For professional advisers only

What is Going on in Markets?

18th March 2022

Summary

- Over the last few months there has been a vicious change within stock markets as to the kinds of companies whose shares are performing relatively well and those which are performing relatively poorly. This has impacted the performance of our portfolios, most notably in January.

- 'Quality' and 'Growth' stocks, which are characterised by strong balance sheets, strong pricing power and superior growth in profits, and which have generally led the ascent of stock markets since the Financial Crisis, have been sold off. In contrast, long-neglected 'Value' stocks, such as banks and energy and commodity companies, have enjoyed a resurgence in popularity. The catalyst has been rising inflation and interest rates which has undermined the valuations of the former.

- At the same time, investors have opted for the perceived sanctuary of larger companies. Shares of smaller- and medium-sized companies, which often have better prospects to grow, have underperformed markedly.

- Having lagged far behind other stock markets, and particularly the US, for many years, the UK's FTSE 100, which has heavy weightings in banks and energy and commodity companies, has proved much more resilient than other stock markets over the last few months.

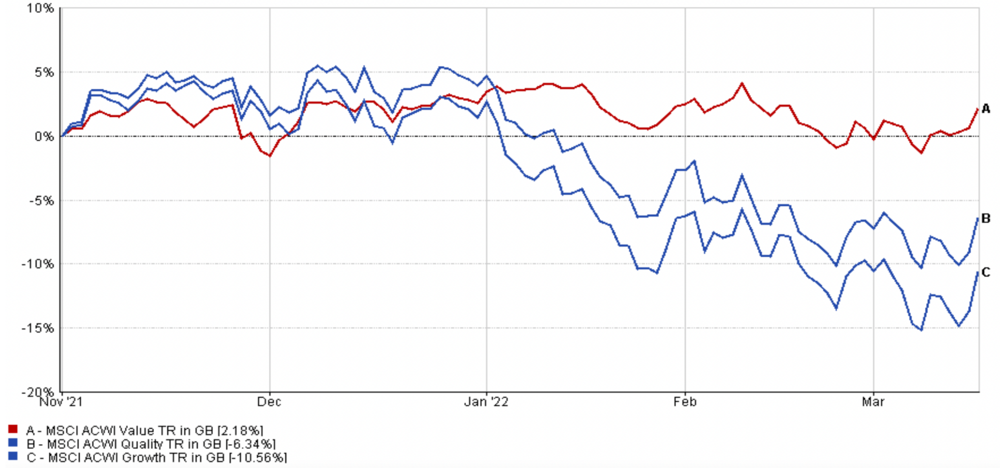
- As the major banks have been reducing their support from markets and we have seen rate hikes in some countries, this has led to weakness in many bond markets.

- Over the long-term markets are driven by company earnings and at some point, the focus will again be on company fundamentals, and this is when we expect there to be a reversal in performance.

- The graphs overleaf illustrate all of these divergences.

Large Capitalisation Stocks Outperforming

Value Outperforming Growth & Quality



FTSE 100 Outperforming Global Peers

Bond Markets Not Providing Protection

Source: Square Mile and FE fundinfo. Data as at 16th March 2022. Past performance is not a guide to future returns.

The Markets, the Outlook and What we are Doing in Portfolios

- The upward trend and possible persistence of inflation as well as worries about the impact of higher interest rates and rising energy prices on economic growth were well established before Russia's invasion of Ukraine. The war has exacerbated these fears.

- The chance of a period of stagflation (slow economic growth coupled with high inflation) has clearly increased and even the possibility of a recession, particularly in Europe.

- Stock markets remain very volatile and, with the economic outlook also being clouded further by the war, we will resist any temptation to make sweeping and reactive changes to portfolios.

- If stock markets were to tumble from here and to the extent that share valuations became glaringly cheap then we would be likely to add to equity exposure in portfolios.

- Conversely, the economic outlook could darken to the extent that corporate profits are substantially undermined and valuations become correspondingly too high. In such circumstances we do not rule out reducing exposure to equities, although this is less likely given the falls already seen.

- Painful as it has been over the last few months, we remain steadfast in our liking of 'Quality' companies with strong balance sheets and dominant market positions. Over the medium and long term we are confident that growth in profits will lead to more healthy valuations.

- By contrast, the heady gains seen recently in the share prices of many 'Value' companies may prove to be excessive and not sustainable.

- The case for investing in successful small and medium-sized companies over the long term is indisputable. However, we are mindful that the share prices of such companies over shorter periods can be very sensitive to the economic backdrop and investor sentiment. For now, we are comfortable with the level of exposure we have to small and medium-sized companies in our portfolios and valuations appear even more attractive after the recent weakness in their share prices.

- As central banks look to slow or stop their buying of bonds, raise interest rates and governments wind back their levels of support, this is likely to drive some government bond yields higher. We believe that this needs a broader, more flexible approach through the use of strategic bond funds in order to succeed in the future.

- As always, we continue to review and to work closely with Square Mile's experienced team of research analysts to ensure that our portfolios contain our highest conviction funds, which are best placed to deliver strong returns in the years ahead.

Andrew, Charles, Chris, Dan, Mark and Will
The Investment Management Team, Square Mile Investment Services
Friday 18th March 2022