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# Investment Review

## Q1 2022



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# 1. Summary

- Ukraine-Russia war brings financial volatility back to the fore.
- UK share markets outperform global peers.
- Inflationary pressure extends on the back of food and energy supply disruption.
- China turns to fiscal stimulus to support the weakening economy.

Q1 2022 has delivered another seismic shock to the global economy with war unbelievably starting on European soil, almost two years after the onset of the global COVID pandemic. The humanitarian and economic consequences of the war have been tragic.

Financial markets have reacted accordingly with increased volatility in the earlier part of the period and price weakness seen across most asset classes. Whilst the economic impact of the war is somewhat contained to Eastern Europe and Central Asia, the effect of higher commodity prices is intensifying global inflationary pressures, in turn causing a headache for central bank interest rate decision makers.



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- This investment commentary review contains information and opinion on current economic and political positions and does not constitute advice.
- The information is provided in good faith and is believed to be accurate, but as some data is provided by third parties this can not be guaranteed.
- Past returns should not be seen as predictors of future returns.

## 2. Market Performance (Year to Date)

Asset Class	Index	Q1 2022
Gold	S&P GSCI Gold Spot	9.7%
UK Commercial Property	FE UK Property Proxy	4.2%
UK Shares	FTSE All Share	0.5%
North America Shares	S&P 500	-2.0%
World Shares	FTSE World ex UK	-2.2%
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	-3.0%
Japanese Shares	TSE Topix	-3.7%
Emerging Market Shares	MSCI Emerging Markets	-4.3%
Corporate Bonds	Bloomberg Sterling Aggregate Corporate	-6.8%
UK Gilts	Bloomberg Sterling Gilts	-7.6%
European Shares	Euro STOXX 50	-8.4%

Performance Data: FE Analytics in GBP to 31/3/2022

### UK Shares

The UK FTSE All Share index, which is an aggregation of the FTSE 100, 250 and Small Cap indices, was the only major stock index to deliver a small positive return in Q1. The influence of heavyweight sectors such as oil & gas (Shell is approximately 6% of the index), pharmaceuticals (AstraZeneca 6%) and banking (HSBC 4%) led to overall market gains, as those sectors were supported by current investment themes i.e. oil price rises, defensive positioning in healthcare and rising interest rates supporting banks' profits.

### Global Shares

Overall global markets have been 'risk-off' this quarter with the Russian invasion of Ukraine and the consequential impact of increased inflationary expectations. North America is relatively insulated from the conflict and the S&P 500 fell just -2.2%, whereas the broader European market as represented by the Euro STOXX 50 (dominated by France and Germany) lost -8.4% of value in Q1. This move reflects the surge in headline inflation to 7.5%<sup>1</sup> mainly from oil and natural gas price increases that raises the possibility of recession in Europe as consumer spending power takes a hit.

The Russian Moscow stock exchange (MOEX) fell over -40% following the invasion and imposition of economic sanctions, with the index down over -50% from its high point in October 2021. Most fund managers with exposure to Russia have since written the value of their holdings down to zero given their inability to sell their positions. Russian specific funds and some Eastern European funds suspended trading as a result and investors suffered heavy losses on paper.

Over the past quarter we communicated to clients that FPC portfolios had only negligible exposure to Russian markets through well diversified global emerging market funds.

<sup>1</sup> [ec.europa.eu/eurostat](https://ec.europa.eu/eurostat)



## 2. Market Performance (Year to Date) cont.

### Fixed Interest

Fixed interest values fell sharply in Q1 with central banks now actively raising interest rates and indicating more aggressive plans to do so than many expected. UK government gilts fell -7.6% and corporate bonds were not far behind -6.8%. Ordinarily you would expect fixed interest to play a 'defensive' role in portfolios, but times are exceptional and with a base of historically low interest rates and inflation pressure on the 'real' return paid to investors, fixed interest yields over this period have risen and capital values have fallen.

### Alternative

Given the onset of war, soft (grown) and hard (natural resources) commodity markets have seen significant supply side disruption and accordingly higher prices. Gold, as a perceived safe haven and also inflation hedge has been a benefactor over Q1, but other precious metals such as silver, platinum and palladium have also risen strongly.

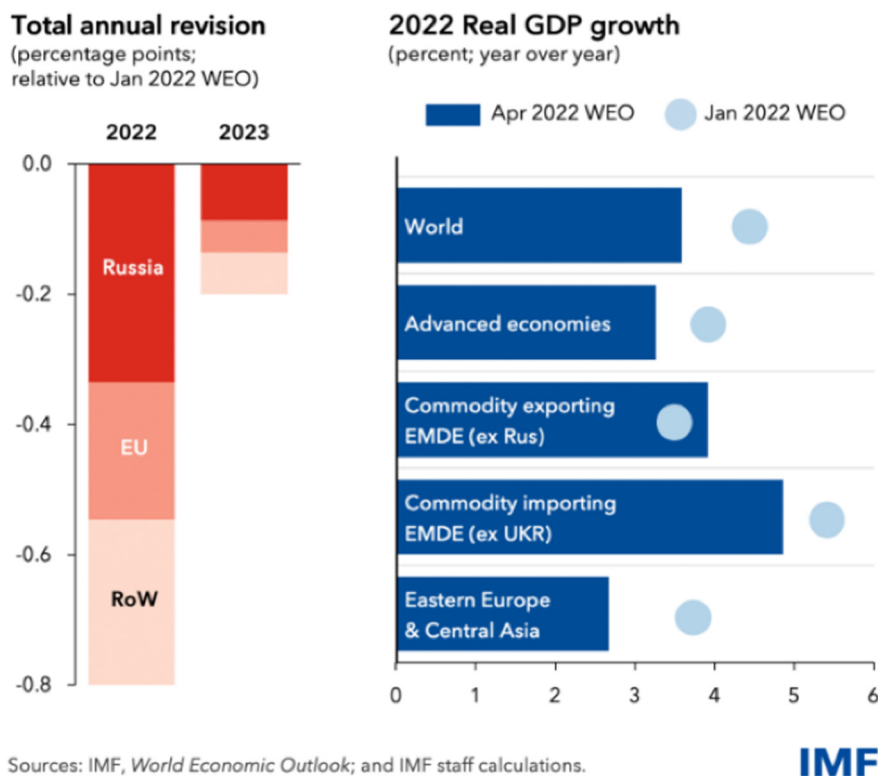
### 3. Ukrainian Conflict

The threat of conflict in Ukraine had been building for some time as Russia conducted ‘military exercises’ on the border, but few expected that such a brazen attack on European territory would take place. The humanitarian consequences of the war have been horrific and the economic impact for Ukraine catastrophic.

Ukraine, Russia and surrounding countries in Europe and Central Asia will clearly suffer considerable damage because of the trading links in the region. However, the ripple effect goes further, given that Russia and Ukraine combined for example supply over 25% of world wheat and Russia supplies almost half of European gas and a quarter of European oil as well as being a significant exporter of metals<sup>2</sup>.

Neighbouring countries that rely heavily on such trading links will find labour, food and energy security significantly impacted. In addition, the flow of refugees into countries such as Poland and Romania adds economic pressure from delivering the humanitarian response<sup>3</sup>.

As a result of the war the International Monetary Fund (IMF) downgraded world economic growth for 2022 and 2023 by -0.8% from its January estimates to 3.6%, with the exception being those countries whose economies are based primarily on exporting commodities. The chart below from the IMF shows the change to forecasts over the quarter:



<sup>2</sup> [worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update](https://worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update)

<sup>3</sup> [blogs.imf.org/2022/04/19/war-dims-global-economic-outlook-as-inflation-accelerates/](https://blogs.imf.org/2022/04/19/war-dims-global-economic-outlook-as-inflation-accelerates/)

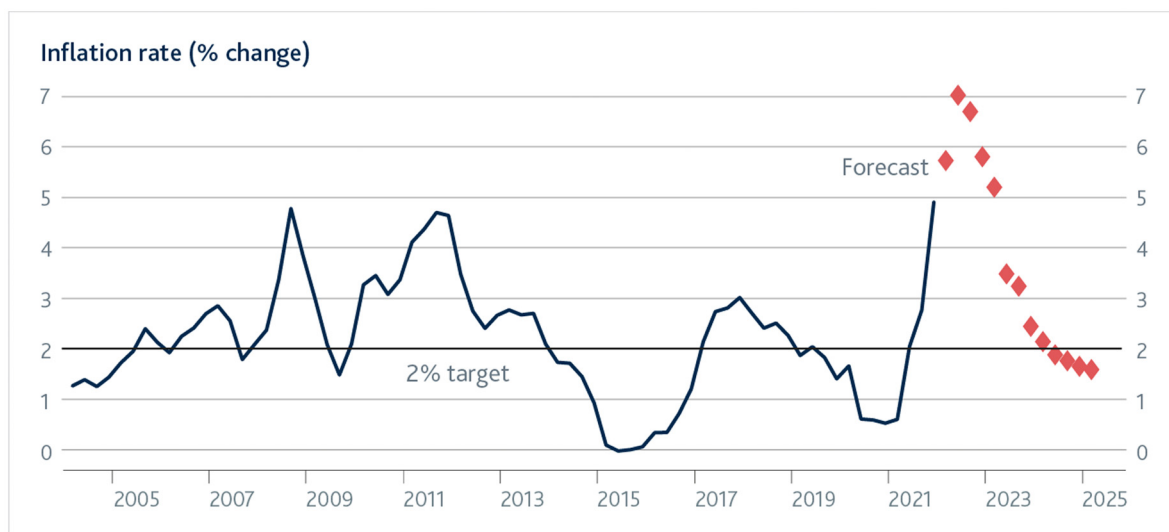
### 3. Ukrainian Conflict cont.

Financial markets aside, a humanitarian disaster has unfolded with the many refugees who have left Ukraine and those who still remain within the country. Furthermore, the impact of rising prices of energy and food will have a direct effect on lower-income households across the globe. As a company FPC is engaging with local organisations to mitigate in a small way the difficulties being faced by such households.

## 4. Inflation a Year From Now

As we are all well aware, current price inflation rates are running at levels last seen in the 1970's, with the latest Consumer Price Index (CPI) in March rising at a 7% rate over the previous 12 months<sup>4</sup>.

However, expectations that prices will continue to rise at such a rate for a sustained period of time are inaccurate. It is true we are likely not at peak inflation yet for a number of months, but thereafter the Bank of England (BoE) expects a rapid fall in the rate. This is because the primary factors driving inflation i.e. rising oil and gas, food and used car prices, along with global supply constraints are unlikely to be sustained. This does not mean that the overall cost of goods and services will fall (though they could), but they will not rise anywhere near as fast as they are currently.



Source: BoE Monetary Policy Report February 2022

However, the BoE projection was made in early February, since which we have had the war begin, which as highlighted earlier created additional strain on global energy and commodity supplies. That said, after an initial spike in the cost of oil following the invasion that took the benchmark WTI Crude price from \$92 a barrel to over \$120, the price fell almost all the way back, before picking up again slightly. Natural gas on the other hand remains at all time highs some 70% above pre-invasion levels<sup>5</sup> and this will have a notable impact on household energy prices and therefore the ability to spend on other items.

So, peak inflation might end up showing double-digit increases in the near term but the above forecast should hold true in that published inflation rates will slow in 2023. This makes the job of deciding what the correct level of interest rates should be difficult for central banks if tackling inflation is the primary reason for raising rates.

Our economic consultant Tricio believes market expectations for UK interest rates will peak at 1.25-1.5% from the current 0.5% and in the US, rates will reach at least 2% by the year end from the current 0.25-0.5%. As ever it is a delicate balancing act of managing rising inflation without restraining consumer spending and business investment too much that could lead to recession.

<sup>4</sup> [ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceinflation](https://ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceinflation)

<sup>5</sup> [oilprice.com](https://oilprice.com)



## 5. China Stimulus Announced

Unlike in the West inflation is not currently much of a concern in China. In fact, having contended with a number of economic difficulties such as an over-leveraged property market and a government clampdown on private enterprise, the political pressure to achieve economic growth has returned.

China has therefore again begun the re-calibration of its economy, this time introducing new stimulus measures by way of cutting business rates and increasing government spending on “mega-projects” and social infrastructure<sup>6</sup>. This is all an attempt to address current economic weakness and ensure President Xi Jinping’s third term as party leader this year by targeting a greater than expected 5.5% annual growth rate. This change of emphasis should see investor sentiment grow more positively over the rest of the year.

To date China has tread a very different line in dealing with the COVID virus as the country continues to implement a zero-tolerance policy, at times quarantining whole areas when an outbreak occurs. The concern is lower efficacy of inferior domestic vaccines and the overall low vaccination rate especially in the older population, which could lead to higher mortality on the mainland, as it did recently in Hong Kong.

This is not only causing a headache for policy makers but it is continuing to impact the world economy through disrupting global supply chains at a time when the West is open for business and looking to spend money.

<sup>6</sup> [economist.com/china/2022/03/12/to-meet-its-ambitious-growth-target-china-turns-to-stimulus](https://www.economist.com/china/2022/03/12/to-meet-its-ambitious-growth-target-china-turns-to-stimulus)

## 6. Looking Forward

In our investment reviews over the past few quarters we have attempted to guide clients in appreciating that returns experienced in recent years have been exceptional and that volatility, which prior to the pandemic had been languishing, could return. Having now experienced a quarter of weakness it would not be surprising to see volatility persist throughout the year as the market grapples with the interest rate tightening cycle we are now clearly in.

Forecasting market prices in the short-term is of course near impossible as there are many variables, known and unknown, that can impact investor behaviour. We anticipated that interest rates would move higher, but had no idea that the next significant global economic event would be a European war.

Notwithstanding the current climate, staying in the game throughout shorter periods of market volatility, be it over a quarter or longer, is the most probable way of avoiding financial and emotional strain and achieving your longer-term financial objectives. Your investment returns should be viewed over a suitably long timeframe. In the words of legendary investor Warren Buffett...

**“Only buy something that you’d be perfectly happy to hold if the market shut down for 10 years”.**



# Invest With Confidence

At the heart of what we do is a simple goal – to help you achieve and maintain financial independence, provide for those who rely on you and live life well.

We do that by providing the financial planning and investment advice you need to secure your future.

We recognise that investors with similar risk profiles may have very different objectives, tax positions and personal circumstances so we adopt a bespoke approach in each case. There are no 'off the shelf' solutions.

We focus on choosing the right blend of assets, managing risk, and minimising tax and costs. Our investment philosophy is founded on a number of key principles which have served our clients well for more than 30 years:

-  Differentiate savings from investment
-  Understand and manage risk
-  Get the "investment recipe" right
-  Avoid market timing
-  Fear inflation
-  Manage tax and costs
-  Process is paramount

We believe you win by not losing and this core principle lies at the heart of our investment approach. To find out more, get in touch.



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