Cantab
ASSET MANAGEMENT

Investment Comment

03 January 2023

Sterling denominated returns of major indices	Q4 2022 %	H2 2022 %	Year 2022 %	Year 2021 %	Year 2020 %	Year 2019 %
Equities						
UK	8.8	4.6	1.6	18.7	-11.8	18.4
World (ex UK)	1.6	3.2	-8.6	19.6	14.0	22.0
Emerging Markets	1.8	-2.1	-10.0	-1.6	14.7	13.9
Fixed Interest						
Overseas Bonds (unhedged)	-3.2	-2.2	-6.4	-4.4	5.6	2.7
Index-Linked Gilts	-6.0	-15.1	-34.5	3.9	11.3	6.3
Corporate Bonds	6.2	-6.1	-17.8	-3.0	8.0	9.5
Property	3.5	-12.0	-24.4	20.8	-9.5	22.4
Cash	0.5	0.7	0.8	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%); ICE BofA Global Broad Market+, Bloomberg UK Government Inflation-Linked Bond, ICE BofA Sterling Non-Gilts. Total Return, Sterling adjusted.

It is safe to say that 2022 has been something of a rollercoaster year for capital markets. Geopolitical issues have dominated headlines and had wide ranging impacts. While Putin's war in Ukraine that began in February must be considered primarily from a humanitarian standpoint, its impact on markets has been profound. Russia's weaponisation of gas supplies to Europe has seen extreme volatility in energy markets. Runaway energy prices have been a key factor in the other dominant story in markets in 2022: inflation. After a decade of low inflation and accommodative monetary policy, 2022 saw rising price levels, propelled by the rising cost of energy, central banks gradually became more hawkish and began to tighten, with global interest rates widely ending the year at their highest levels in well over a decade. This investment comment focuses on the main drivers of market movements over the three months to 31 December 2022.

The MSCI USA index posted a quarterly loss of 0.7% in sterling terms. Markets largely rode out weak earnings reports from the S&P's heavy hitters at the start of the quarter and were buoyed by US inflation data surprising to the downside, which prompted analysts to believe that the Federal Reserve may soon slow the pace of its monetary tightening. The Fed settled for a 50 basis point rise in December following several 75 basis point increases, leaving the borrowing rate at 4.5%. With the Fed having stated they expect rates to rise to between 4.5% and 5% it may be that we are nearing the end of the rate hiking cycle. The Fed has indicated that rates are likely to remain high in the short to medium term. Weaker than expected retail sales data in November and weak business survey data demonstrate the delicate balancing act facing the Fed in controlling inflation while avoiding plunging the economy into a protracted recession. The US labour market has, however, remained strong and posted average monthly job gains of 272,000 over the past three months, figures which have provided relief to the White House. Despite strong Democrat performance in the midterm elections, the Republicans will take control of the House of Representatives in January, which is likely to restrict the Democrats' ability to pass meaningful legislation.

The MSCI Europe ex-UK Index rebounded 11.5% over the quarter. After the euro fell below parity with the dollar for the first time since 2002 at the end of the previous quarter it rose markedly to finish December trading at $1.07. Easing inflationary pressures across the quarter have provided some much needed relief: November's inflation data showed a fall in the Eurozone price level for the first time in 17 months, as inflation fell more than expected to 10.0% from October's reading of 10.6%. Elsewhere, in Spain, the first Eurozone country to report inflation data for December, the fall in inflation again outstripped expectations and has provided hope of a quicker decline in inflation across the bloc. The ECB has been careful to guard against the notion that this may lead to a more dovish pivot and implemented a 50 basis point rise at its December meeting, leaving its benchmark borrowing rate at 2%, the highest level seen since the financial crisis.

The MSCI UK Index surged 8.8% in the three months to 31 December. Another quarter of political turnover in the UK saw Liz Truss replaced by Rishi Sunak as Prime Minister and Jeremy Hunt assuming duties as Chancellor of the Exchequer. The Bank of England ('BoE'), like the Fed and ECB implemented a 0.5% rate rise in December. Governor Andrew Bailey said that he expects a rapid fall in inflation 'probably from late spring onwards'. The rise in rates was mainly motivated by a tight labour market which provides persistent inflationary pressure. Higher mortgage rates have led to four consecutive months of house price declines, the most prolonged period of falls since the financial crisis. The BoE expects a 0.1% contraction in GDP for the final quarter of 2022, which would put the UK into a technical recession; however the BoE adjusted their forecasts upwards in December to predict a shallower recession than forecast a month prior.

The MSCI Asia Pacific ex-Japan and MSCI Emerging Markets Indexes posted quarterly losses of 4.0% and 1.8% respectively. After China began the quarter by re-electing President Xi Jinping for a third term and a ripple was felt across markets as his selection of loyalists prompted fears that China would continue to focus on its zero-covid policy, the State Council announced the most severe restrictions would be lifted in December, following considerable protests the week prior. The fear now, with a new winter wave of Covid taking a grip on the country, is that the economy may struggle over the remainder of the winter and beyond if the country becomes overrun and is forced into further lockdowns. With large numbers of new infections a day, Japan, India, USA and Italy, among others, have imposed restrictions on Chinese arrivals. Elsewhere Beijing's announcement of a substantial support package for its semiconductor industry provided a clear signal of intent to become self-sufficient in chip production and avoid being dictated to by the US.

Elsewhere in Emerging Markets, the year's strong performers Brazil and India pared back gains. The MSCI Brazil Index fell 5.0% over the quarter, as Brazil approved a constitutional amendment to allow new President Lula, who took office on January 1, to increase Brazil's fiscal spending cap by at least $28bn for one-year, in order to fulfil campaign pledges, with a large proportion of the increase used to maintain a $115 monthly cash transfer to the poorest fifth of Brazilian households. The prospect of a larger fiscal package has concerned businesses, who fear the strain that it could place on Brazil's finances.

The MSCI Japan Index ended the quarter up 5.1%. It was a volatile quarter for Japanese markets in many respects. The Yen plunged to a 32 year-low against the dollar in November as the Bank of Japan ('BoJ') persisted with its ultra-loose monetary policy in the face of Q3 GDP data coming in considerably below expectations. The BoJ then sprung a major surprise in December, announcing changes to its monetary policy by adjusting its yield curve control measures. The BoJ announced it would sharply increase its bond buying and, while keeping the target yield for its ten-year bonds unchanged at 0%, allowed the yield to move 0.5% either side of the target, an expansion from the previous 0.25%. In response the ten-year bond yield surged by the most in almost two decades, reaching a high of 0.47%, while the Nikkei 225 Index fell 2.5% and the Yen rallied 4% against the dollar.

The final quarter of 2022, much like the majority of the year, brought little certainty for global macroeconomics and markets. More uncertainty lies ahead in 2023, and the extent of a probable global recession remains to be seen. However, expectations are that the outlook will become clearer as the year progresses and inflationary pressures wane.

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