CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY

20 DECEMBER 2022

OVERVIEW

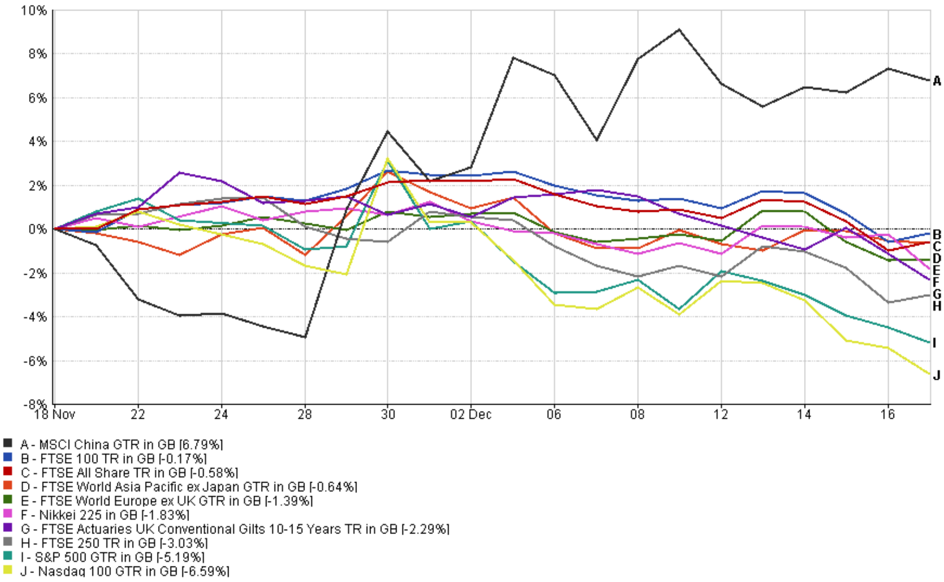
The last month has seen investment markets largely moved by two themes – the possibility that inflation has peaked so leading to less aggressive monetary tightening by central banks and China moving away from its strict zero- Covid policy.

The biggest challenge for most economies this year has been inflation running at levels way above target. Central banks have taken action to combat inflation by reducing demand through increasing interest rates aggressively. Even the Bank of Japan (BoJ) has now tweaked its ultra loose monetary policy by widening its 10 year Japan Government Bond yield target to +/-0.5% from +/-0.25%. The investment markets have been closely watching for indications that inflationary pressures are easing which would imply that central banks would pivot and ease monetary policy. There have been a number of false dawns which have seen equity market rallies, but the November US inflation figure of 7.1% pa (falling from 7.7% pa in October) was lower than expected providing some evidence that inflation had peaked. Petrol prices in the US have fallen as well as agricultural prices, so leading to lower food prices. Core inflation, which excludes energy and food prices, also fell. Currently there seems little sign that wage rises are stoking inflation. This better news on inflation saw global investment markets rise sharply. In the UK, November's inflation figure was lower but an above target level may prove to be more persistent as any fall in the oil price has less of an impact than in other economies due to the high level of fuel taxation. Utility bills may also increase from April 2023 after the current price cap lapses.

One of the key concerns for 2023 is the prospect of a global recession. The inverted US yield curve (the difference between the two year and ten year US government bond) is indicating a high risk of recession. The market is currently predicting that US interest rates will peak in the early part of 2023 and then start to fall. The US Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB) have increased interest rates aggressively throughout 2022 as they seek to slow demand. Following their December meetings, all three central banks eased the pace of their interest rate hikes, each increasing rates by 0.5% in the face of inflation seemingly moderating. Nevertheless, the Fed and ECB were united in their respective decisions, but remained hawkish in their rhetoric. Jay Powell, Chair of the Fed, is not currently expecting a recession and warned that interest rates would not fall as the market was anticipating. The ECB expects inflation to remain above target through to 2025, so interest rates will have to rise significantly. The Bank of England's Monetary Policy Committee had a three way split with two members wishing to leave interest rates unchanged and one wanting a further 0.75% rise. The UK is very likely in recession as the third quarter saw GDP contract by 0.2% and indicators point to a further contraction, although mild, in Q4. These relatively hawkish tones from central banks were unexpected as inflationary prospects appeared to have improved, consequently equity and bond markets fell.

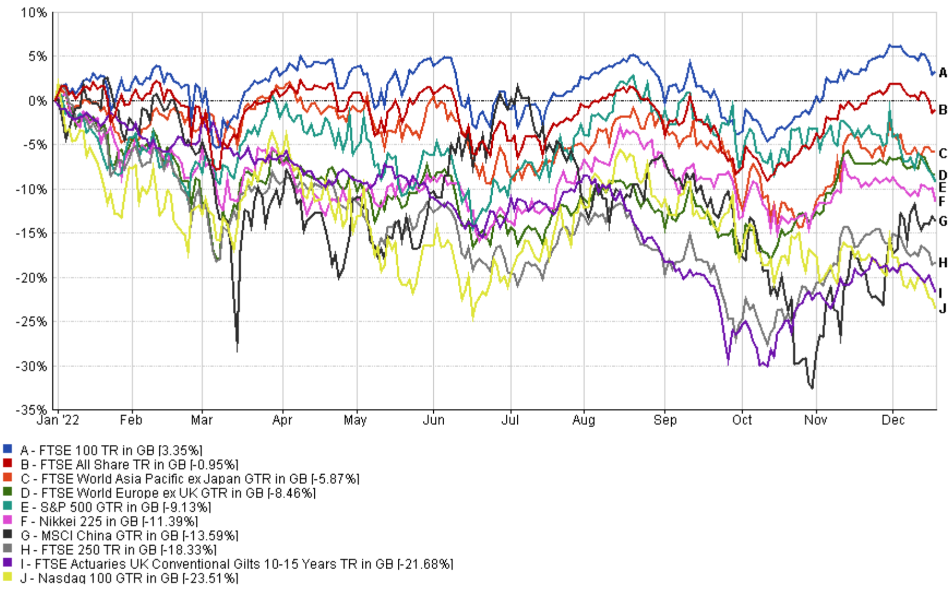
Asian markets had risen in recent weeks following China relaxation of some of its onerous Covid-19 restrictions after widespread protests against three years of rolling lockdowns. As the restrictions are lifted it is likely that the infection rate will soar, as many people remain unvaccinated. China's zero-Covid policy has put a tremendous strain on its economy with growth slowing. Covid constraints have seen international companies relocating their supply chains away from China, benefiting countries such as Vietnam and Mexico. It will take time for the Chinese economy to reopen fully as lockdowns could be re-introduced along the way. However, the change in policy has led to markets anticipating increasing economic growth over the medium term. Hong Kong shares were also given a boost very recently when a ten year stand-off over audits between Chinese and the US regulators appeared to be resolved. The US had threatened Chinese companies with being forced off New York stock exchanges if they did not have access to the work of auditors in China. Access has now been agreed.

ONE MONTH INVESTMENT MARKET STERLING RETURNS



18/11/2022 - 19/12/2022 Data from FE fundinfo2022

YEAR TO DATE INVESTMENT MARKET STERLING RETURNS



31/12/2021 - 19/12/2022 Data from FE fundinfo2022

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge 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

2022 has been a difficult year for bond, equity and property investors. Even cash investments have been severely impacted by high inflation. The dreadful war in Ukraine, above target inflation, aggressive monetary tightening by the central banks, a strong US dollar and slowing economic growth all weighed on investment markets. There have been periods of optimism as markets anticipated easing of monetary policy as growth slowed and inflation appeared to be moderating. The FTSE 100 index (the hundred largest UK listed companies) has been the best performing index of the developed markets helped by its exposure to the energy and mining sectors coupled with its overseas earnings. The Nasdaq which had performed so strongly in recent years experienced a sharp fall as a result of rising interest rates, leading to values of the future earnings of many of its constituent companies being reduced and impacting on their share prices. Above target inflation and rising interest rates have also taken their toll on the prices of government bonds. As government bond yields have risen and looked more attractive, investors have sold riskier assets such as commercial property to take advantage of them.

Heading into 2022, it now appears that inflation has peaked although it is likely to remain above target for some time to come. Therefore, central banks will continue to raise rates until they believe that inflation is definitely heading towards target. There is a chance that they will overtighten and recessions of varying degrees will occur around the world. We continue to stay invested in a mix of equity funds, both income and growth oriented with some passive exposure. The yields of high quality fixed interest assets do look more attractive and we have increased holdings as appropriate. We expect equities to recover but cannot say when, and believe that clients should remain invested so that they participate in the equity market recovery when that occurs.

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OUR VIEW .... Continued

The past twelve months have been especially painful for those reliant upon their portfolios for income. Drawing income whilst portfolio returns are neutral or even negative, exacerbates declines in portfolio values and increases income withdrawal rates. To maintain cash coverage for withdrawals we have been selling either assets that have maintained price stability, or which appear unlikely to offer significant upside as the investment tide turns. Carefully selected risks are usually strongly rewarded over time – market losses generally become embedded to only a limited degree – but keeping cool heads during an exceptionally difficult period of the market cycle is difficult for all concerned. Ultimately, patience and steadfastness will be rewarded rather than knee-jerk reactions.

CHRISTMAS CLOSING

Our offices close at 2.00 pm

on Friday 23 December 2022

and

reopen at 9.30 am on

Tuesday 3 January 2023.

We take this opportunity to wish all clients a very Merry Christmas and our best wishes for 2023.

CARTLIDGE MORLAND

83-85 Mansell Street London E1 8AN
t: +44 (0)20 7709 5560
e: enquiries@cartlidgemorland.com
www.cartlidgemorland.com