Marlborough





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March 2022

Multi-Asset fund range

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Commentary

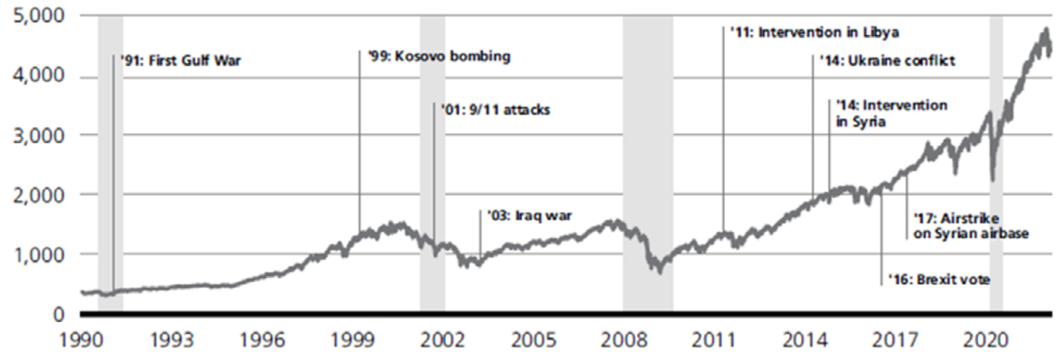
- ***Further upside risks to inflation due to Ukraine conflict***
- ***Central banks likely to slow the pace of rate tightening***
- ***Economic growth to moderate in 2022, but still robust, despite inflation***

Russia makes up about 0.3% of MSCI's global equity index. Russia, Ukraine and Belarus together represent only 2.1% of global GDP. This implies that the direct impacts of the conflict will be relatively limited. Indeed, geopolitical events in general tend only to have short-term repercussions for markets - see the chart below.

Nevertheless, there will be ripple effects that could spread far and wide, especially if the war drags on. Most notable for investors (and consumers) will be the effect on inflation. The immediate impact will be on energy prices: Russia supplies 65% of Germany's gas imports. European natural gas prices have spiked sharply, along with the oil price, and this is already pushing up heating bills. But there are knock-on effects to consider, too, in the form of food price inflation. Natural gas is used in nitrogen-based fertilisers; Russia and Ukraine make up about one third of global wheat exports and one fifth of global corn exports. Together, the two countries produce just under half the world's sunflower seeds - in fact, the sunflower is Ukraine's national flower and has become a symbol of solidarity in recent weeks. Supplies of all of these will be restricted in the months ahead, leading to price increases.

We could also see an uptick in the supply issues experienced late last year. Many German car manufacturers rely on parts produced in Ukraine; with these parts no longer forthcoming, Volkswagen has been forced to close factories and furlough 8,000 workers. Meanwhile, the closure of European Union airspace to Russian planes and the tit-for-tat response from Moscow, together with the blocking of land transport routes, will also cause headaches. In the first half of 2021, over 300,000 containers were shipped by rail from China to Europe, via Russia, and sea-shipping bottlenecks will have seen even more freight travelling this route

The market impact of geopolitics tends to be short-lived
S&P 500 index; shaded areas indicate US recessions



Source: Bloomberg, UBS, as of February 2022

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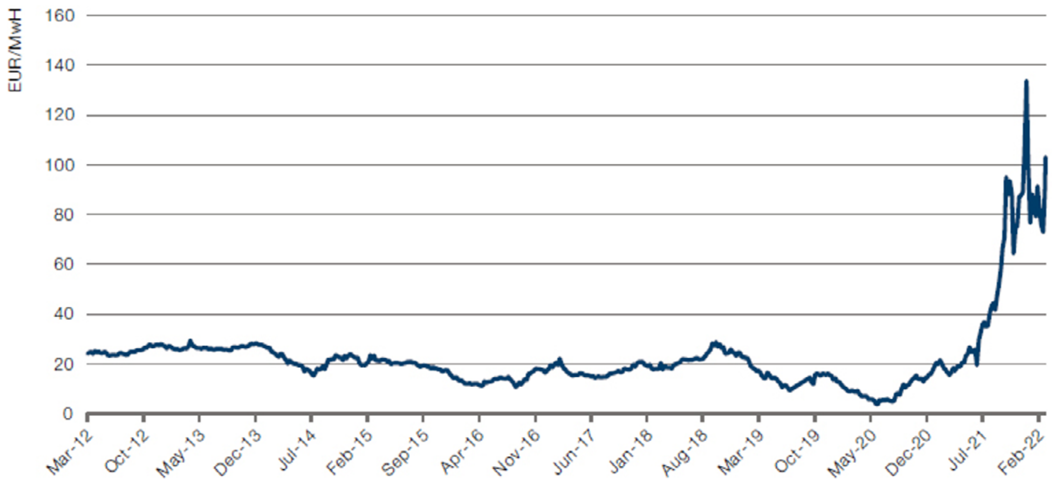
Eurpopean natural gas prices have surged



Source: Bloomberg, as of 28 February 2022

since then. Freight forwarders will now be scratching their heads trying to find yet another solution.

Here in the UK, Covid has largely been relegated to the second page of the news, but it is easy for us to forget that the UK was hit by the Omicron wave ahead of many other areas. Whilst society here is now returning to normal (almost), other countries and regions are still facing restrictions. These measures are pulling down growth projections for Q1 2022. The higher oil price will also have a dampening effect: an increase of $10/ barrel is estimated to shave 0.4% off GDP growth. Central banks were already taking action to keep inflation in check, but will now be very wary of potential policy error (raising rates too much, leading to heightened risk of recession). Investors have now begun to moderate their expectations regarding the pace of interest rate hikes. Several central banks are holding their rate-setting meetings in mid-March, so watch this space...

Although slowing, we still think economic growth for the full year will be above trend. Ongoing easing of Covid restrictions and the release of pent-up demand should underpin this growth, so for now we are retaining our bias towards economically sensitive value-style funds. The UK economy and stock market should be beneficiaries of current trends, so we have maintained our moderate overweight exposure. Similarly, we have not changed our view on fixed income assets, preferring short-duration exposure to limit the negative impact of inflation.

UK

- ***UK economy and market well- placed in the changing environment***

The UK market continues to weather the storm of recent upheavals relatively well; the FTSE 100 is now the only major market with positive returns on a year-to-date basis. UK shares are still cheap relative to other developed markets, and dividend yields are attractive in the continued hunt for income. The UK market contains lots of economically sensitive, cyclical stocks in the oil, gas and mining sectors, which stand to benefit from increased demand as economies reopen. We have maintained our overweight stance.

US

- ***Company earnings ok, but growth trajectory slowing***
- ***Pace of rate hikes expected to slow***

Away from the epicentre of the Ukraine conflict, US companies continue to perform quite well. Almost all large companies have now delivered their Q4 2021 results, and the overall picture is satisfactory, with margins ahead of where they were at the same point in the previous year. But with the growth

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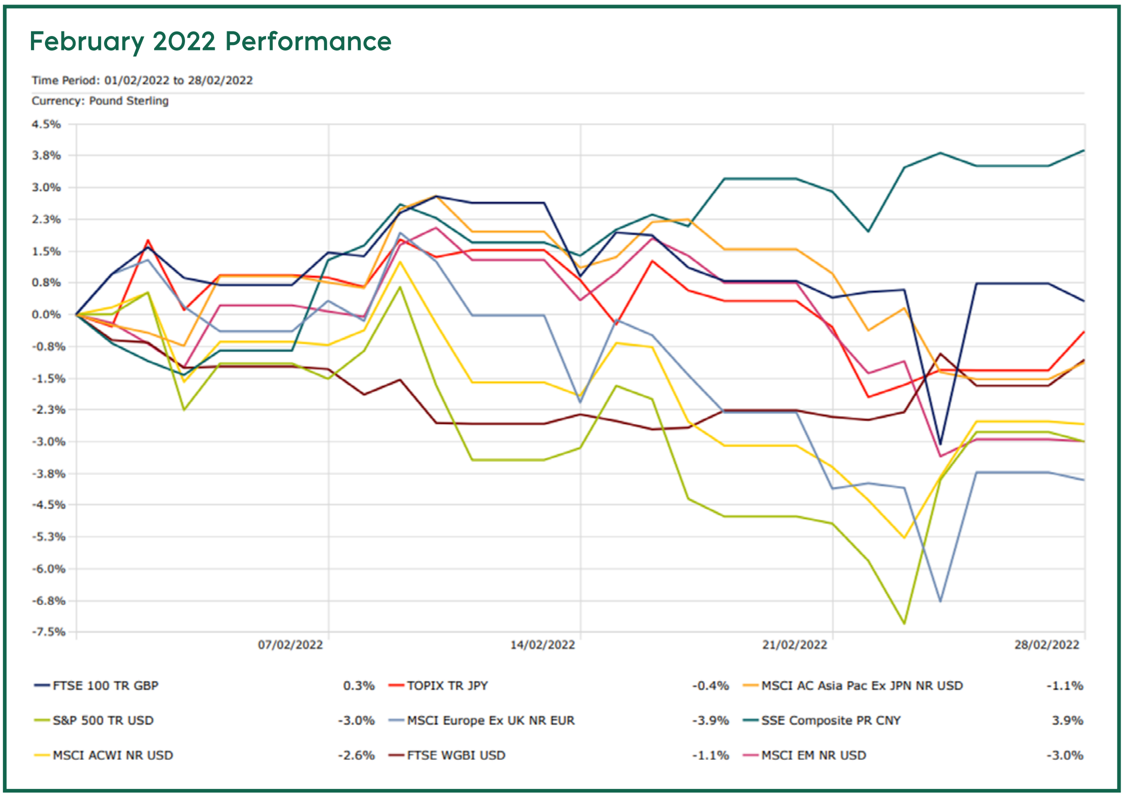
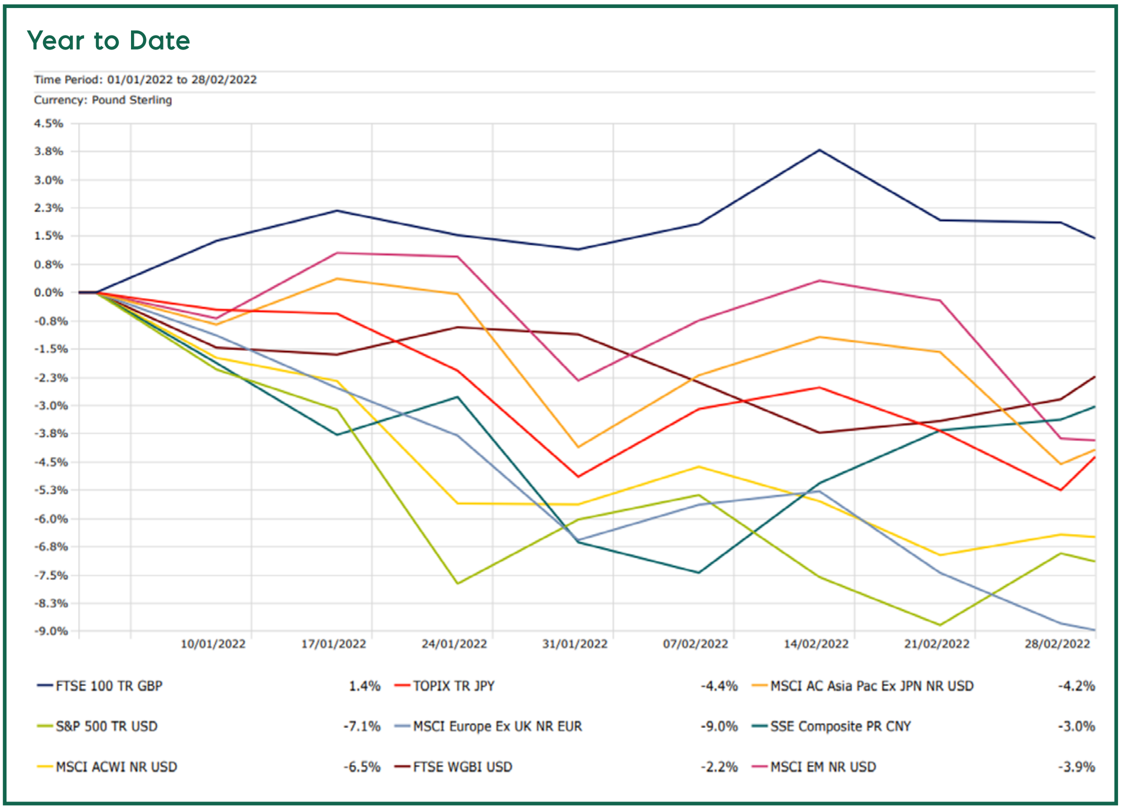


Source: Morningstar Direct



Source: Morningstar Direct

picture less rosy due to Covid constraints, analysts have been cutting expectations for Q1 2022 earnings. This has kept the pressure on many companies whose share price valuations were relatively high to begin with. Analysts and investors have also been cutting their expectations for rate hikes. Ten days ago, markets were pricing in a better-than-even chance of a 0.5% increase at the next Federal Reserve System (Fed) meeting in mid-March; this is now almost completely priced out. This easing of pressure could provide some respite for beleaguered growth stocks.

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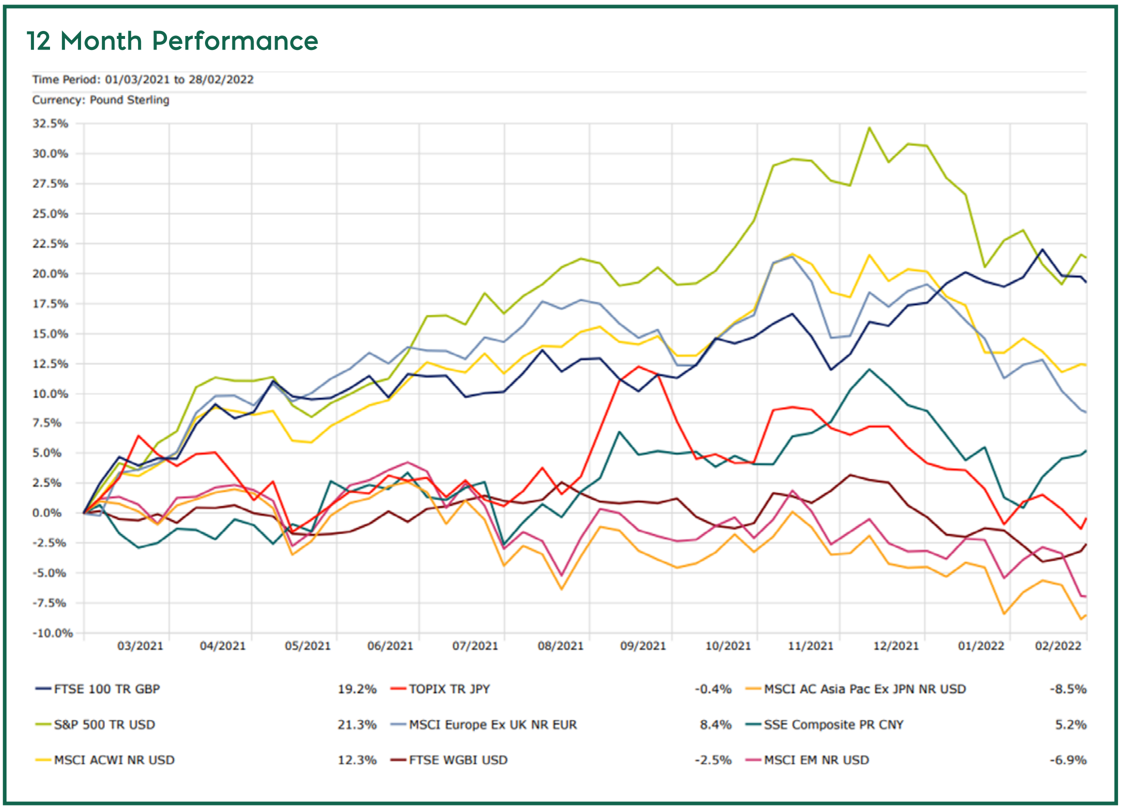

Source: Morningstar Direct

Another silver lining may come in the form of tax refund cheques, which are being posted this month. $78bn will be returned to taxpayers; this is 63% up on the previous year. The average cheque is just over $3,500, and for many will be the single biggest payment they receive all year. Consumer spending is the engine of the US economy, so this will provide a welcome boost.

However, despite these potential positives, we prefer to retain our moderate underweight stance for now.

Europe

- ***Ukraine poses a risk***
- ***Monetary policy tightening unlikely***

Because of geographical proximity and trade links, the Ukraine conflict poses the highest risk to the European economy. Earlier in February, the European Central Bank (ECB) had indicated that it was considering an end to the Asset Purchasing Programme (the European version of quantitative easing), effectively opening the door to interest rate hikes later this year. For the moment, it seems likely that any tightening measures will be delayed until the economic impact of the conflict can be assessed.

Aside from less-hawkish monetary policy, fiscal measures may also be ramped up. The new German government may be more willing to run a budget deficit, particularly in the light of their recent announcement that defence spending will almost double to 2% of GDP. Other countries are likely to follow suit to meet their NATO commitments.

With risks and rewards balanced, we maintain our neutral position.

Asia

- ***Chinese monetary policy remains supportive***
- ***Supply-chain easing to support exports***

With all the focus on events in Europe during February, Asian markets were a source of relative stability; indeed, Chinese shares rebounded strongly after a weaker January. March in China sees the 'Two Sessions' - the parallel meetings of the National People's Congress and the Chinese People's Political Consultative Conference. This annual gathering is the venue for the announcement of economic and growth objectives for the year.

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This year will also provide some insight into whether President Xi Jinping will be offered a third term, and who his eventual successor might be. In the meantime, monetary policy remains supportive, and a post-lockdown upturn in global trade will provide further support for the export-led economies of the region. We remain moderately overweight.

Fixed income

- ***Upside risks to inflation***

Usually a risk-off episode such as we experienced in February would see bonds rally. But this time, the trigger event is putting upward pressure on inflation, so government bond prices declined slightly. Credit markets underperformed, as expected, but credit spreads are only slightly wider than the pre-pandemic average, indicating ongoing confidence in the strength of company earnings.

Despite the inflationary environment, though, yields on 10-year US Treasury bonds are hovering close to the 2010-2019 (pre-pandemic) average. This can be interpreted in two ways: rates have been held down by the powerful bond-buying programme, or rates are staying low in anticipation of weaker economic growth ahead. With rate hikes in the offing, the potential for curtailed growth cannot be discounted, but we still believe the global economy is sound: growth for the full year should be above long-term trends, Covid restrictions and supply chain pressures are easing, and China - now the second-largest economy - is adding stimulus. We have maintained our bias to shorter-duration bonds less sensitive to interest rate rises.

Market Round Up

Performance of major markets	February		Year to Date		12 months to 28th Feb	
	Sterling Terms	Local Currency	Sterling Terms	Local Currency	Sterling Terms	Local Currency
UK (FTSE 100)	0.31%	0.31%	1.44%	1.44%	19.22%	19.22%
US (S&P 500)	-3.00%	-2.99%	-7.14%	-8.01%	21.28%	16.39%
Europe (MSCI Europe Ex UK)	-3.91%	-4.09%	-8.96%	-8.69%	8.40%	12.42%
Asia (MSCI Asia Pac Ex Japan)	-1.13%	-1.13%	-4.17%	-5.07%	-8.45%	-12.14%
Japan (TOPIX TR JPY)	-0.40%	-0.43%	-4.36%	-5.24%	-0.37%	3.36%
China (SSE Composite)	3.88%	3.00%	-3.03%	-4.88%	5.24%	-1.33%
Emerging Markets (MSCI EM)	-3.00%	-2.99%	-3.92%	-4.83%	-6.94%	-10.69%
All World (MSCI ACWI)	-2.59%	-2.58%	-6.49%	-7.37%	12.34%	7.81%
World Govt Bonds (FTSE WGBI)	-1.07%	-1.06%	-2.23%	-3.15%	-2.54%	-6.47%

Source: Morningstar.

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Economic Projections 28/02/2022)

Economic Growth

Country/Region	Real GDP YOY Growth (%)					
	2021		2022		2023	
	JAN	FEB	JAN	FEB	JAN	FEB
UK	7.1	7.2	4.5	4.3	2.2	2.1
USA	5.7	5.7	3.8	3.7	2.5	2.5
Eurozone	5.1	5.2	4.0	4.0	2.5	2.5
Japan	1.7	1.9	2.9	2.8	1.4	1.7
China	8.1	8.1	5.2	5.2	5.1	5.2
Asia	6.0	5.7	5.4	5.4	5.1	5.2
Emerging Markets	6.5	6.5	5.0	4.9	4.7	4.8

Source: Bloomberg.

Interest Rates

Country/Region	Central Bank Interest Rates (%)					
	2021		2022		2023	
	JAN	FEB	JAN	FEB	JAN	FEB
UK	0.25	0.25	0.80	1.10	1.20	1.40
USA	0.25	0.25	1.15	1.35	1.80	2.10
Eurozone	0.00	0.00	0.00	0.05	0.05	0.30
Japan	0.00	0.00	0.00	0.00	0.00	0.00
China	4.35	4.35	4.30	4.30	4.30	4.30

Source: Bloomberg.

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Foreign Currency Exchange Rates

Currency Pair	Exchange Rate					
	2021		2022		2023	
	JAN	FEB	JAN	FEB	JAN	FEB
GBP/USD	1.35	1.35	1.38	1.38	1.40	1.40
EUR/GBP	0.84	0.84	0.84	0.84	0.84	0.84
EUR/USD	1.14	1.14	1.14	1.15	1.16	1.18
USD/JPY	115.08	115.08	115.00	116.00	115.5	115.00
EUR/JPY	130.90	130.90	131.00	132.00	131.00	133.00
USD/CNY	6.36	6.36	6.50	6.45	6.48	6.28

Source: Bloomberg.

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