



CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY



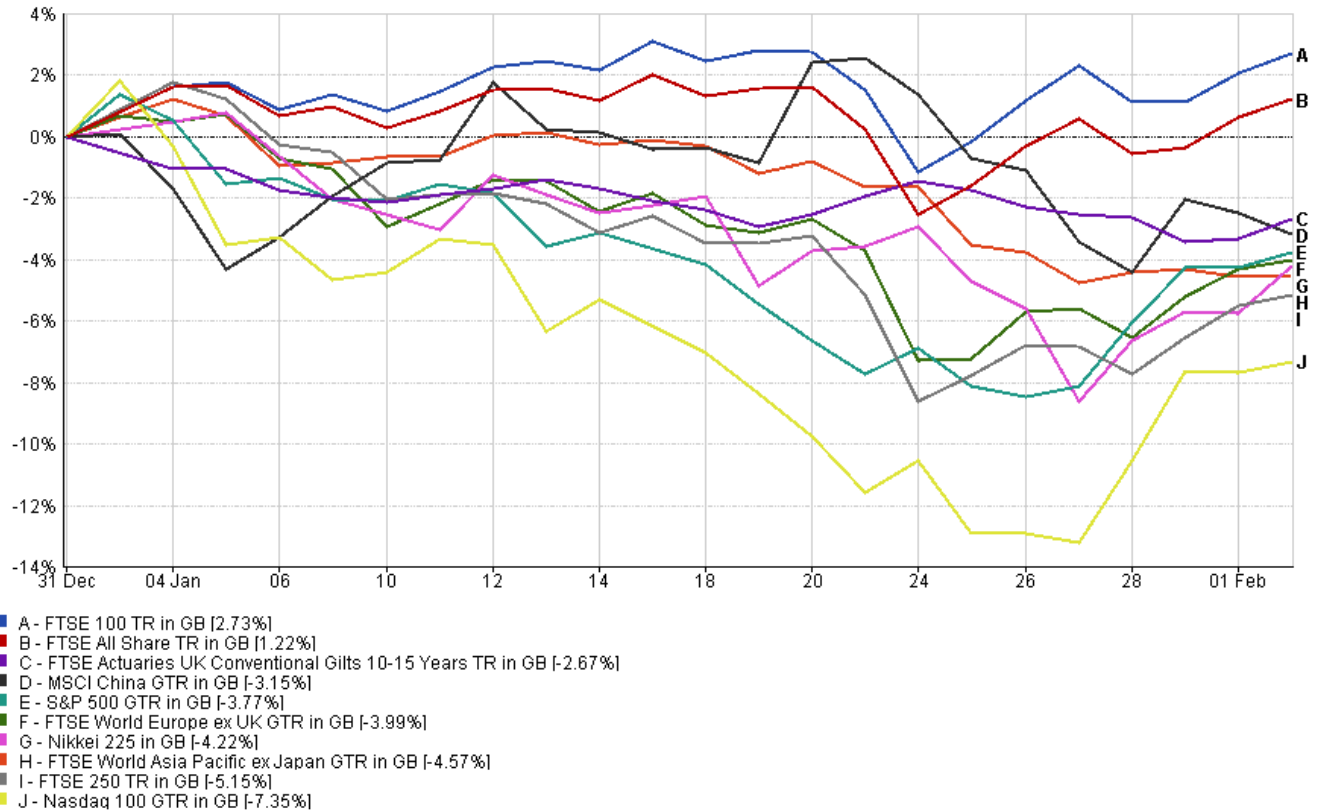
3 FEBRUARY 2022



OVERVIEW

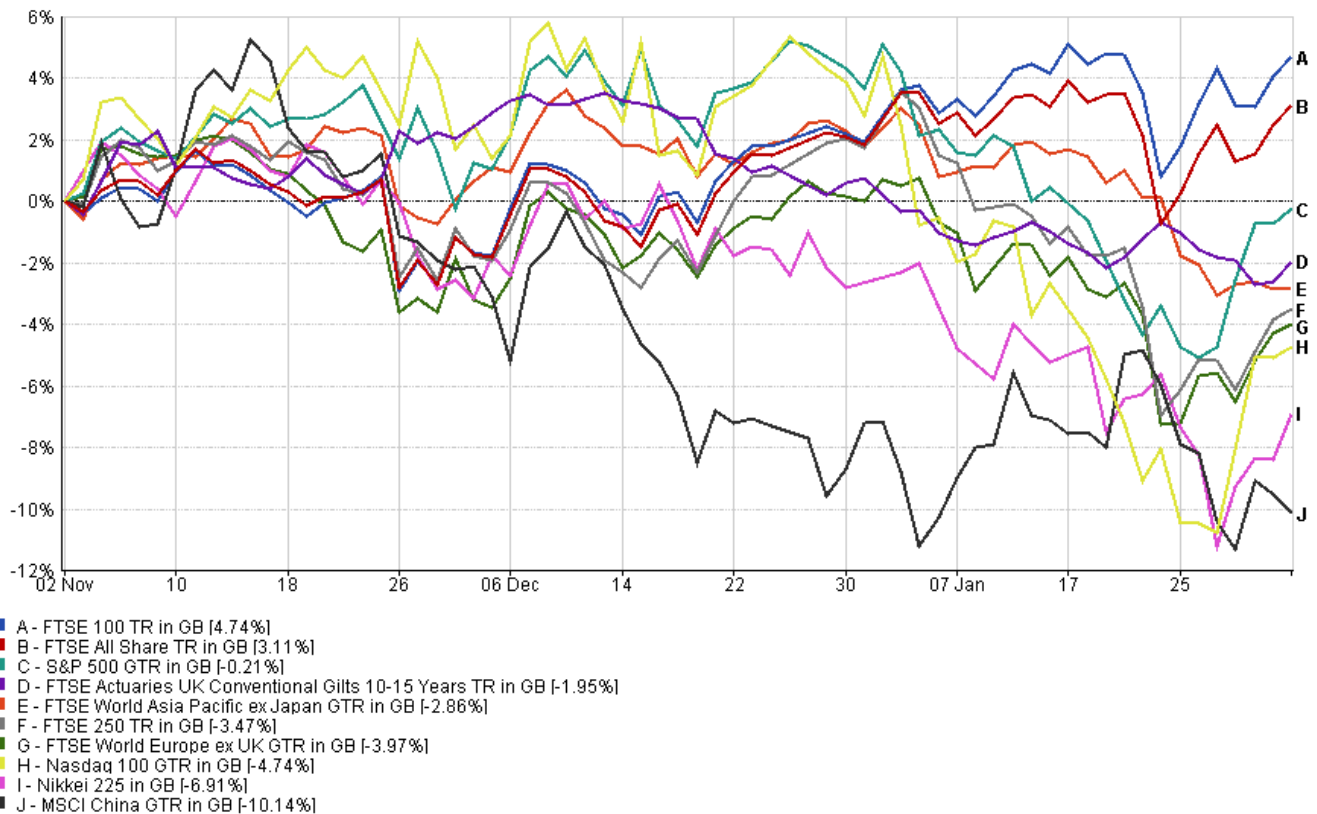
Investment markets over the past month have been very volatile as above target inflation around the world appears to have become more persistent than initially anticipated and action from central banks is required to ensure that it is controlled. In December 2021, the US Consumer Price Index (CPI) reached 7% pa and the UK CPI rose by 5.4% pa. January 2022 data show that the eurozone CPI increased by 5.1% pa. Even Japan, which has experienced years of deflation, registered a rise in CPI of 0.5% pa in December 2021. To bring inflation back down towards its 2% pa target and believing that the economy is now sufficiently strong to support higher interest rates, the Bank of England has already begun to tighten monetary policy, with interest rate rises announced at its December and February meetings and Bank Rate now standing at 0.5% pa. The US Federal Reserve (Fed) looks set to commence raising rates in March 2022 and throughout the rest of 2022/3, whilst the European Central Bank (ECB) has still to raise rates as it believes that the eurozone recovery is behind that of other major economies. Asset purchase programmes originally put in place to support economies and markets over 2020 and 2021 due to the pandemic are being wound down/stopped - so withdrawing liquidity from markets. Geo-political worries are always present and the threat of a Russian invasion of Ukraine has also affected investor sentiment. It remains to be seen if Russia does invade as the US, UK and the European Union will impose sanctions if it does.

ONE MONTH INVESTMENT MARKET STERLING RETURNS

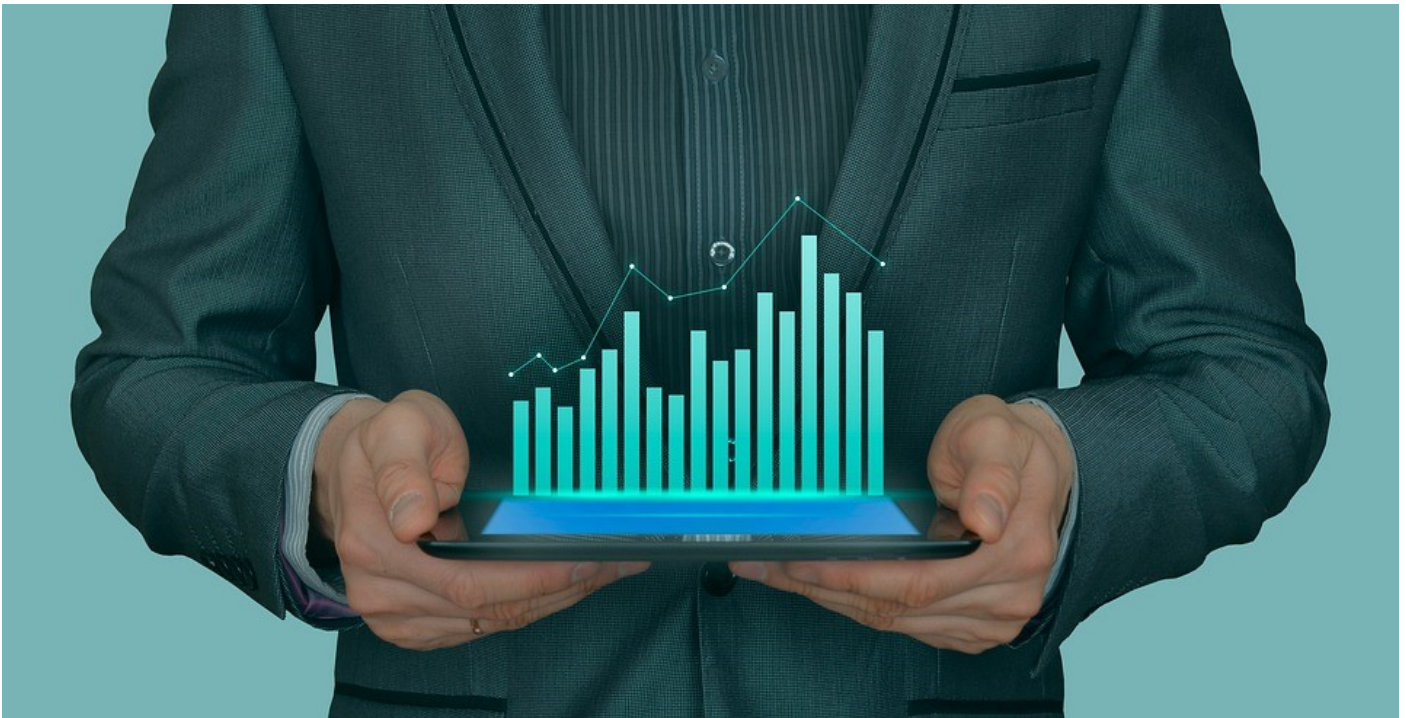


31/12/2021 - 02/02/2022 Data from FE fundinfo 2022

THREE MONTHS INVESTMENT MARKET STERLING RETURNS



02/11/2021 - 02/02/2022 Data from FE fundinfo 2022



The most recent significant falls in equity markets came before and after the latest meeting of the Fed on 25/26 January 2022, at which the Chair of the Fed, Jerome Powell, indicated that the interest rates would rise by 0.25% in March and that its asset purchase programme would cease. However, he also did not rule out that monetary policy may tighten more quickly and more strongly than expected to control rapidly rising inflation. The probability of the Fed's benchmark interest rate reaching 1% by the end of June 2022 ie increases of 0.25% at each of its next three meetings has risen significantly. It would now appear that global monetary policy is entering a new phase as the central banks embark upon an era of rising interest rates. The economic backdrop of above target inflation, increasing economic growth and low unemployment is appropriate for interest rates to rise, as economies seek to reverse the ultra-loose monetary policy which was necessary to support the world through the pandemic. US economic growth is at its strongest level in over twenty years. Gross domestic product (GDP) grew at 6.9% pa in the last quarter of 2021 and by 5.7% over the whole of 2021. US economic growth is around 3% above its pre-pandemic level although recent restrictions imposed as a result of the spread of omicron could see the growth rate fall back temporarily.

The eurozone has seen collective economic growth of 5.2% over 2021, so regaining its pre-pandemic growth level, although Q4 saw a slowdown due to high Covid-19 infections and renewed restrictions. France, Spain and Italy all grew strongly in 2021, but surprisingly Germany lagged their growth rates. Consumer spending has fallen in Germany, which coupled with supply constraints, has impacted on its export-led economy - manufacturing vehicles, machinery and equipment rather than consumer goods. The slowdown in China has also had a negative impact as China is nowadays Germany's second largest export market.

The UK economy expanded to a size beyond its pre-pandemic level in November 2021, but the onset of omicron may have reversed the trend to some extent in December 2021, as infections surged and some restrictions were re-imposed.

China's zero-Covid strategy has led its manufacturing and services activity to move close to contraction. Local governments in several regions have had to impose more virus controls which has led to lower production, as well as restrictions on transportation and sales of manufactured goods. Smaller Chinese manufacturing companies have been hardest hit due to weakening export demand. Local consumption has also been negatively affected by the reintroduction of lockdowns. Chinese economic growth has suffered with Q4 growth falling to 4% pa from a level of 6.5% pa a year before. The Chinese equity market has been negatively affected by slowing growth and the problems in the property sector. The authorities have recently taken a series of monetary and policy easing measures aimed at supporting growth. Looser monetary policy should prove supportive of the economy and the equity market.



Global economic growth indicators still point to expansion as economies re-open and recover further after pandemic-related restrictions are lifted. Early corporate earnings reports from the US show that earnings are around 25% higher than a year ago. With omicron seemingly now receding and hopefully with it the worst of the Covid-19 pandemic, consumers and businesses should start to spend again. If companies can continue to grow and inflation does not get out of control, equity markets should recover from recent falls quickly. Global inflation should start to fade as consumers resume spending on services such as travel and leisure and spend less on manufactured goods, for which extraordinary demand has led to strains being put on supply chains so fuelling inflation. The rising oil price has also fed into inflation but as supply increases, the price should fall and pressure on inflation dissipate.

The prospect of tightening monetary policy as interest rates increase, together with the omicron virus strain - now deemed less dangerous than other mutations - has seen a rotation out of growth stocks, including those of technology companies, to those of more economically sensitive or cyclical companies, such as those in the financials and leisure sectors. The performance of the tech-heavy NASDAQ index illustrates the change in sentiment as the future earnings (and therefore valuations) of these growth companies are calculated on interest rates which are moving upwards. The share prices of unprofitable, very speculative technology companies have been worst affected as they will find it harder to service their loans. The US mega-tech companies which have largely driven the exceptional returns of the US stockmarket over the pandemic, have announced mixed fourth quarter earnings. Apple, Alphabet and Microsoft's earnings held up well beating forecasts whilst Netflix and particularly Meta (formerly Facebook) disappointed. Profitable technology companies should continue to thrive in the longer term. The shares of companies which will benefit from economic recovery and those hardest hit by the pandemic have risen recently, as earnings should improve as economies expand - including banks, oil companies, airlines and vehicle manufacturers. The UK equity market which has greater exposure to these more cyclical sectors has performed relatively well of late.



The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartledge Morland's Investment Services team.

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

We continue to run fully diversified portfolios in accordance with clients' objectives and risk tolerance. We invest across geographic sectors and in a blend of funds, some of which have greater exposure to cyclical companies and others which are more growth oriented. Whilst higher inflation and rising interest rates have a negative impact on fixed interest assets we maintain exposure to the sector, investing in a range of funds. Fixed interest provides downside protection for a portfolio in the event of heightened volatility in equity markets. Corporate bond fund returns are also driven by credit selection ie are the companies issuing the bonds/ debts likely to be able to service their debts? Good stock selection is key to returns. Currently the level of defaults are low. Commercial property is still included to a degree in some portfolios and its returns are closely linked to the health of the underlying economy. After the many difficulties experienced by commercial property funds during the pandemic, recent returns have been relatively strong from well diversified funds. They provide good income flows to portfolios, offer diversification away from equities and fixed interest, and should provide some inflation protection.

Apart from those holding significant cash deposits, most individuals and companies regret increases in interest rates. When combined with elevated inflation they sap optimism and potentially cause distress. The banks make more money when interest rates are high, as do businesses holding huge cash deposits, such as insurance companies. Aside from them and private investors with large deposits, nobody will welcome rate increases and many will feel uncertain or despondent. Presently financial markets reflect these concerns.

The global economy and its financial system have so far failed to 'normalise' since the Great Financial Crisis. The emergence of the COVID-19 virus and 'lockdowns' quickly returned the global economy to an even more precarious position but fortunately, that proved temporary.

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OUR VIEW continued

The withdrawal of quantitative easing (itself very much an emergency response) and signs of meaningful interest rate increases are all positive signs for the global economy. Essentially, it is healing from the shock of the pandemic and embarking upon a fresh phase of expansion. This is likely to be both exciting and profitable but there is always some danger of over-reaction from the central banks to rising inflation, which could throw recovery into reverse. The central banks appear highly conscious of this and to be acting in a cautious, coordinated, manner which is reassuring. Generally, we retain strong expectation of profit from equities and better yields from bonds, following period of shorter term pain.

If you have any queries please do not hesitate to contact us via your Cartlidge Morland consultant.



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