

4 April 2022

Dear Equity Client

GLOBAL EQUITIES – 1st Quarter 2022

Equity markets experienced a volatile first quarter. The MSCI World Index (including Emerging Markets and dividends) decreased -5.4% (US\$ terms, -2.5% UK£ terms*) over the period. The release of the Federal Reserve's December minutes in the second week of January triggered a sharp drop in investor confidence when it became clear that inflation is more of a threat than earlier perceptions. This exacerbated the fears for the imminent US tightening cycle. On top of this, the unexpected Russian invasion of Ukraine on 24 February further affected the low investor confidence. The market dropped by -13.0% (US\$ terms, -10.3% UK£ terms*) before turning for the better on 8 March.

The initial reason for the high levels of global inflation is predominantly to be found in supply chain constraints on many fronts, rather than in particularly strong demand. Logistical complications from the pandemic take long to get resolved, with shipping and container costs two of the key culprits. This has also affected the oil price, further increasing inflation. The war has worsened these circumstances because of its effects on energy and food prices. Russia's dominant energy position in Europe along with Ukraine's as a major global grain producer have moved spectacularly into play.

The war is a threatening factor to world capital markets on both a geopolitical and economic front. On the former, it is encouraging to see the level of restraint NATO and other relevant governments demonstrate on the war, with glimmers of hope for progress from some of the Russian/Ukrainian negotiations. Whilst the war carries on, the two main issues foremost in investors' minds are US inflation and the potential risk that their economy may be facing an imminent recession. There are fortunately some indications of improvement on the former. Whilst relevant cost indices remain elevated, some important ones have started rolling over. For example, from their respective Pandemic peak levels, the WCI Composite Container Freight Index has dropped by over a fifth, the New York Fed Supply Chain Pressure Index by over a quarter, and the ISM Manufacturing Delivery Index by 17%*. The Oil price has dropped by a fifth and is currently below \$100*. These are promising signs of the Pandemic inflicted trade constraints now in process of freeing up.

The new US tightening cycle, along with the accompanying de-rating of equity valuations, is already in process. Shareholders are now dependent on their businesses delivering ample operational growth for them to earn reasonable returns. Historically, this has predominantly been the case during tightening cycles. The US economy is currently benefitting well from moving on from the Pandemic constraints, but we have taken notice of their yield curve that has flattened from the inflation effects on short rates, potentially indicating a recession is just over a year away. Against this, recessions do not usually go hand-in-hand with negative real rates, as the US currently enjoys. It is clear how important a resolution to the war is also in this context. In the interim, we own a number of high quality, highly cash generative franchises that operationally should continue to grow in double digits.

We appreciate all your support.

With best wishes.



Gerrit Smit
Partner – Head of Equity Management

**Source: Bloomberg. 2 April 2022.*

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