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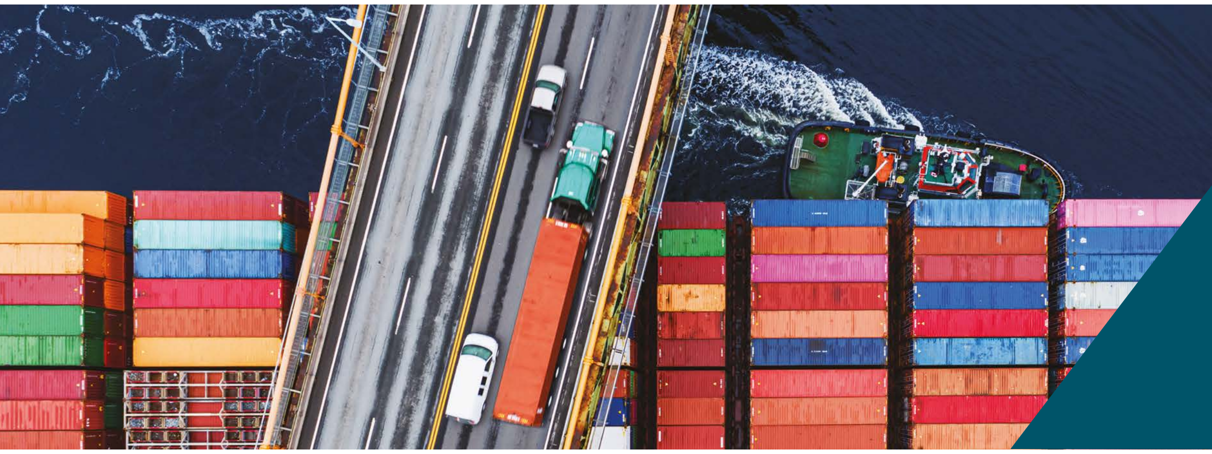
# Investment Commentary



Q1
2022

## Overview

The appalling invasion of Ukraine by Russia on 24th February is significantly the most important event of the first quarter. Our thoughts go out to those involved and for the dreadful loss of life and destruction of property. We can only hope that the de-escalation of military activity currently being considered by Russia will lead to a swift and lasting peace.

Prior to the invasion, financial markets were already facing a new reality. Inflationary pressures, to some extent created by Covid-induced supply chain bottlenecks, have been deepened by the war. Russia and Ukraine are two large suppliers of essential commodities including oil, gas, cereals, fertilisers and some metals which have experienced sharp price rises which has exacerbated the problem. The oil price, alone, is up 38% over the quarter and we are seeing major increases in gas and electricity prices. In the UK the domestic energy cap has seen a very sharp rise sufficient to double or treble household energy costs. Central bank's traditional approach to rising inflation is to push interest rates higher and this has begun in the UK and the US. They also need to start scaling back the accommodative monetary policy put in place during the pandemic.

The economic picture has become much more clouded, and at this moment growth forecasts are a guess at best. The Organisation for Economic Co-operation and Development (OECD) has reduced its pre-war forecast for global growth from 4.5% to 3.4% for this year. While the Office for Budget Responsibility has suggested that UK inflation could reach 9% by the end of the summer. Reported economic numbers remain impacted by the recovery from Covid with fourth quarter GDP growth rates reaching 6.9% in the USA, 6.6% in the UK and 4.6% in the Eurozone. China's recovery rate has slowed to 4.0%, due to the impact of their strict lockdown policy over Covid. More broadly, India's economy grew by a solid 5.4%.

The movement in stock market indices, over the quarter, appears sanguine in the face of the geopolitical and economic problems. This can, to an extent, be put down to good performance being concentrated in a relatively small number of stocks and sectors, as explained below. In troubled times, smaller companies tend to perform worse than their larger peers and this is reflected in the table below for the UK market. The pattern has been mirrored in other markets around the world.

The following table sets out the market movements over the past quarter.

| Index | 31/12/2021 | 31/03/2022 | Change |
|---|---|---|---|
| CBOE UK 100 | 732 | 750 | +2.5% |
| CBOE UK All Companies | 13,304 | 13,347 | +0.3% |
| CBOE UK 250 | 20,919 | 18,636 | -10.9% |
| MSCI Private Balanced | 1,849 | 1,799 | -2.7% |
| MSCI Private Growth | 1,993 | 1,949 | -2.2% |

## Macro-economic picture

The UK market has, for once, led the field in producing a positive return. The top 100 companies account for about 80% of the market value and there have been strong gains from the four largest; Shell (+30%), AstraZeneca (+17%), HSBC (+17%) and Rio Tinto (+24%). A heavy concentration to resource and mineral companies meant a further five of the next seven largest companies also made gains. The impact these have had on the index conceals that over half of the constituents fell during the period and that of these 24 stocks fell by more than 20%. From a sector perspective, oil and mining stood out while pharmaceuticals, telecoms and banks also made positive ground. While the top 100 share index moved ahead its performance was in stark contrast to the more domestic mid and smaller capitalisation indices which registered double digit percentage falls during the quarter. Overseas equity markets were also weak.

Bond markets also suffered severe falls as the interest rate outlook changed. The UK 10-year government bond yield, which moves inversely to prices, rose from 0.9% to 1.67% and the US 10-year yield rose to 2.35% from 1.62%. These moves put pressure on so called “long duration” stocks. That is, those where profitability is many years way while the company grows. This has particularly affected non-profitable technology stocks in the USA. Last year we pointed out that technology stocks drove the market higher. This year, where profits do exist, the reaction has been less severe. The super-sized Amazon, Apple, Alphabet (Google) and Microsoft have seen their share prices fall by between 2.5% and 6%. But where things have gone wrong the reaction has been painful with Facebook (now Meta) and Netflix seeing their prices down 34% and 36% respectively.

## Outlook

In our last two quarterly reports we have alluded to the risks associated with rising rates of inflation. The situation in Ukraine and the subsequent rise in the oil price, and indeed many other commodities, has heightened that risk. Further rises in global interest rates are inevitable to combat inflation although central banks need to be careful not to overreact, by being too aggressive, and induce a recession. As monetary policy tightens, we continue to favour shares in companies on reasonable valuations but with enough pricing power to underpin real earnings growth. Holding real assets whether these be equites or property is favoured.

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