MARKET COMMENTARY

Executive Summary

In a continuance of the issues seen year-to-date, May was characterised by rising inflation, interest rate hikes and ongoing supply chain issues driven by Russia's invasion of Ukraine and China's zero COVID policy. Despite these concerns, major markets were marginally positive in May, providing some respite from losses sustained earlier in the year.

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Global Economy

Inflation continued to dominate headlines. In the UK, April's CPI came in at 9%, driven by a significant increase in the energy price cap. With another increase expected in the Autumn, inflation is anticipated to remain elevated in the medium term – the Bank of England forecasts a peak of 10%, before falling back to 6% by the end of 2022. In contrast, US inflation appeared to have passed its peak, coming in at 8.3% for April versus 8.5% in March. In Europe, Eurozone inflation came in at a record 8.1% for May, increasing pressure on the European Central Bank (ECB) to tighten monetary policy – the ECB's main policy interest rate remained in negative territory (-0.50%) throughout the month.

Central banks have been walking a tightrope of late – looking to increase interest rates and temper inflation without tipping the economy into recession. As anticipated, both the Bank of England (BoE) and the US Federal Reserve continued to raise rates in May. The BoE agreed a 0.25% hike, upping the base rate to a 13 year high of 1%. Similarly, following a 0.25% increase in March, the Fed upped rates by a record 0.5% in May – the largest rise in 20 years. In the face of persistent inflation, it seems likely that both central banks will continue to raise rates for the next three to four meetings, at least.

The gloomy economic outlook is raising fears of an imminent recession. The US economy contracted 1.5% in the first quarter of 2022. While UK GDP is estimated to have grown by

0.8% in Q1, the rapidly rising cost of living continued to squeeze household finances. There is a feeling among investors that the global economy is reaching a moment of reckoning, with recession, or a period of low growth supported by government spending and low unemployment, both possible outcomes.

May saw a continuance of a key theme year-to-date, namely the outperformance of 'value' stocks versus 'growth' sectors such as technology. Against a backdrop of rising rates, investors have shied away from long duration growth stocks with heady valuations and moved towards those stocks with proven cash flows. This rotation continued apace in May, with aggregate global value stocks gaining 1.7% over the month versus a 2.6% loss for the global growth index. The ongoing preference for value helped bolster markets with less tech exposure and more 'traditional' stocks, such as the UK income sector.

Markets

Moving on to markets, a rally in the latter half of the month helped many major indices remain in the black for May. Aggregate world equities finished the month marginally stronger, up 0.2%. In the United States, markets were up 0.2%, though technology heavy indices were down 1.7% on average, compounding losses suffered in 2022.

The UK stock market had another positive month, with UK large-caps up 1.1% in May. The UK has been the standout performer year to date, predominantly as a result of its exposure to commodity producers and the ongoing preference for value stocks in the rising rate environment. However, positive performance was not universal, with mid-cap stocks down 1.4% on average as risk adverse investors continued to seek the relative safety of the large-cap index.

Elsewhere, both European and Japanese equities finished the month showing marginal gains, returning 0.04% and 0.7%, respectively.

Chinese equities were highly volatile during the month. Shanghai, China's largest city and financial hub, remained under tight lockdown throughout May as part of the countries zero COVID policy, impacting economic growth and adding to global supply chain concerns as exports faltered. On average, stocks fell by more than 8% in early May, before staging a recovery in the second half of the month. The rally was in part due to news that the Chinese government would cut the main mortgage interest rate by a record amount. The move, designed to limit the impact of the zero COVID policy and a slowdown in the property sector, was welcomed by investors. The index ultimately finished the month 0.9% up.

Elsewhere in emerging markets, Indian equities retreated 3% over the month, as higher interest rates and weakening growth prospects soured investor sentiment.

Fixed Income

May offered some respite for fixed income investors, driven by signs that US inflation had passed its peak. Global aggregate bonds gained 0.3%, while the yield on a UK 10-year gilt rose 20 bps to finish the month at 2.1%. In contrast, the US 10-year Treasury fell slightly over the course of the month, finishing May at 2.8%.

Commodities

May saw no let up for commodity market volatility, as markets continued to feel the shock of Russia's invasion of Ukraine and China's zero COVID policy. The Brent oil price gained $16, finishing the month at $123, as the EU discussed possible sanctions on Russian exports. Towards the end of the month, it agreed a compromise which will lead to a partial embargo of Russian oil by the end of the year. Elsewhere, gold fell over 3%, finishing the month at $1,838, while the price of wheat (of which Ukraine was a major exporter prior to the war) climbed further, raising fresh fears about the cost of living.

Currencies

In the currency markets, sterling rallied against the dollar, gaining almost 3% over the month. The pound posted a similar gain versus the Yen.

| Whitechurch Investment Team | May 2022 |

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