Investment Comment

03 March 2022

We are shocked and saddened by the events that have unfolded in Ukraine in the last seven days. We must acknowledge that this is first and most importantly a human crisis with horrific consequences for millions of people. We all express our desire for a just peace as soon as possible.

Public fear and uncertainty have translated into heightened market volatility with the VIX surging to a one year high late in February. Equity markets were broadly down on the month with the MSCI All Country World Index (ACWI) falling 2.6%. Bonds performed similarly to equities, but commodities rallied strongly amid heightened supply concerns.

The MSCI USA Index posted a monthly loss of 3% in February. Consumption in the US remains strong as indicated by the 3.8% rise in retail sales in January and strong flash PMI data in February. However, with continued demand and soaring energy prices affecting business costs, inflation in January again surprised to the upside climbing to 7.5%. Markets still expect an interest rate rise this month and further monetary tightening from the Fed this year, but due to uncertainty over the global growth implications of the conflict in Ukraine, expectations for aggressive near term moves have eased. The US has imposed wide ranging sanctions on Russia in response to their invasion of Ukraine. Along with the UK, EU, and Canada, they have elected to freeze the assets of some of the largest Russian banks and have removed some from the Swift international payments system. They have also targeted Russia's military capabilities by restricting high end technology and chip exports.

Europe was the worst performing major market, falling 3.9% over the month. Much of the data released in February indicated that the European economy was in good health, with unemployment falling to 7% and service sector activity rebounding to pre-Omicron levels. However, amid rising energy costs, inflation rose to a new high of 5.8% in the Euro Area. The US and 30 allied countries are set to release 60 million barrels of oil in an effort to contain the oil price surge, but with around a quarter of the EU's crude oil imports and 40% of its natural gas imports coming from Russia, the EU may be more economically challenged over the short term than other economies. Markets seem to have acknowledged this and now view a policy rate hike in 2022 as unlikely.

The UK equity market was flat over the month, reflecting the index's weighting to energy and mining stocks. PMI survey data revealed the strongest growth in services activity since June last year amid looser pandemic measures. Inflation edged up 10 basis points to 5.5%, a new 30-year high. Although markets still expect the Bank of England to raise interest rates by 25 basis points this month, the potential growth implications of the Ukraine conflict resulted in a dampening of 2022 rate hike expectations compared with the intra-month peak. As well as the institutional sanctions imposed, the UK government have also frozen the assets of nine oligarchs with reported links to the Russian government and are drawing up plans to seize UK land and property belonging to these individuals.

The MSCI Asia Pacific ex-Japan Index fell 2.3% in February. China continues to buck the global inflation trend, with consumer prices in January rising by just 0.9%. Unlike most developed markets where recent PMI data has indicated strong demand and economic expansion, China's Composite PMI in February signalled only marginal expansion with survey constituents such as employment and export sales still contracting. Policymakers have vowed to stabilise growth this year so market attention has now turned to this month's annual meeting of China's top legislative body where economic targets and potentially more stimulus measures will be announced. Chinese local governments and state-backed entities have recently begun financially backing the 'metaverse', an

alternate digital reality where people work, play and socialize. During the month, seventeen new companies were added to the recently formed Metaverse Industry Committee. This move should reassure investors that despite imposing restrictions in technology and gaming last year, the Chinese government are still encouraging innovation and emerging technologies.

Japanese equities continued to struggle in February, with the MSCI Japan Index down 1.1%. Renewed COVID-19 restrictions and ongoing supply chain disruptions resulted in slower expansion in the manufacturing sector and a further contraction in the service sector. At the corporate level, Toyota has been forced to shut down all of its plants across Japan after a suspected cyber-attack on one of the carmaker's largest parts suppliers. The news comes just days after Japan joined other G7 nations in applying tougher sanctions on Russia. On trade, an agreement was reached between the US and Japan on steel which will suspend the 25 per cent levy on steel imports that was imposed during Donald Trump's presidency. The deal is similar to the one agreed by President Biden with the EU in October.

Historically, elevated geo-political risk has tended to increase market volatility and has often resulted in negative equity returns over short time periods. Thus far we have experienced the former, but since the invasion date itself, the latter has not transpired. History has also shown that selling assets during these periods can be detrimental to long term portfolio returns. We will continue to assess the implications of the conflict on different asset classes, but we have confidence that remaining invested in our diversified portfolios is the best course of action for clients.

cantabam.com

Cantab Asset Management Ltd
50 Station Road, Cambridge CB1 2JH
01223 52 2000
advice@cantabam.com

5th Floor, 8 Angel Court, London EC2R 7HP
020 3651 0570
advice@cantabam.com