5 July 2022

Dear Equity Client

GLOBAL EQUITIES – 2nd Quarter 2022

Equity market volatility continued over the second quarter. The MSCI World Index (including Emerging Markets and dividends) decreased by -15.7% (in US$ terms, -9.0% in UK£ terms), bringing the first half of the year performance to -20.2% (in US$ terms, -11.3% in UK£ terms).

Investors have been confronted with a potent combination of negative factors. Fears for structurally high inflation and aggressive Federal Reserve (Fed) tightening are further fueled by fears of an ongoing Ukraine war. The renewed lockdown of the world's second largest economy and trading partner, China, has further damaged the global supply chain and world trade. Risk for a US recession is growing while the inception of the Fed's quantitative tightening process has brought uncertainty about overall capital market liquidity and potential effects on interest rates. It is not surprising that many investors are inclined to rather watch circumstances unfold from the proverbial sidelines.

The challenge investors are facing is to form a firm impression as to whether this combination of negative factors is still in process of worsening, or not. It is no mean feat to reach a firm conclusion on this, but we have some indicators to consider. Whilst headline US inflation keeps rising (from the rising energy and food prices), core inflation has rolled over two months in a row. Important supply chain indices (e.g. Supply Chain Pressure, Backlogs, Delivery Time) have been in downward trends for months already. The World Container Freight Cost Index is down over 30% since its peak in September 2021, and could soon drop below its level a year ago. Major mineral commodity prices are dropping, with wheat and corn following suit. China is slowly releasing some of their cities out of their lockdowns. The US yield curve has flattened, but has not yet inverted, while US economic conditions do not indicate material risk of a deep recession. Analysis of the Fed's balance sheet suggests that they will not necessarily have to sell securities for some time. Unfortunately there is little indication of the Ukraine war's outcome, and therefore of how energy costs may change. Our impression, though, is that the overall array of negative factors is currently in a slow process of stabilising.

Both the S&P 500 and the MSCI AC World indices are now in bear market territory in Dollar terms. We should add that the currency itself has played a major role in the translation of the performance. That said, the event of a bear market has historically, over the successive twelve months, delivered an average return of well into double digits. The main exceptions were in 1973 (with the Oil Crisis and a fourteen year period of high inflation) and 2008 (with the Financial Crisis). Also in this context, there has historically been only five other occasions with a worse than -15% Dollar S&P 500 performance in the first half of the year. The median performance over the successive half years was +15%.

Capital markets are digesting the environment of higher inflation and interest rates, offering attractive opportunities. The high quality businesses we own are well positioned to keep delivering operationally.

Thank you for all your support.

With best wishes.

Gerrit Smit
Partner – Head of Equity Management

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