Cantab
ASSET MANAGEMENT

Investment Comment

01 July 2022

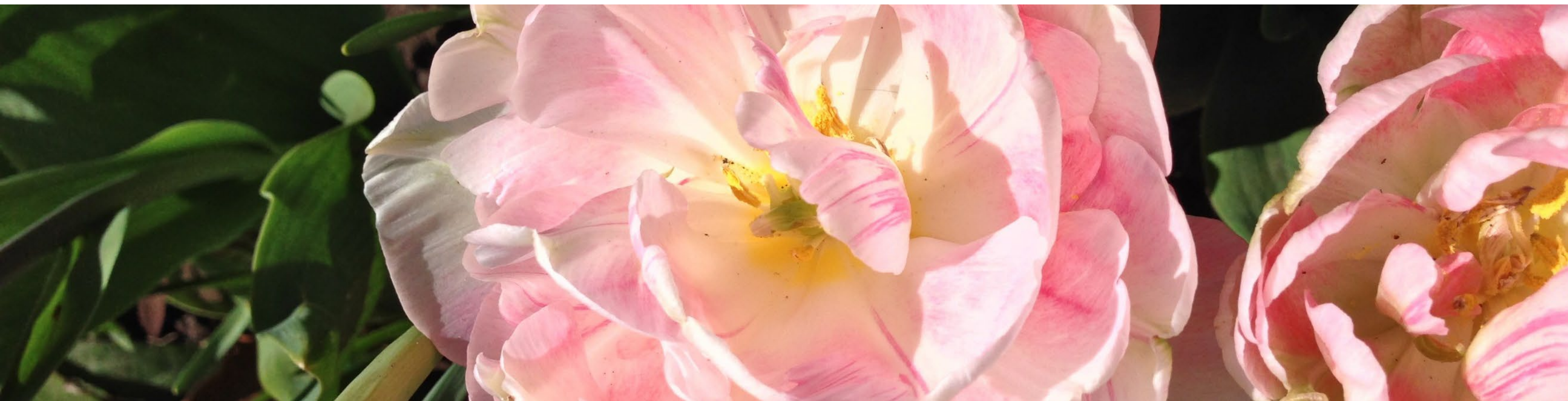
Sterling denominated returns of major indices	Q2 2022 %	H1 2022 %	Year 2021 %	Year 2020 %	Year 2019 %	Year 2018 %
Equities						
UK	-4.8	-2.9	18.7	-11.8	18.4	-9.8
World (ex UK)	-9.3	-11.4	19.6	14.0	22.0	-3.5
Emerging Markets	-4.8	-8.1	-1.7	14.7	13.8	-9.2
Fixed Interest						
Overseas Bonds (unhedged)	-0.3	-4.3	-4.4	5.6	2.7	5.1
Corporate Bonds	-6.7	-12.4	-3.0	8.0	9.5	-1.6
Property	-12.7	-14.1	20.8	-9.5	22.4	-7.8
Cash	0.1	0.0	0.0	0.0	0.0	0.0

Source: MSCI UK IMI, All Country World Ex-UK, Emerging Markets, UK IMI Liquid Real Estate, Cash Equivalent (GBP 1W LIBOR -1%); BofA ML: Global Broad Market+, Sterling Non-Gilts. Total Return, Sterling adjusted.

2022 is shaping up to be a very different year to 2021. The conflict in Ukraine has created the greatest European security threat since World War II. The recovery from Covid-19 is fractured with supply chain disruptions across the globe, and a new era of aggressive monetary tightening in the face of sharply higher inflation is redefining the investment landscape. As a result, the first half of 2022 concluded with fixed income and equity markets posting substantial losses. Energy is the only positive equity sector year to date whilst assets at the top-end of the risk spectrum, illustrated starkly by cryptocurrencies, have plummeted. Global equities in dollar terms were down 15.79% on the quarter but the relative dollar strength meant that in sterling terms the global equity MSCI ACWI index was only down 9.12%.

The MSCI USA Index posted a quarterly loss of 9.88% as investors weigh the increasing possibility of a US recession. Yields on 10-year Treasuries have doubled since January as inflation, after moderating slightly in April, surprised to the upside in May, reaching a four decade high of 8.6%. The Federal Reserve reacted with a 75-basis point interest rate hike in June, its largest rate rise in nearly 30 years, exceeding initial expectations and pushing the funds rate to 1.75%. 30-year mortgage rates have jumped from c.3% to c.6% this year and the US housing market appears to be softening. PMIs came in below expectations and consumer confidence is weakening. Such decelerating macro data, whilst indicating slowing growth, may at least put the brakes on inflation and reduce the need for such steep rate hikes. A 'soft-landing', however, whereby inflation is brought under control without tipping the US economy into recession, seems increasingly unlikely, albeit not impossible.

The MSCI Europe ex-UK Index dropped 8.65% in Q2 as Putin's brutal offensive in Ukraine persists and the European Central Bank (ECB) faces the same balancing act as the Fed between inflation and growth, only with more sustained energy price pressure. With pipeline throughput of Russian gas currently operating at 40% capacity, energy security has raced up the agenda for European nations and the EU has unveiled its REPowerEU plan to transition away from Russian gas. This is, however, not a short-term fix, and



with energy prices up c.39% year on year, inflation at 8.1% and eurozone wage growth expected to double to 4% this year, ECB sentiment has turned more hawkish. Despite reduced growth forecasts and sinking consumer confidence, net asset purchases will end on 1 July and interest rates will be raised by 25 basis points, also in July, the first rate hike in 11 years. European debt sold off sharply in response, prompting the ECB to announce the launch of its 'anti-fragmentation' tool. The idea is to support bond markets and tighten spreads in countries like Spain and Italy where yields have risen more rapidly, and hopefully avoid another Eurozone debt crisis.

The MSCI UK Index fell 4.46% over the quarter. Whilst UK equities have held up relatively well this year, reflecting the index's exposure to energy and mining, monetary policy remains the principal focus for investors. Inflation read 9.1% in May and is now forecast to exceed 11% in October when the next energy price cap increase is expected. The Bank of England raised interest rates by 25 basis points twice over the quarter, pushing borrowing costs to 1.25%. Concurrently growth expectations slowed, the housing market showed signs of cooling, unemployment ticked up by 10 basis points to 3.8% and retail sales weakened. On a more positive note, some indicators show that the UK could be approaching peak inflation and there are hopes that Chancellor Rishi Sunak's plans for a windfall tax on energy companies will provide meaningful support to those lower income households disproportionately impacted by the rising prices.

The MSCI Asia Pacific ex-Japan Index posted a quarterly loss of 3.04% as a June rebound in Chinese equities partially offset weakness in Australian, Taiwanese, and Indian markets. After Shanghai spent April in lockdown, with some companies even employing a 'Living at Work' scheme, an easing of restrictions through May and June was met with investor optimism. In addition, contrary to most central banks, a modest 2.1% inflation rate allowed The People's Bank of China to loosen monetary policy through an interest rate cut and increased infrastructure spending without de-anchoring inflation expectations. Chinese manufacturing and services sectors expanded in June for the first time in four months and technology stocks were given a boost as Beijing announced its intention to reduce uncertainty around regulation. However, concerns over China's 'zero-Covid' policy and the low vaccination uptake among the elderly persist.

Japanese equities continue to struggle, with the MSCI Japan index falling 7.44% over the quarter. As with China, the May inflation reading of 2.5% allowed the Bank of Japan (BoJ) to maintain its ultra-loose monetary policy, leaving the key short-term interest rate unchanged at -0.1% and vowing to maintain bond yields "around zero". This dovish stance, in combination with the Fed's aggressive monetary tightening, has exacerbated a dramatic drop in the value of the yen to a historic low against the dollar, putting pressure on Governor Haruhiko Kuroda to raise rates. Although PMIs are climbing and inflation was slightly ahead of the BoJ's 2% target, Kuroda still believes the economy is too weak to tighten monetary policy. Japan is at least now slowly embracing a wider re-opening of its borders after a prolonged period of strict Covid protocols, which should aid growth.

The MSCI Emerging Markets Index lost 4.00% over the quarter. The Russia-Ukraine war remains intense and devastating. Ukraine reported that the number of Russian missile attacks more than doubled in the last two weeks of June and the UN has warned that nearly 16 million people in the country need humanitarian assistance. Eastern Europe continues to feel the effects of the war through soaring energy prices and the direct impact on trade, whilst net commodity exporters such as Brazil are benefitting from spiking commodity prices. Historically, a strengthening US Dollar and rising US Treasury yields has negatively impacted developing economies, particularly those economies with large dollar-denominated debt. However, inflation is softening in developing economies where rates were raised earlier than their developed market counterparts. Valuations in emerging markets look relatively attractive, and there are signs of a tentative economic recovery in China.

Two interesting quotes from the ECB Forum in Portugal last week: "it's not a science, what we are doing, there is an element of art" and "we now understand better how little we understand about inflation". These comments were from the ECB President Christine Lagarde and Federal Reserve Chairman Jerome Powell, respectively. We continue to reflect on the difficulty of forecasting and navigating economic cycles. As the celebrated economist, Paul Samuelson, commented many years ago - the stock market has predicted nine of the last five recessions.

At Cantab, we do not attempt to make major macroeconomic calls, but rather build defensive characteristics into portfolios to navigate volatile markets with caution. We continue to encourage clients to stay invested, stay diversified and to focus on long-term objectives. With uncertainty comes opportunity.

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