our portfolios are viewing the possibility of a recession in the U.S. Since then, inflation in the U.S. has risen to 8.3%, which is a 40 year high, and the Federal Reserve (Fed) has increased interest rates in the U.S. by a further 0.50 basis points to a range of 0.75 -1%. Markets have now priced in this level of increase for the next two meetings.

By raising interest rates the Fed is trying to slow the economy down by moderating growth, which in turn should manage inflation. Even before announcing the recent rise in rates the expectation of tighter financial conditions in the U.S. was already starting to impact the economy. An example of this is U.S. mortgage rates reaching their highest levels in more than a decade.

In the UK the Bank of England has increased interest rates to 1% with further rate rises expected. In contrast to the U.S. however they have warned that higher energy prices shall push inflation above 10% in the final quarter of the year. This shall result in UK gross domestic product (GDP) falling by 1% in the final quarter, leading to a recession in the UK. The Bank of England's chief economist has advised that inflationary momentum in the UK is currently strong and further rate rises will be required. The number of further rises is however dependent on how far inflation falls due to households reducing their spending as a result of the cost of living crisis.

In Europe, the European Central Bank (ECB) president Christine Lagarde has signalled that the bank's first rate rise for more than a decade is expected at July's meeting. The current rate of inflation in the European Union is 8.1%, which has surged due to rocketing energy prices and economic headwinds caused by the war in Ukraine. There are however signs that energy prices in Europe are starting to fall as the spikes seen earlier in the year have subsided.

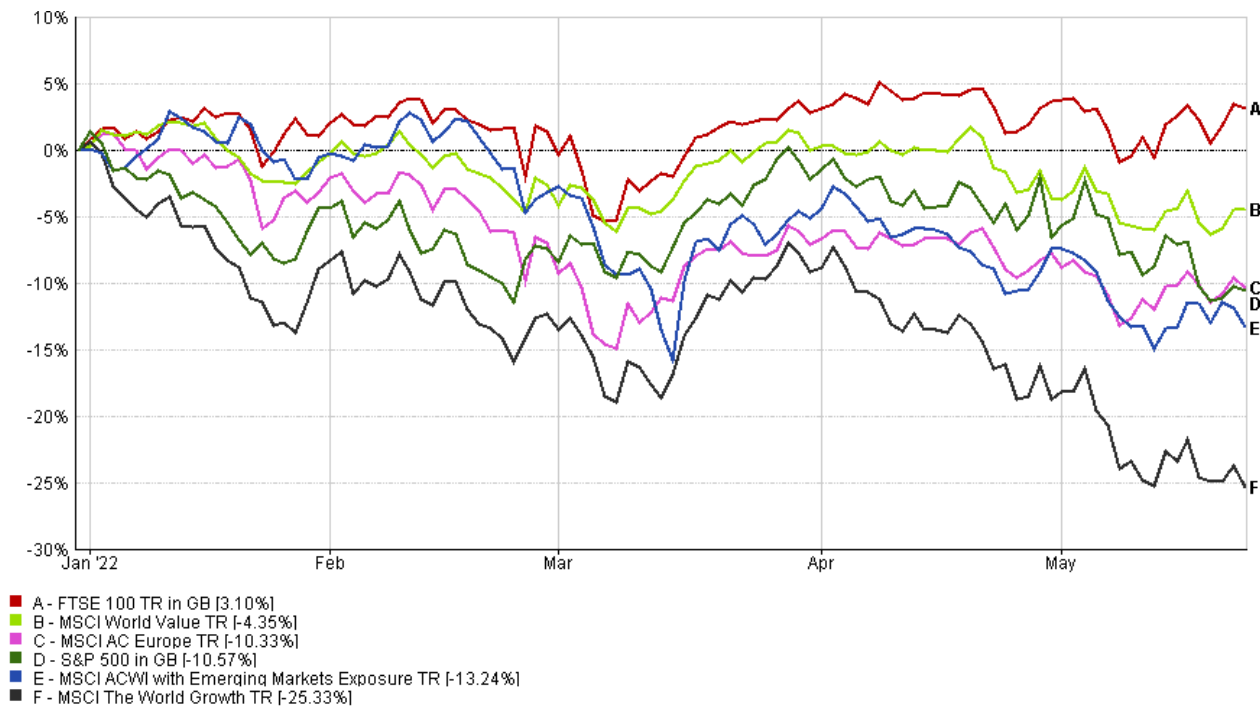
With interest rates rising and the expectation that this shall continue, markets have been re-rating the value of equities and bonds with significant losses being recorded. The FTSE 100 Index has been the only index to largely weather the current volatility, primarily due to its exposure to the energy and materials sectors. More recently U.S. indices have started to fall back further, as a result of their exposure to technology and lacklustre quarter one results from a number of consumer retailers.

Last week the share price of retailer Target fell by 25% after it stated that profit margins will be hit by higher freight, wage and fuel costs. A similar downbeat assessment was also given by Walmart as it cut its earnings guidance the previous day. Both companies indicated that they have seen a fall in consumer spending over the first quarter. These reports concerned investors, as they were viewed as a possible precursor to an economic slowdown in the U.S. and instigated a further sell off across U.S. indices.

First quarter earnings in the U.S. were seen as being fairly strong and beat consensus estimates across all sectors. The guidance for the rest of the year however is cautious as companies are becoming more concerned with the growth outlook and are moving their focus from margin expansion to margin preservation.



Global Indices Performance Year to Date



31/12/2021 - 24/05/2022 Data from FE fundinfo 2022

Past performance is no guide to the future and future yields cannot be guaranteed. Unit prices can fall as well as rise, therefore the value of your portfolio and holdings shall also fall and rise.

The last eighteen months have been challenging for businesses in China with wide sweeping regulatory changes, heightened geopolitical tensions with the U.S. and zero-Covid measures being implemented to deal with the surge of the Omicron variant. This has resulted in Chinese equity markets experiencing a sharp decline so far this year, and they now stand at valuations not seen since 2015 when compared to developed markets.

Shanghai has been in lockdown since early March, and this has continued to create further strain on the global supply chain. Shanghai is the busiest port in the world and handles 20% of China's international trade. There has been severe congestion at ports across China with hundreds of container ships waiting days to dock at Shanghai throughout April and May. The lockdowns across various parts of China have also raised issues internally as truck drivers trying to deliver materials across the country have had issues with permits, testing and also not wanting to enter infected areas, in case they are unable to leave. All of these factors have had a knock on affect across global ports, with ships arriving weeks late.

There have been concerns in relation to China's vaccines, which are viewed as not being as effective as the ones produced outside of China. With the Omicron variant being more transmissible than previous variants, China's zero approach to Covid has been significantly

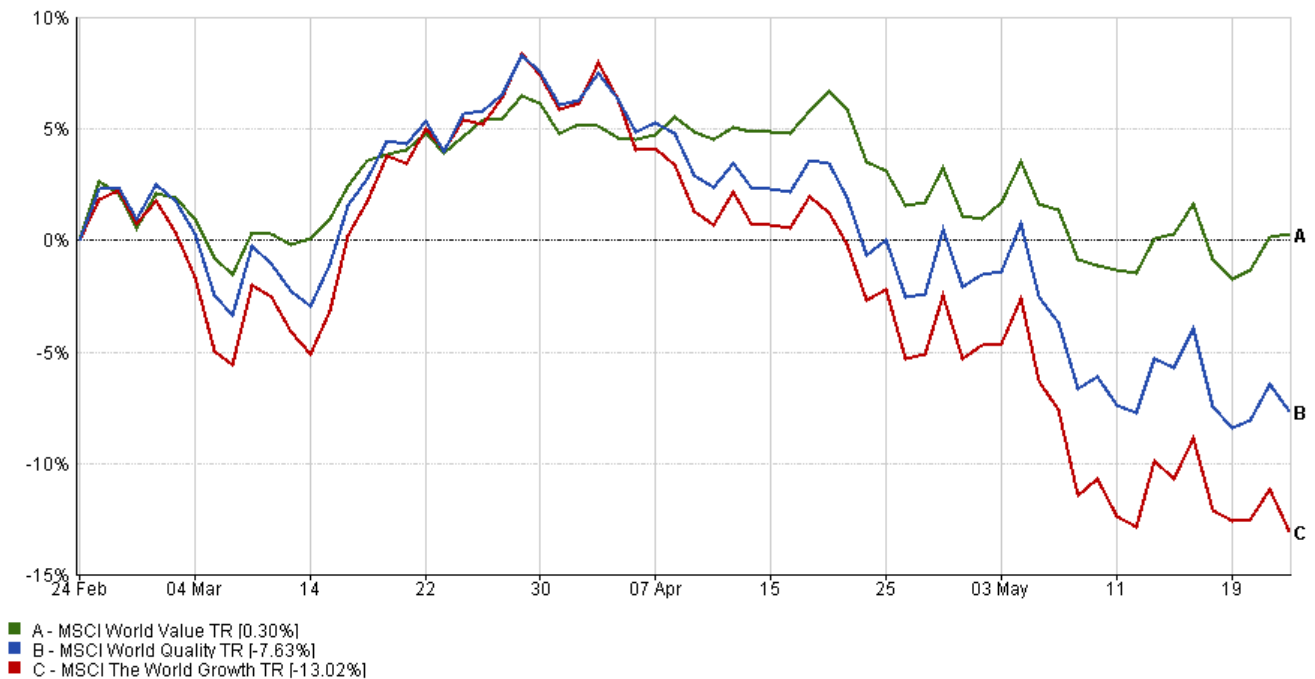
challenged. In response to the lockdowns and weakening consumer sentiment in China, the Chinese government has accelerated its stimulus measures. In an attempt to increase credit supply in the market several benchmark rates have been lowered including prime lending rates. It has also indicated that it will maintain ample liquidity to provide financial support to key sectors in the economy.

Short term the outlook for China is unclear, however if China does develop a new vaccine internally that is more effective than their current ones, or if it moves away from its zero tolerance stance, then these could be viewed by markets as significant turning points for China.

The high levels of global inflation and recession concerns, supply chain issues in China as a result of Covid lockdowns and the war in Ukraine, which is having a devastating toll on Ukraine and causing concerns of a global food shortage, are all affecting global markets. As can be seen from the chart above, the MSCI World Growth Index has had a particularly torrid start to the year, particularly when compared to MSCI World Value, as market sentiment has rotated away from growth. This has been beneficial to the FTSE 100 indices, to which our portfolios have some exposure, but has been largely detrimental to many global sectors resulting in our Advisory Portfolio Service portfolios underperforming for the year so far.



Investment Style - Three Month Performance

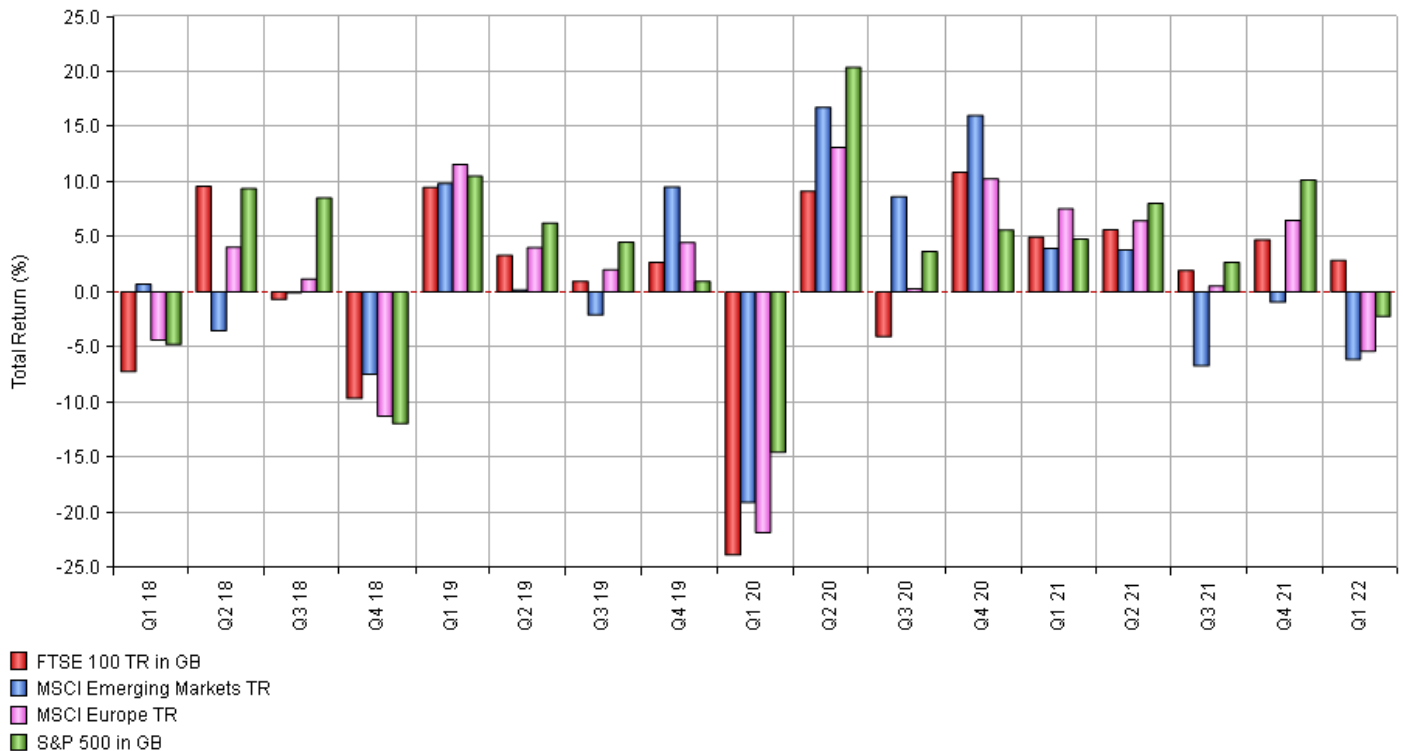


24/02/2022 - 24/05/2022 Data from FE fundinfo 2022

In the short term we would expect this swing to value to continue. We would also expect the holdings within our portfolios with a greater weighting to quality companies with pricing power and strong

balance sheets to start to recover, as high inflation and rising interest rates start to affect the global economy. Evidence of this can already be seen over the short term, as shown in the chart above.

Quarterly Index Performance - Quarter One 2018 - Quarter One 2022



03/2018 - 03/2022 Powered by data from FE fundinfo



In the previous chart we have compared the performance of the FTSE 100 to a number of major global indices on a quarterly basis since the start of 2018. What is apparent, that during this period the two worst performing periods, Q4 2018 and Q1 2020, were both directly followed by the two best performing quarters.

This chart highlights that when markets drop, you should avoid selling out of the market. By selling out when markets are falling and remaining in cash, you crystallise the losses that you have made and miss out when markets do recover. 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.

Taking into consideration current market conditions and the factors covered within this bulletin, we would expect to see minimal growth in our portfolios until global commodity prices come down and stability returns to the global economy.

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



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Investment Manager
Technical Team



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