Cantab
ASSET MANAGEMENT

Investment Comment

07 June 2022

Global equities, as measured by the MSCI ACWI, ended May almost flat after significant intra-month volatility. The principal drivers of investor sentiment over the month were: central banks wrestling with a growth-inflation trade-off, the persisting Russia-Ukraine war, and economic growth concerns in China.

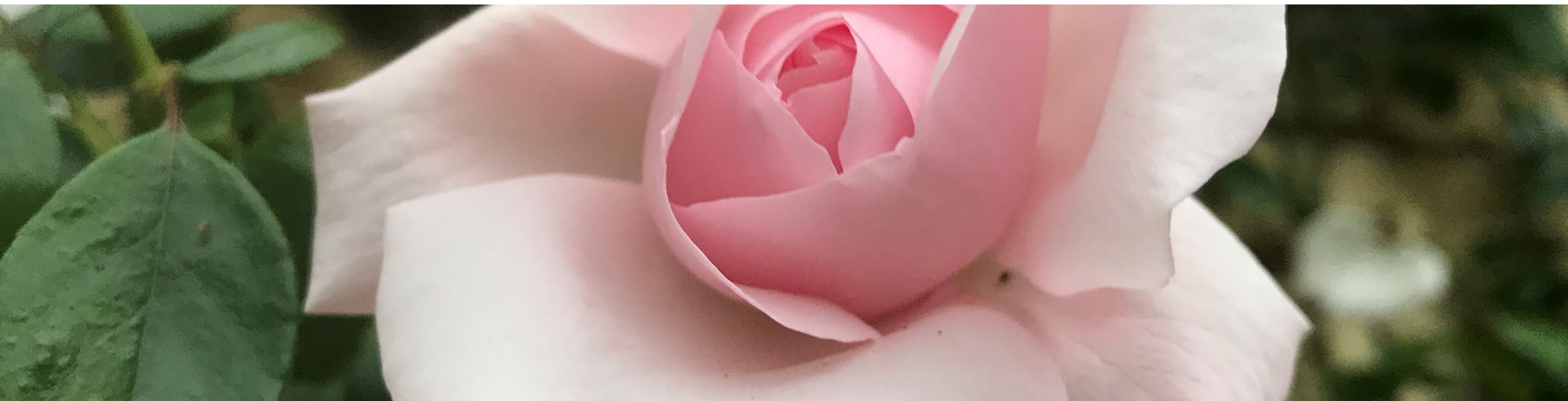
After extreme equity market volatility, the MSCI USA Index eventually settled just 0.65% down on the month. The Federal Reserve raised interest rates by 0.5% in May, with Federal Reserve Chair Jerome Powell commenting that monetary policy will continue to tighten until it is clear that inflation, currently at 8.3%, is returning to their 2% target. Markets are now pricing in 50-basis-point hikes in June and July but are less certain on the size of the September hike. Powell also indicated, for the first time, that the Federal Reserve may struggle to deliver a 'soft landing' (cyclical slowdown which avoids a recession), conceding that economic slowdowns in China and Europe will make this difficult. The idea that the US may suffer a 'hard landing' in 2023 was reinforced by a 1.5% GDP contraction in Q1 and US manufacturing output showing signs of slowing. The US 10-year Treasury yield was choppy through May, as bond markets anticipate further monetary tightening amid the backdrop of stubborn inflation and slowing growth.

The MSCI Asia Pacific ex Japan and MSCI Emerging Markets Indices were both flat over the month. Growth concerns in China have been exacerbated by severe lockdowns. However, contrary to most central banks, The People's Bank of China (PBoC) does not have high inflation to address and thus continues to loosen monetary policy. The PBoC cut its main mortgage interest rate from 4.6% to 4.45% in May, the biggest reduction on record, to support the property sector and stimulate growth. Covid infections fell and Chinese manufacturing and non-manufacturing PMIs beat expectations, reflecting improving demand conditions. That said, the PMIs remain in contractionary territory. The month ended on a positive note with a technology sector rally in China after a number of the big technology names, including, Alibaba, Baidu and JD.com, beat analysts' earnings expectations.

Japanese equities rose 1.25% in May, as measured by the MSCI Japan Index. Despite the consumer price index rising 2.5% year on year in April, the most since October 2014, the Bank of Japan (BoJ) remains committed to its dovish policy stance, leaving the key short-term interest rate unchanged at -0.1%. BoJ Governor Haruhiko Kuroda stated that "there has been no sharp increase in medium- to long-term inflation expectations as the rise in prices driven by energy prices lacks sustainability". Japan is also slowly embracing a wider re-opening of its borders after a prolonged period of strict Covid protocols. It has now doubled the daily cap on the number of visitor arrivals to 20,000 and is announcing a timeline for further relaxation of the rules over the summer months.

The MSCI Europe ex-UK Index was flat over the month, as investors continue to weigh up the headwinds of the Russia-Ukraine war, inflation, and policy normalisation. European Central Bank (ECB) sentiment shifted towards more aggressive monetary tightening throughout May to address the record 8.1% Eurozone inflation and the highest inflation seen in Germany in nearly half a century. This inflation data has strengthened the case for a 0.5% ECB interest rate hike in July, though Chief Economist Philip Lane has stated that quarter point rises will be the benchmark. Whilst there is no sign of a resolution to the war in Eastern Europe, the EU has also unveiled its REPowerEU plan to transition away from Russian oil and gas. This would likely result in the bloc using 5% more coal over the next five to ten years and more nuclear power, sparking criticism from environmental groups. The plan includes a ban on most Russian oil imports as the EU seeks to deprive Putin of this source of revenue but includes a temporary exemption for pipeline-delivered oil in order to give Hungary, Slovakia and the Czech Republic time to wean off Russian crude oil supplies.

The MSCI UK Index posted a 0.88% monthly gain in May, with a large weighting to the energy sector continuing to support UK equities. As expected, the Bank of England raised interest rates by 25 basis points to 1% as inflation forecasts now project an inflation



rate exceeding 10% by autumn of this year. Inflation rose from 7% to 9% in April, with the Office for National Statistics stating that the 54% increase in Britain's energy price cap in April caused almost three quarters of this rise. Whilst the labour market remains tight, with unemployment at its lowest since 1974, other economic data was less positive. The UK May business surveys softened, consumer confidence was at its lowest on record and March GDP contracted 0.1% month-on-month. There are, however, hopes that Chancellor Rishi Sunak's plans for a windfall tax on energy companies will provide meaningful support to lower income households.

As businesses, governments, and central banks attempt to navigate this period of higher inflation, we are reminded of the importance of investing in a diversified portfolio with exposure to a range of asset classes. We continue to recommend following the empirically supported advice to stay invested in such a portfolio through periods of distress and volatility.

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