



CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY



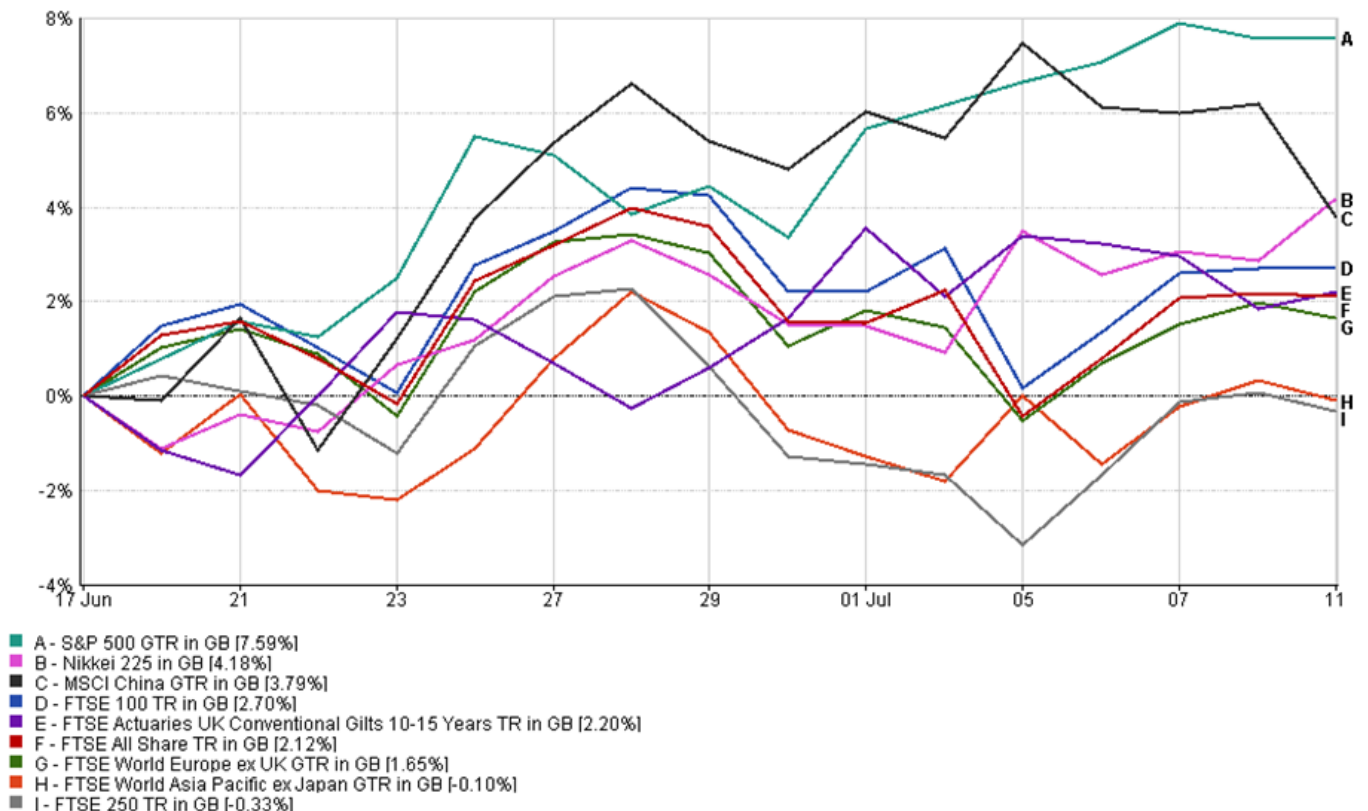
11 JULY 2022

OVERVIEW



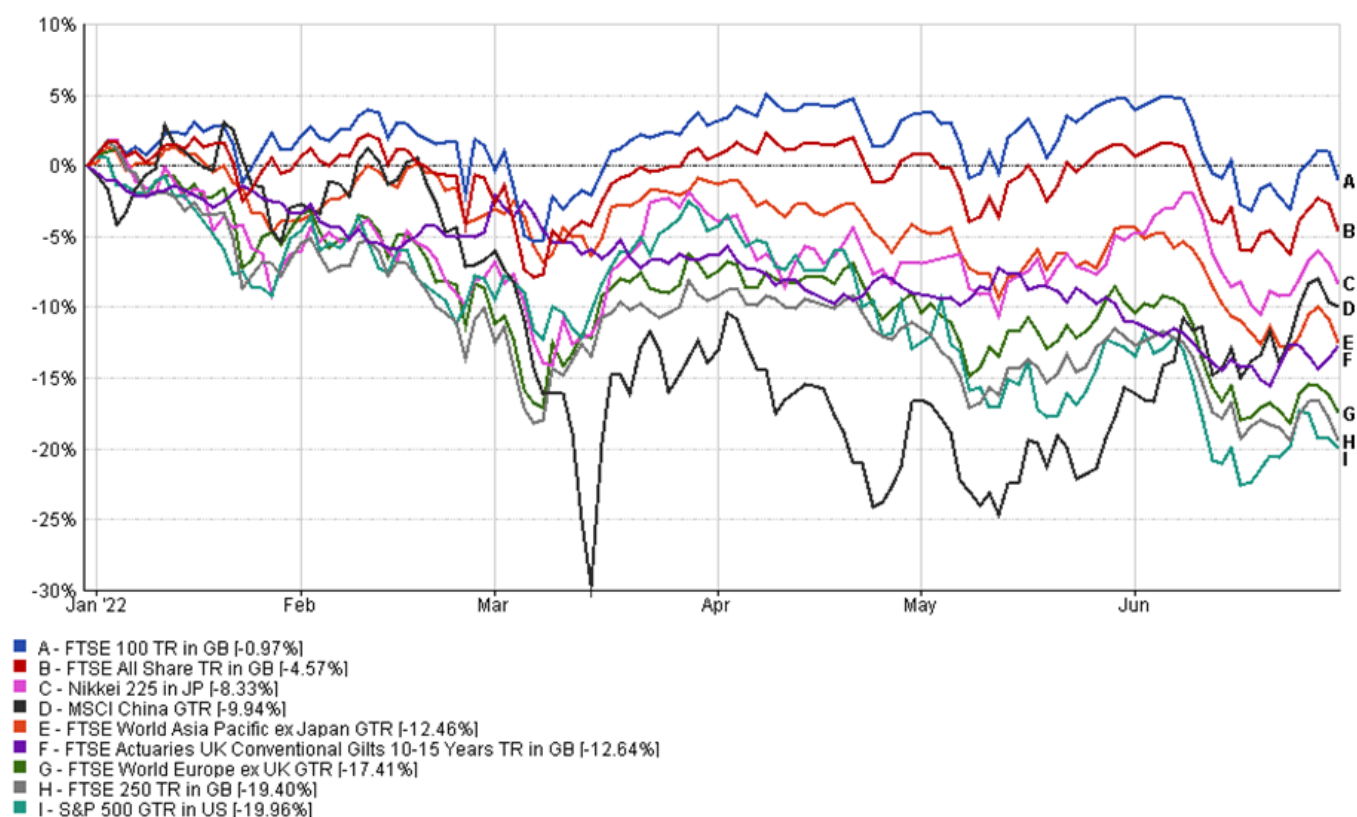
Since our last investment commentary (17 June 2022), equity markets have remained volatile but the more growth-oriented US equity market has made strong gains very recently. The Japanese and Chinese markets have recovered to some extent. Despite this short term uptick, the year to date figures show losses for all major markets. Although still losing value, the UK equity market has performed better than other markets due to its greater exposure to cyclical/defensive companies with strong cash flows, which have made reasonable returns in the face of rising interest rates and higher energy and commodity prices.

INVESTMENT MARKET STERLING RETURNS FROM 17 JUNE 2022



17/06/2022 - 11/07/2022 Data from FE fundinfo2022

INVESTMENT MARKET LOCAL RETURNS JANUARY TO JUNE 2022



31/12/2021 - 30/06/2022 Data from FE fundinfo2022

The first half of 2022 saw the S&P 500 index record its sharpest drop in fifty years, as the US Federal Reserve (Fed) raised interest rates and indicated that even tighter monetary policy would be required to tackle above target inflation. More recently, US and European equity markets have risen as investors considered whether the central banks may need to temper their plans for interest rate rises as global economic growth slows. Recent economic data point to weaker business activity in Europe and the US with US consumers tightening their spending. Recession fears have strengthened with the US Treasury market warning of recession as the 10 year Treasury yield remained below the two year Treasury yield ie an inverted yield curve. However, stronger than anticipated US employment data for June 2022 saw the number of new jobs increase sharply and the unemployment rate stabilise at a historically low level of 3.6%. Wages have increased by about 5.1% pa in the US. Against this background, the US Federal Reserve is likely to increase the Fed Rate significantly - by another 0.75% - at its policy meeting later this month. US interest rates could reach 3.5% by the end of the year, a level at which economic activity would be severely squeezed. The Fed believes that to combat above target inflation it would require “some slowing in economic growth and tempering in labour market conditions”.

In the face of recessionary risks and possible falling demand, commodities prices have fallen, including the oil price, which has slipped from over \$120 per barrel in mid-June to around \$100 as we write. A weaker global economy together with falling commodities prices should have a significant impact on inflation. However, the fall in commodities prices is not due to an increase in supply but speculators believing that demand will decrease as global economic growth slows.



Western investors had started to invest heavily in Chinese equities once again as strict lockdown measures were reduced and Chinese regulators signalled an easing in the way that technology companies are policed. As the lockdowns eased in May, manufacturing activity and domestic demand increased. The Chinese authorities were able to stimulate the economy further in terms of interest rate cuts, fiscal stimulus and infrastructure spending. Until very recently, the Chinese equity market had started to outperform other leading equity markets which were negatively affected by stagflation worries. However, as we have seen over the past few days, it is unlikely that China's zero Covid policy will disappear anytime soon given President Xi's commitment to it. Restrictions have once again been introduced in six cities in China, including Shanghai, affecting some 30 million people. Consequently, the prospect of lower demand for commodities has impacted on oil and metals prices and on investor sentiment.



It should be remembered that high levels of inflation, rising interest rates and a global economic slowdown will impact on prospective company earnings as seen in the performance of equity markets over the first half of 2022. Economically sensitive sectors, such as consumer discretionary and IT, have seen the largest outflows. There has been a shift towards more defensive sectors such as consumer staples and healthcare, but even the earnings of these types of companies will be affected by weaker economic growth.



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

As inflation remains above target, the central banks continue to raise interest rates and the global economy slows, investment markets are likely to remain unsettled over the summer, exacerbated by the thin trading typically seen during the summer holiday period. We are expecting company earnings to be less robust. A lot of the bad news is probably priced in – take UK smaller companies which have fallen around 28% from their peak in September 2021 as measured by the IA UK Smaller Companies sector average. Many of the companies have strong cashflows and balance sheets. There is scope for these types of companies to survive the economic downturn and prosper, whether independently or as potential M&A targets. Fixed interest assets have fallen sharply over the last six months against the backdrop of above target inflation and rising interest rates. Uncertainty abounds due to the range of possible outcomes for inflation. A very severe recession appears to be priced in, but strong balance sheets and very low employment should offer support to credit markets.

Commercial property funds have offered positive returns this year as the income stream arising from the asset class proves attractive during periods of higher inflation.

It is vital to remember that the after-effects of the 2008/2009 'great global financial crisis' continue to overshadow credit markets. There is a limit to how far interest rates can rise to curb inflation – without 'killing the patient'. In the US the limit or 'terminal rate' is thought by analysts to be 3.50% p.a. and in the UK as low as 2.50% p.a. The maximum the Eurozone can bear is probably less. These factors combined with the Bank of Japan holding out against higher interest rates, suggest the world must live with a strong dollar for some time to come. Much of the selling in global equity markets in anticipation of potential recession appears overdone and 'value' is now exposed, with the FTSE 250 just one example. The point will be reached at which buyers return according to herd instinct but probably not until later this year, when the outlook for global inflation and interest rates will become clearer together with the prospects for global growth.



OUR VIEW continued

As we have said previously in our 'Commentary' the situation in Ukraine and sanctions against Russia are merely contributory factors because the resultant rise in oil and gas prices fuels inflation rates. Conversely, higher energy prices act as a drain on consumer consumption and squeeze spending on other goods and services. In this sense, they provide an alternative to higher taxes or interest rates as a means of controlling inflation.

Russia is threatening to 'weaponise' gas supplies to Germany and certain former client states in Eastern Europe. Turning off 'Nordstream 1' for essential maintenance is gamesmanship. Certainly it puts pressure on the states concerned but it is generally thought that sufficient gas can be supplied from elsewhere to keep 'the lights on and the wheels turning' over the winter. Inevitably, European markets are currently alert to fears this may not be the case and are suffering disproportionately in consequence.

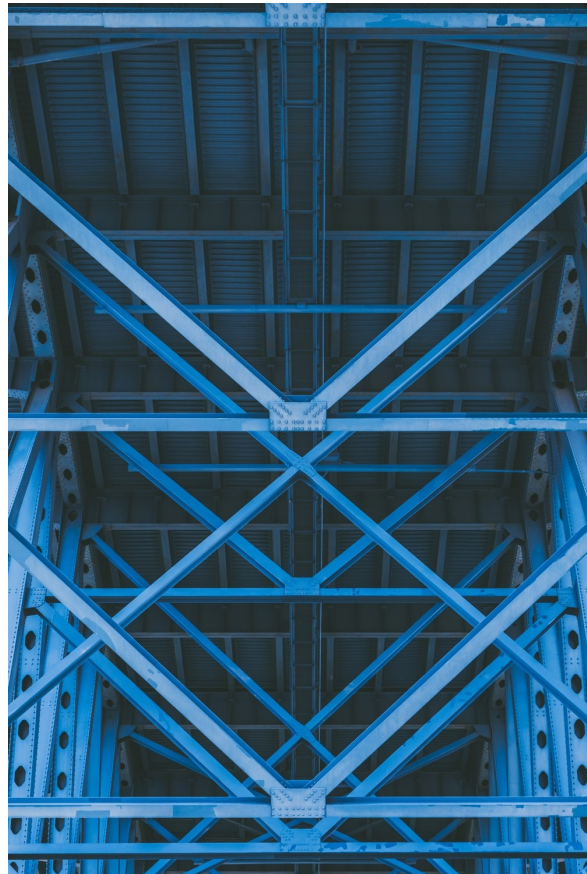
Portfolios have lost ground over the past six months and with the exception of commercial property, assets have fallen in value. Bonds have in some cases suffered similar losses to equities. Undoubtedly, volatility will continue for some time yet but statistical evidence strongly suggests a strong rally to come - for all it does not guarantee it. For investors, the 'white knuckle ride' downwards is uncomfortable although the elimination of over-ripe valuations is often cathartic. The long haul upwards, often in short, sharp bursts, is infinitely more desirable and it always happens eventually.

As we never tire of saying, Cartledge Morland portfolios are highly diversified mitigating downside risks and positioned to take advantage of a wide range of profit making opportunities in the longer term. We will not sell assets when prices are 'at the bottom' unless we consider recovery will take too long and potentially higher returns might be achieved by investing in different funds or asset classes. Smaller companies and mid-cap positions have suffered disproportionately but limited market coverage by analysts of the stocks concerned typically leads to over-reaction when markets turn sour. Fundamentals will re-assert themselves in due course.

If you have any queries do not hesitate to contact your usual Cartlidge Morland consultant.

OUR VIEW continued

With income generation in mind over this period of unsettled markets, we have included more equity income fund exposure in portfolios as yields have become more attractive and the funds have a bias towards companies with strong balance sheets and strong dividend cover. Even some technology companies have made their way into income funds as their yields have risen as their share prices have fallen. We believe that infrastructure assets should now be included in some portfolios for the diversification that they offer coupled with strong income streams. Companies which provide 'pipes and wires' for energy suppliers in regulated industries offer attractive, inflation linked income with some potential for capital return too. As the world moves towards achieving net zero carbon targets, governments will have to ensure that significant investment is made in new technologies and in the infrastructure to support them.



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