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Keeping you informed matters

Economic review

April 2022

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Outlook

With global inflation rates at multi-decade highs, where next for investors as concerns grow that rising costs are here for the foreseeable future? The Russian invasion of Ukraine galvanises the West, with increasing evidence of apparent atrocities committed against civilians.

It was a difficult start to the year for many markets as they grappled with the new inflation paradigm. This was intensified in late February following the invasion of Ukraine by Russia. After an initial risk-off phase, with safe havens such as government bonds and gold providing limited downside protection, markets have begun to regain their composure into the quarter end as the economic fallout becomes clearer.

While the Russian trading economy isn't big enough to upset markets with retaliatory moves to sanctions, the West's dependency on their energy exports is a different matter. Europe's reliance in particular, with the Kremlin threatening to switch off supplies, has been creating significant upward pressure on already rising prices. Oil peaked at $130 per barrel in March and natural gas prices have risen over 50% since the start of the year – both now at a ten year high. These higher energy costs, coupled with supply-chain disruption from the pandemic, had already been pushing inflation rates higher. In response, central banks have begun to tighten policy and raise interest rates, impacting global bond and equity markets alike.

While raising interest rates may subdue demand and can dampen inflation, this alone will not change the reality of a painful spike hitting consumers in the short term. As expenditure on essentials such as food, heating and transport increases, the understanding is that the subsequent reduction in discretionary spending should eventually lead to a fall in demand for other goods, with prices stabilising.

However, as mentioned in the recent market update, evidence suggests that after ten years of low and falling commodity prices, we are at the beginning of a new commodity super-cycle. Demand for resources that have been in short supply through the pandemic returned swiftly as the world reopened from the lockdowns, with metals, grains, hydrocarbons and precious metals all up significantly.

We have therefore begun to reassess the balance within our strategies to account for these factors as the certainty of their impact becomes clearer. Investments such as inflation linked bonds and real assets such as property already feature in our portfolios and have provided solid returns over the last six months. In this more uncertain geopolitical backdrop, we also look for more portfolio diversifiers and stabilisers through assets such as infrastructure, gold and gold mining companies, healthcare and renewable energy.

In his attempt to disrupt the world order, Vladimir Putin has inadvertently galvanised the West in a number of these areas. As we have seen, most of Europe has been spurred into action with increased defence spending, an area many of the fund managers we engage with are now considering. War often leads to periods of rapid technological advancement, and many of the high quality companies we already hold will indirectly benefit as research and development spending picks up. While this doesn't transfer to our ethical strategies, the urgency surrounding the need for new energy supplies through clean and renewable energy will certainly be a growth area going forwards. Russia has acted to intensify this focus, a new form of defence against future aggressions.

One other area of defence we would typically hold in this sort of backdrop is government bonds. Interestingly, as the inflation and interest rate situation has unfolded, the yield curve – an often reliable indicator of future recessions – has recently inverted in the US. This occurs when short-term debt instruments have higher yields than long-term instruments of the same credit risk profile. While this would normally suggest expectations are for a decline in longer-term interest rates associated with a recession, we are unable to marry this outlook to the US economy from here.

Not only is the US economy a dynamic and innovative one, but its lower reliance on overseas energy than most other developed economies has largely insulated it from the effects of the war in Ukraine. It has also just experienced one of the most profitable years for corporations since the 1950s, driven by strong household demand and the passing of price hikes onto consumers. We might have considered the US expensive relative to other developed markets lately, but recent events have made this an obvious haven. The largest and growing market in this instance, provides security.

We believe one economic positive from the conflict will be the drive now to improve productivity in major economies. Higher productivity leads to cost reductions and thereby reduces inflation.

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Key facts about the world

United Kingdom

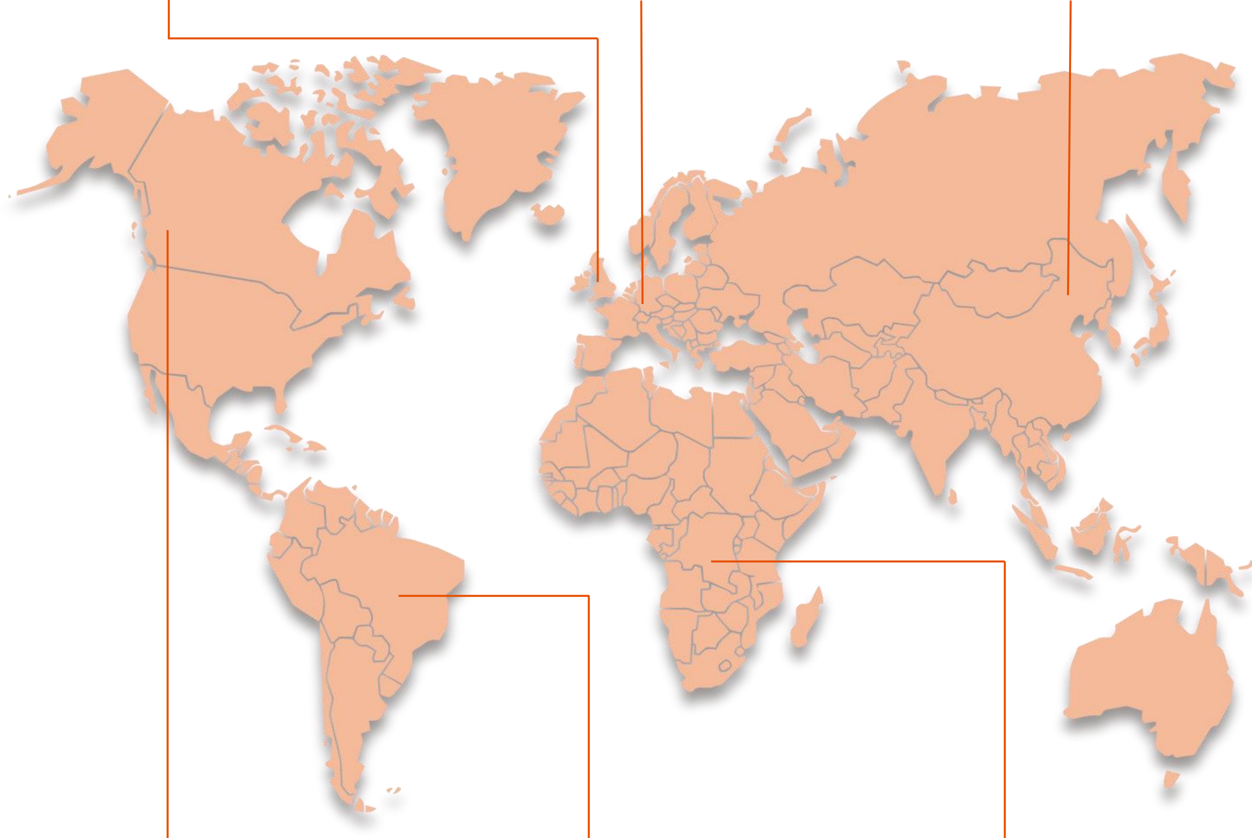
- House prices surge by 1.4% in March; the biggest rise in six months.
- Consumer price inflation (CPI) hit a 30-year high of 7% in March. CPI forecast close to 9% by Q4 2022.

Europe

- Germany suspended approval of the Nord Stream 2 gas pipeline to Russia.
- Eurozone gas prices up 55% QTD to €121 per megawatt hour.
- Russia removed from the MSCI Emerging Markets Index.

Asia

- 26m people confined to their homes in Shanghai to curtail Covid outbreak.
- Chinese President Xi Jinping has pledged to try to reduce the economic impact of the pandemic.



North America

- US unemployment rate dropped from 3.8% in February to 3.6% in March.
- The Federal Reserve raised interest rates by 0.25%; alongside it preparing to slash $95 billion off its balance sheet on a monthly basis going forwards.

South America

- Brazil policymakers have increased borrowing costs to 10.75% - highest in five years.
- LAC (Latin America and Caribbean) – China trade projected to double by 2035 and exceed $700 billion.

Africa

- Egypt has suffered a 14% currency devaluation related to the US dollar.
- Saudi Arabia sends $5 billion to Egypt to help deal with the soaring commodity prices.
- Tunisia’s political crisis worsens as the president dissolves parliament.

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Q1 Performance Review

Key facts

- Inflation linked and short duration bonds perform well
- Mid and small cap UK and global equity suffer in Q1 as investors turn to large cap security
- Income and value have offered positive returns over capital growth focused holdings
- The US looks increasingly like a safe haven trade for sustainable growth in this geopolitical backdrop
- Real assets such as property offer strong inflation protection

Bond markets have struggled to provide the level of protection one might expect in this environment as the geopolitical, inflation and rising interest rate outlook creates additional volatility. However, our exposure in lower risk strategies to short maturity issues through the AXA US Short Duration (-1.48%) and Royal London Short Duration Global High Yield (-1.26%) funds cushioned the worst of the volatility in their sector (IA High Yield index -3.76%), as did the M&G Corporate Inflation Linked Bond fund (-0.39%).

In the core UK equity exposure, the more defensive income and value focused funds such as BlackRock UK Income (+1.86%), new addition River & Mercantile UK Recovery (-1.21%) and JOHCM UK Opportunities (-4.30%) offered the best returns in Q1. Unfortunately, the previously best performing L&G Future World Sustainable UK Growth fund (formerly L&G UK Growth Trust) suffered, as did the Jupiter UK Smaller Companies fund (-19.72% and -16.62% respectively), with their focus on UK mid and small cap companies, where the larger names in the FTSE heavyweight energy and financial sectors saw the bulk of the positive returns.

Understandably, a very mixed bag from the global equity exposure, with the Loomis Sayles US fund (-4.79%) performing better than other world regions such as Europe (Premier Miton European Opportunities -13.77%) which is affected more by the war. New entry Prusik Asian Equity Income has been a positive addition, up 7.39% over the quarter versus the IA Asia Pacific Ex Japan index down -3.24%. Similarly, value focused BNY Mellon Sustainable Global Equity provided further positive returns (+1.16%), while emerging markets continue to combat Covid and the weakness led by China (-14.5%), where some 16m people are now under lockdown in Shanghai to slow the recent surge in cases.

Real assets exposure such as the BMO Commercial Property Trust (+11.04%) and Standard Life Investment Property Trust (+6.82%) have been bright spots in a very challenging quarter for performance. In ethical portfolios, the Downing Renewables & Infrastructure Trust has also been a positive contributor (+4.64%). Home REIT, which now provides c8,000 beds to the homeless in the UK, has also performed well after a volatile start to the year, recovering early losses into the quarter end.

SECTOR	Q1 2022	1 year to 31/03/22	1 year to 31/03/21	1 year to 31/03/20	1 year to 31/03/19	1 year to 31/03/18	5 years (annualised)
IA OE UK Index Linked Gilts	-6.7%	3.8%	-1.0%	5.3%	6.3%	-0.1%	2.8%
IA OE £ Corporate Bond	-5.6%	-4.4%	9.2%	0.8%	3.0%	1.8%	2.0%
IA OE Property	2.8%	10.5%	-2.3%	-2.6%	2.3%	6.6%	2.8%
IA OE UK Equity Income	-0.1%	10.8%	32.5%	-20.7%	3.6%	0.4%	3.9%
IA OE UK Smaller Companies	-13.1%	-3.8%	67.4%	-18.2%	-2.6%	14.6%	8.0%
IA OE North America	-2.9%	15.9%	42.5%	-3.9%	15.8%	0.4%	13.0%
IA OE Europe Excluding UK	-7.6%	4.3%	39.5%	-9.2%	-1.2%	5.8%	6.7%
IA OE Japan	-5.8%	-4.5%	31.9%	-3.6%	-3.5%	9.1%	5.0%
IA OE Asia Pacific Excluding Japan	-3.2%	-5.1%	48.5%	-11.3%	3.2%	7.2%	6.7%
IA OE Global Emerging Markets	-6.7%	-8.7%	47.3%	-15.8%	-1.3%	8.9%	4.0%

Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

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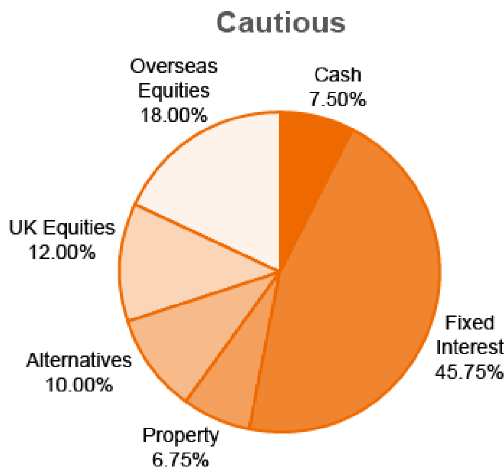
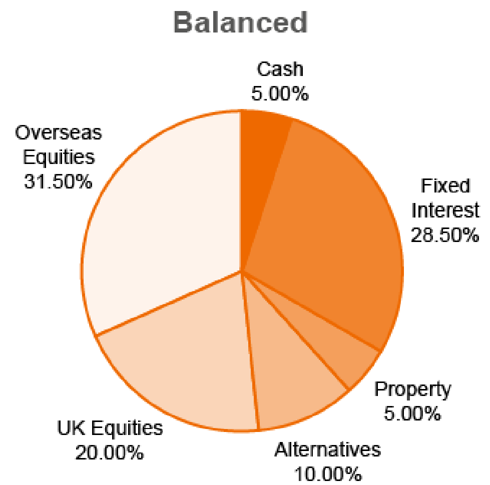
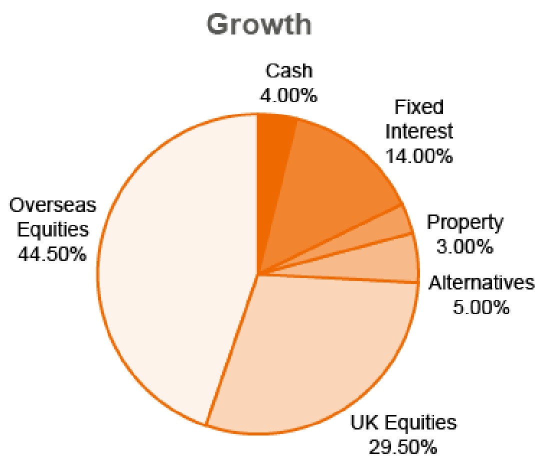
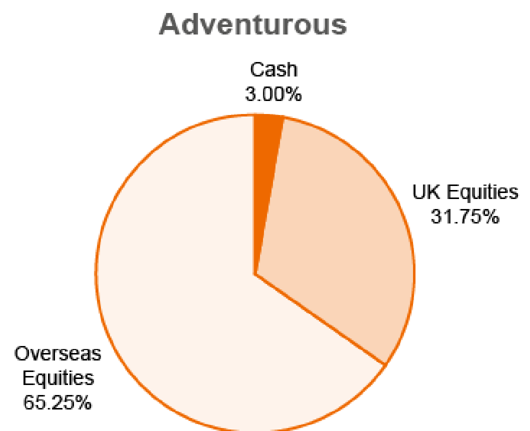
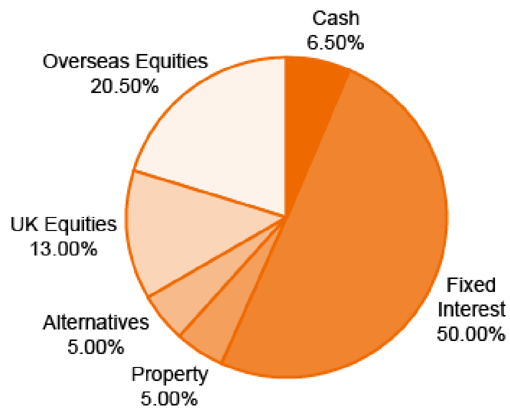
The positioning of our strategies







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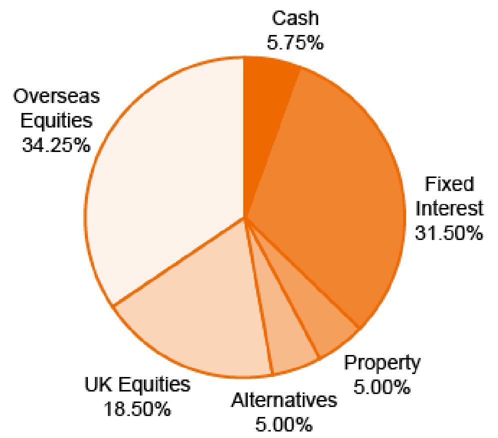
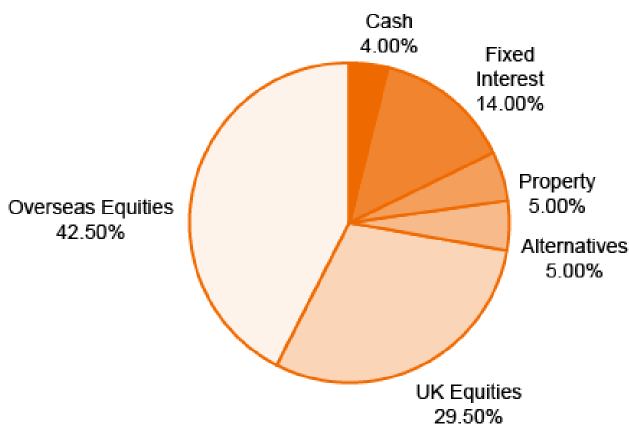
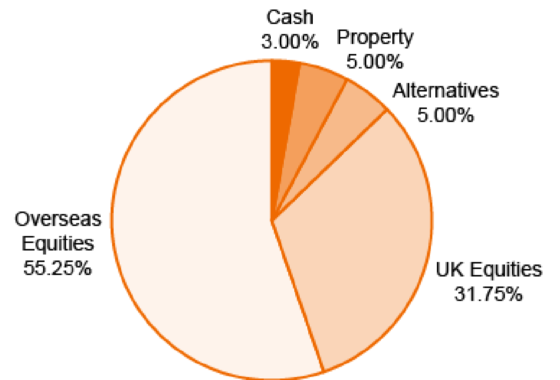
Cash 6.50%
Fixed Interest 50.00%
Property 5.00%
Alternatives 5.00%
UK Equities 13.00%
Overseas Equities 20.50%


Ethical Balanced
Cash 5.75%
Fixed Interest 31.50%
Property 5.00%
Alternatives 5.00%
UK Equities 18.50%
Overseas Equities 34.25%


Ethical Growth
Cash 4.00%
Fixed Interest 14.00%
Property 5.00%
Alternatives 5.00%
UK Equities 29.50%
Overseas Equities 42.50%


Ethical Adventurous
Cash 3.00%
Property 5.00%
Alternatives 5.00%
UK Equities 31.75%
Overseas Equities 55.25%

Disclaimer

Opinions constitute our judgment as of this date and are subject to change without warning. The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance is not a reliable indicator of future results and forecasts are not a reliable indicator of future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down. The information in this document is not intended as an offer or solicitation to buy or sell securities or any other investment, nor does it constitute a personal recommendation.

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