

Investment Comment

03 April 2023

Sterling denominated returns of major indices	Q1 2023	Year 2022	Year 2021	Year 2020	Year 2019	Year 2018
	%	%	%	%	%	%
Equities						
UK	3.0	1.6	18.7	-11.8	18.4	-9.8
World (ex UK)	4.4	-8.6	19.6	14.0	22.0	-3.5
Emerging Markets	1.1	-10.0	-1.6	14.7	13.9	-9.3
Fixed Interest						
Overseas Bonds (unhedged)	0.2	-6.4	-4.4	5.6	2.7	5.1
Index-Linked Gilts	4.2	-34.5	3.9	11.3	6.3	-0.4
Corporate Bonds	2.4	-17.8	-3.0	8.0	9.5	-1.6
Property	-0.6	-24.4	20.8	-9.5	22.4	-7.8
Cash	4.2	3.5	0.0	0.0	0.7	0.7

Source: MSCI UK IMI, All Country World Ex-UK, Emerging Markets; ICE BofA Global Broad Market+, Bloomberg UK Government Inflation-Linked Bond, ICE BofA Sterling Non-Gilts; UK IMI Liquid Real Estate; Cash Equivalent (GBP 1M LIBOR). Total Return, Sterling adjusted.

The first quarter of 2023 was positive overall for global markets, despite worrying developments in the banking sector. The major news headlines came in March, with the collapse of mid-size US lender Silicon Valley Bank (SVB). Despite a swift and comprehensive response from regulators which helped to contain market fallout, investors looked both locally and globally to assess the adequacy of other financials' balance sheets, which saw several other lenders come under significant stress. Although US employment and housing data remained strong, stress in the financial sector prompted the Federal Reserve to taper the pace of monetary tightening with a rate rise of 0.25% in February. In global equities, strong gains made at the start of the quarter were pared back in March, with the MSCI ACWI closing the quarter with a gain of 4.4%. Global bonds, as measured by the ICE BofA Global Broad Market Index, ticked over, adding 0.2%. These numbers mask significant variation underlying the main indices, with the 'Value'-oriented winners of 2022 giving back gains as the Financials sector faced indiscriminate selling and smaller companies continuing to struggle in the face of macroeconomic uncertainty.

The MSCI Europe ex-UK Index recorded a considerable gain of 8.9% in the quarter. The macroeconomic picture for Europe was considerably brighter by the end of the quarter than it had been at the start: Eurozone business activity comfortably overshot expectations in February and March, finishing the quarter at a ten month high; the labour market showed continued resilience as unemployment remained near all-time lows at 6.7%; the European Commission issued an upward revision of 50 basis points to its forecast for 2023 Eurozone growth, to 0.8%. European financials were not immune to knock-on effects from collapses the other side of the Atlantic. Most notably Credit Suisse was bought out by UBS in a deal which involved the Swiss National Bank writing off \$17bn in risky Additional Tier 1 (AT1) debt, meaning that these debt holders, who normally take priority above equity holders in cases of insolvency, went uncompensated. This triggered a further sell off in global financials, however these losses were recovered to a degree in the following days as investors assessed the balance sheets of major financials and it appears that the insolvencies seen in



March are more likely to be isolated cases than posing a systemic risk. The European Commission unveiled its response to Joe Biden's Inflation Reduction Act: its proposal, the Net-Zero Industry Act, sets a target of 40% of the EU's energy needs to be realised from net-zero technologies, to reduce EU dependence on energy imports and to foster clean energy innovation.

The MSCI UK Index rose 3.0% in the three months to 31 March. Quality Growth mandates performed well as Financials and Energy softened, but smaller companies have not yet seen the bounce which would reflect a true 'risk-on' environment. The outlook for UK growth received similar upward revisions to those seen in Europe: UK GDP is now forecast to fall just 0.3% in 2023, avoiding a technical recession, before returning to growth in 2024 and returning to pre-pandemic levels of GDP in the final quarter. After recording an unexpected surplus of £5.4bn in January, Chancellor Jeremy Hunt had greater headroom when delivering the Spring Budget in March. The Budget included significant reforms to UK pension legislation, offering greater incentives to those saving for retirement and to ensure that limits on pension savings do not push those who would otherwise work into early retirement, an issue seen in particular in the NHS. For further information on the Budget please refer to our note to clients, dated 15 March 2023. After two years of negotiations, the Prime Minister announced that the UK will join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Indo-Pacific free trade bloc which will be worth 15% of global GDP following the UK's accession. It is estimated that joining the bloc will add £1.8bn to UK GDP in the long run.

The MSCI Asia Pacific ex-Japan and MSCI Emerging Markets Indexes posted respective quarterly gains of 1.3% and 1.1%. China dropped its quarantine requirement for international visitors at the start of January, the last of its significant Covid-19 restrictions. After recording just 3% growth in 2022, its slowest annual growth rate since 1976, China announced its lowest growth target for the year ahead in three decades at around 5%, which is expected to be easily met by a boost in household consumption following the removal of Covid-19 restrictions. Exports and imports were weaker in January and February, which showed respective declines of 6.2% and 10.1% from their levels a year prior. Falling global demand for exports remains an ongoing issue for China and looks likely to remain so: following strained US-China tensions in February when the US shot down suspected Chinese aircraft over the Atlantic Ocean, a survey from the American Chamber of Commerce revealed that 24% of US companies operating in China are considering moving manufacturing or sourcing out of the country, a 10% increase from last year.

The MSCI Japan Index ended the quarter up 3.3%. Current Governor of the Bank of Japan, Haruhiko Kuroda, who has overseen monetary policy in the country for over two decades, will step down in April and former board member Kazuo Ueda was announced as his replacement. The 71-year old academic is widely regarded as a safe pair of hands and has previously warned against an early exit from the country's ultra-loose monetary policy regime and so drastic policy changes would come as a surprise. Inflation falling to 3.3% in February, after having recorded its highest level since 1981 a month prior and marking the first fall in inflation for ten months will come as welcome relief to Ueda, who has reiterated that monetary policy will be driven by the inflation outlook.

After a bruising year for global equities in 2022, the first quarter of 2023 saw a degree of a reversal of fortunes as all major indexes added gains. Recent macroeconomic outlooks and data have been, for the large part, notably more positive with many economies that had looked destined for recession in 2023 now look well positioned to avoid them. Increasingly positive economic data will continue to present a conundrum for policymakers in 2023 as they seek to bring rate-hiking cycles to a close, while controlling inflation, which, despite naturally declining as last year's inflationary shocks fall out of the data, remains elevated. We continue to see opportunities for long-term gains as market sentiment remains muted.

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