



**CARTLIDGE MORLAND**

INDIVIDUAL WEALTH MANAGEMENT

# INVESTMENT COMMENTARY

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**27 APRIL 2022**

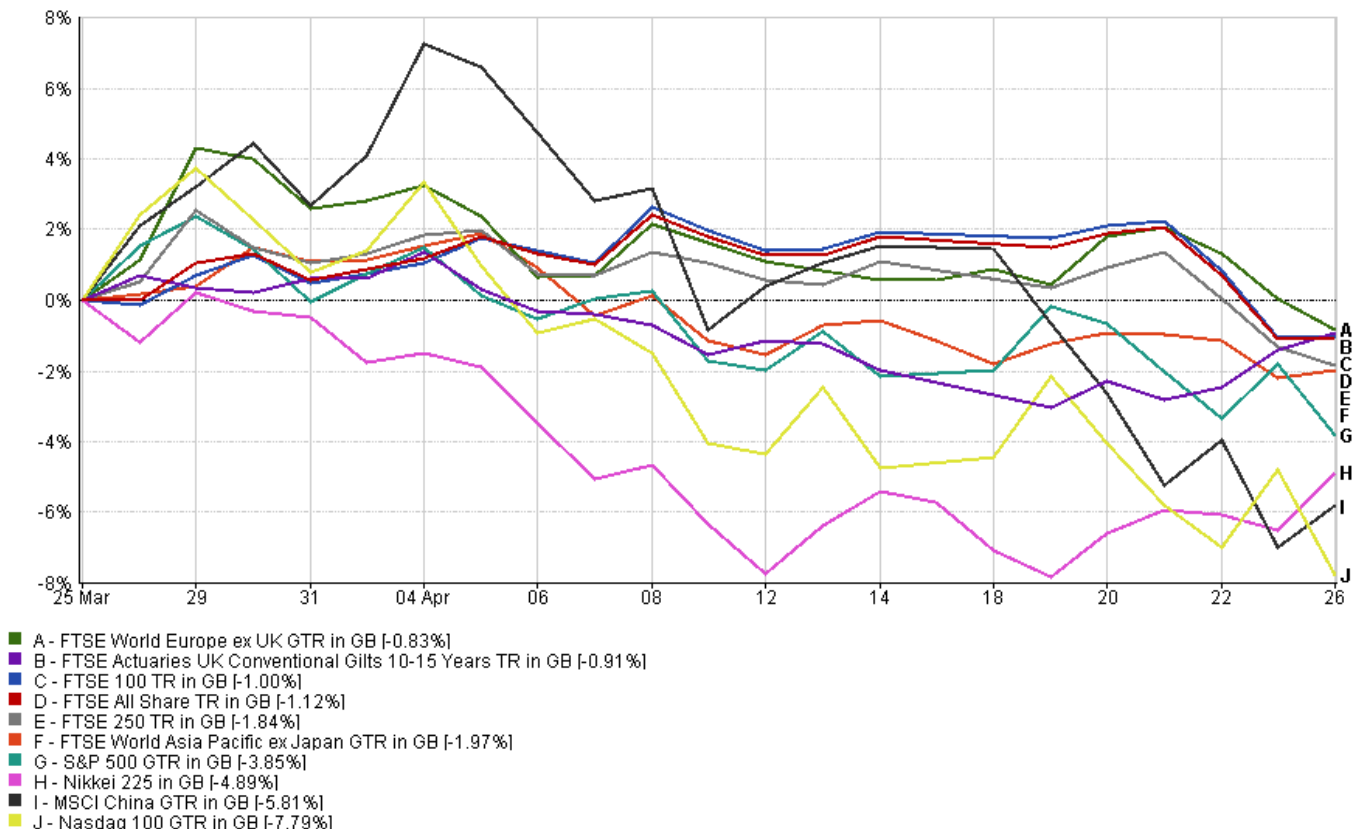
## OVERVIEW



Inflation continues to soar around the globe as a result of rising energy prices, increasing food prices and higher wages. The terrible conflict in Ukraine continues, resulting in social and economic upheaval in the country, which has also impacted on global energy and food prices. Restrictions imposed as a result of the Covid-19 pandemic are generally easing globally with the

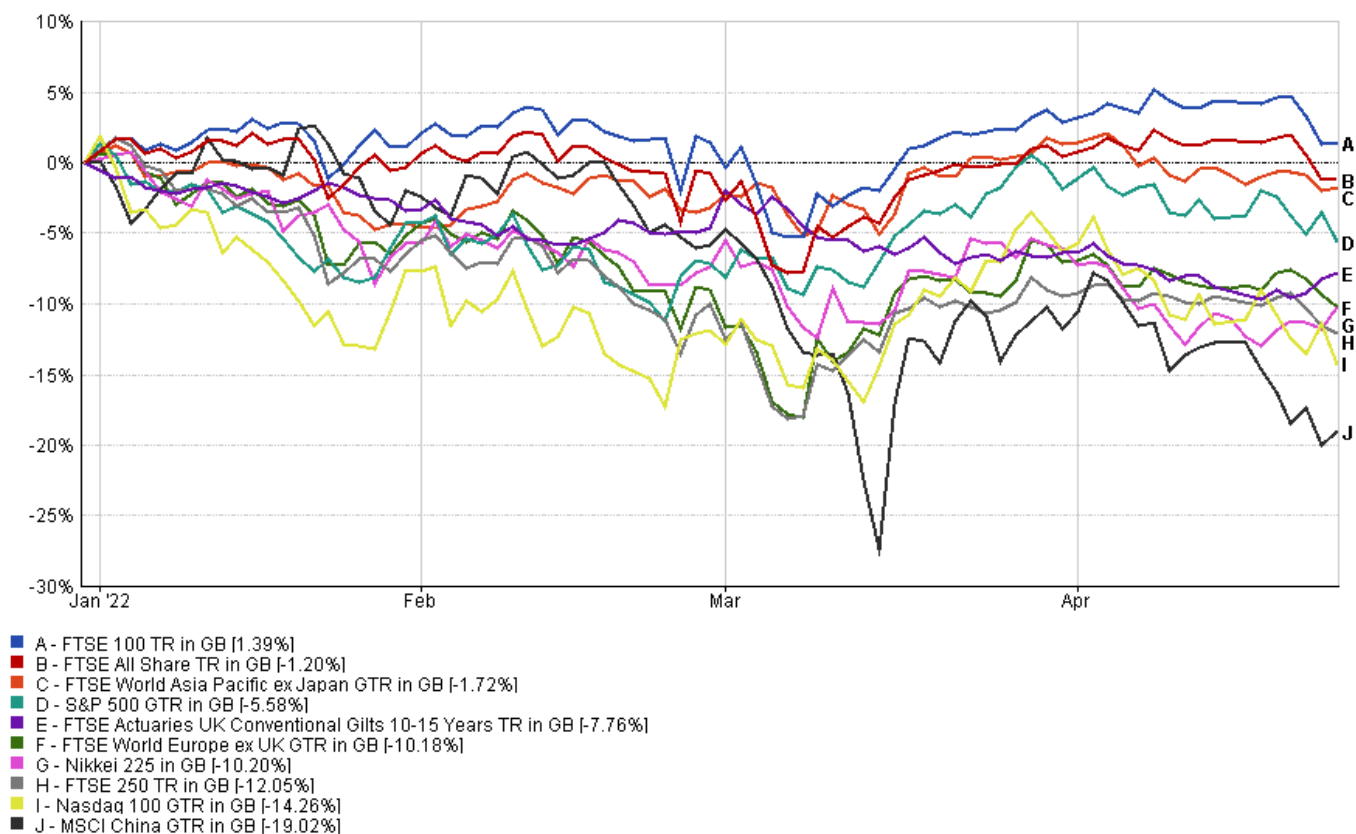
exception of China. Key cities and regions in China have returned to strict lockdowns which has impacted on supply chains, prices and global economic growth. The major central banks are faced with controlling inflation through tightening monetary policy and winding down pandemic-related quantitative easing programmes. The challenge will be whether inflation can be brought under control without sending economies into recession.

## INVESTMENT MARKET STERLING RETURNS OVER ONE MONTH



25/03/2022 - 26/04/2022 Data from FE fundinfo 2022

## INVESTMENT MARKET STERLING RETURNS YEAR TO DATE



31/12/2021 - 26/04/2022 Data from FE fundinfo2022

Recently, investors have appeared to have taken the prospect of persistent above average inflation more seriously, reacting negatively to the comment made by Jerome Powell, Chair of the US Federal Reserve (Fed), that a 0.5% rate rise is “on the table” indicating that the Fed may need to raise interest rates more quickly than expected to bring inflation under control. Equity markets fell sharply on this news. The Fed Funds Rate is now expected to rise to between 2.75% and 3.00% by the end of 2022 which would be its highest level since the global financial crisis. This assumes that inflation peaks in the next few months but more interest rate rises could be forthcoming if inflation proves a lot stickier than expected. There has been much discussion about the inversion of the US yield curve – the yield of two year US government bond is higher than that of the ten year bond. The shorter term bond yield would be higher as the Fed is increasing shorter term rates and the longer dated bond yield is lower, as investors believe that over the longer term, interest rates will have to be reduced as economic growth slows as a result of the near term higher rates. The fear is that the US Fed tightens monetary policy too much sending the economy into recession. The inverted yield curve in the US has proved a reliable indication of recession in the past – normally within the following 20 to 24 months. The Fed is seeking a soft landing through higher interest rates which should slow the economy and moderate ‘demand’ growth. Currently, the US economy looks in reasonably good shape as unemployment remains very low and balance sheets of US companies look quite strong.

The Bank of England (BoE) faces similar challenges, with inflation in March running at 7% pa, some 5% above target. The BoE has already increased interest rates three times since December 2021 with further increases expected over this year. The European Central Bank (ECB) had resisted calls for it to increase its main interest rate in the face of eurozone inflation running at 7.5% pa in March. Whilst Christine Lagarde, the President of the ECB, has been of the view that raising rates in 2022 will choke off economic growth, the steep rise in inflation may see the ECB raise interest rates as early as July. Even Japan has experienced inflation

with consumer prices rising by 1.2% pa in March 2022. However, the Bank of Japan (BoJ) looks set to maintain its dovish monetary stance, perhaps welcoming the resulting weaker yen in comparison to the US dollar. The People's Bank of China is expected to maintain loose monetary policy throughout 2022 to support its economy. Economic growth has been held back by ongoing Covid-19 restrictions in some of the major commercial areas such as Shanghai and Beijing. If the strict lockdowns continue through the year, the Chinese economy could be severely impacted, perhaps even falling into recession and leading to slower global economic growth.



The UK equity market has performed relatively well over 2022 helped by its greater exposure to 'value'/dividend producing companies. In the face of rising inflation and increasing interest rates, investors seek more defensive companies including those in the consumer staples sector, such as Diageo and British American Tobacco. Energy companies have also performed well as prices remain high. Bank shares have generally risen as banks will benefit from rising interest rates. The shares of growth companies have been lacklustre as future earnings are valued at a lower level as a result of higher interest rates. Some of the growth companies in the US have fallen sharply including Netflix, which has announced a fall in the numbers of subscribers which reached record levels during pandemic-related lockdowns. Alphabet, the parent company of Google, posted a \$1.5 bn drop in quarterly profits with advertising revenue in Europe falling as a result of the war in Ukraine. Consequently, sentiment towards technology stocks around the world deteriorated with the tech-heavy NASDAQ falling nearly 4% very recently. The European equity market has been similarly impacted but also companies with greater exposure to Russia have been adversely affected as a result of the Russian invasion of Ukraine and the subsequent sanctions. The Japanese equity market has been impacted by global concerns about inflation and growth but its weaker currency has also deterred investors. The Chinese equity market continues to be negatively affected by the ongoing Covid-19 lockdowns in key economic regions and lack of any significant stimulatory monetary measures that had been expected to support economic growth.

Fixed interest markets have performed poorly as a result of above target inflation and rising interest rates. Government bond yields of developed economies have risen as a result ie their prices have fallen. Riskier areas of the fixed interest market have suffered as investors have become more risk averse. On a positive note, default rates currently remain low, although these could rise if economic growth is choked off by aggressive monetary tightening.



**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 seek to invest in income producing assets in portfolios over a period when capital growth prospects are challenged. Our equity exposure across sectors usually includes income producing funds which have performed relatively well in the face of rising interest rates and inflation due to their more value/cyclical nature. Our fixed interest exposure comprises mainly gilt funds which provide some 'insurance' in the event of severe equity market volatility, high quality corporate bonds for the income they produce and global bonds for further diversification and currency exposure. UK commercial property funds have made solid returns as the economy recovers following the easing of pandemic-related restrictions. The asset class also offers an income stream to investors.

Our optimism for investor returns over the course of 2022 is now constrained by further pandemic related uncertainties (China/Asia Pacific/Emerging Markets) and the extent to which investor sentiment has been tempered by predictable increases in interest rates and bond yields, which are an inevitable and desirable consequence of the move away from the 'life support system' of quantitative easing, exceptional deficit spending and ultra-low bond yields. Investors are inevitably nervous as the central banks break the status quo, not only to tackle inflation, but also to restore function, purpose, yields and normality to bond markets utterly perverted by nearly 14 years of heavy central bank bond purchases.

The change of direction described above is painful for bond investors. Part of the capital profits resulting from central bank buying have been stripped away but yields are being restored as a result. Ten year US Treasuries are now yielding almost 3% pa and gilts almost 2% pa. Subject to inflation falling to the degree the central banks are predicting, these yields are increasingly attractive but will need to rise further in the UK and in Europe. US Treasury yields probably have further to go too.

The restoration of acceptable yields to global bond markets presents potential challenges to equity markets. Corporate and government debt ownership carrying a fixed income, will appear more attractive to some investors than unpredictable dividend income and share buy-backs from equities.

Market traders (and it is their activity which has most influence over pricing) are thrashing about amidst a range of signals. Such signals provide little short term predictability in terms of direction beyond some



## OUR VIEW .... continued

continued fall in bond prices and in consequence, higher bond yields/interest rates. The question is whether the latter when combined with escalating consumer prices will take so much money out of the global economy that demand for goods and services falls so leading either to a recession or very sluggish economic growth. Against the latter background, companies would struggle to increase their earnings and dividend distributions.

Unfortunately, there is no clear answer to this dilemma and it is that very uncertainty which is causing such volatility in developed equity markets and a growing sense of general gloom. Presently, there are greater risks of a shorter term recession but few definite predictions of one. The US economy continues to expand with a fully utilised workforce and higher wages (prices too unfortunately). Conditions are similar in the UK and Europe lags only due to the additional uncertainties caused by the war in Ukraine.

We have not devoted much coverage to the war in Ukraine in this bulletin. It will become a major factor for investors if there are military exchanges between Russia and any of the NATO allies as this would severely affect sentiment. In the meantime, Europe in particular seeks to wean itself off dependency on Russian gas and oil. Inevitably, global oil and gas prices have risen as a result adding a dimension to inflationary pressures over which the central banks have no influence. Stable oil and gas prices but far higher than the world has recently benefitted from appear a likely outcome – but one to which the global economy will adapt.

When managing investments, one should never be influenced by hyperbole nor usually by absolute assertions. On a day, a week, a month or even a year in which equity prices are falling – they are not the place to be. Nobody wishes to hold them at such times. The opposite applies to those same periods when equity prices are rising. Predicting the right days, weeks or years is impossible with any reliable degree of accuracy which means investors must take a long term view and tolerate shorter term trends/fluctuations, painful and worrying though they can be. The current period of uncertainty and foreboding will pass.

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