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Portfolio Review *March 2022*

Developed markets rose in March, rebounding from their lowest point of the year. However, last month's rally masks a lot of pain for investors over the first quarter in what has been a difficult start to 2022. Market volatility continued over the course of the month with equites initially falling materially as the Russia-Ukraine situation developed, before rallying to end the month higher than they started. Commodity prices soared given Russia is a key producer of several important commodities including oil, gas and wheat. This contributed to a further surge in inflation as well as supply chain disruption. Central banks were in action as interest rates were lifted in some key economies. Elsewhere, Chinese equities were negatively affected by renewed Covid-19 outbreaks, leading to new lockdowns in some major cities.

The economic sanctions imposed on Russia by developed nations were extended to remove some Russian banks from the SWIFT payments system and impose restrictions on the Central Bank of Russia's (CBR) international reserves. The CBR responded with extraordinary measures such as increasing interest rates to 20% and imposing capital controls to limit outflows. The severe sanctions will no doubt inflict significant damage to the Russian economy, which is expected to enter a deep recession, despite the fact that exports of oil and gas have generally continued. Due to its high dependency on Russian gas, Europe avoided putting in place sanctions that could put imports of energy and related payments at risk. However, the Biden administration, due to the modest US dependency on Russian supply, did announce a ban on Russian oil imports.

Energy and commodity markets were very much in focus. Following a 27% gain in 2021, representing its best annual performance in 42 years, the Bloomberg Commodity Index advanced 25% in the first quarter of 2022. Brent crude spiked as much as 79% in March, before retreating to end the month "only" 39% higher at around $103 per barrel. The pullback in crude was due in part to optimism surrounding Russia/Ukraine settlement talks and an announcement from President Biden that the US will release 180 million barrels of emergency stockpiles from the US Strategic Petroleum Reserve (SPR). The US said it would release one million barrels a day over a six-month period to help mitigate fears of global supply shortages which was enough to provide some relief to markets. However, while the historic SPR announcement will help the oil market re-balance this year, it will not fix the structural deficit and rebuild global inventories.

It is not just oil that has seen double digit price rises, a whole host of other commodities have posted meaningful gains in the last three months from nickel (+55%) to wheat (+30%) and palladium (+18%) to name just a few. Unsurprisingly, inflation figures continue to run hot. Data showed consumer prices for the twelve months to February accelerated to 6.2% in the UK and 5.9% in the euro area. In the US, inflation reached a 40-year high of 7.9% and is expected to remain elevated over the coming months, before perhaps moderating towards the back end of the year when supply and demand dynamics may start to ease.

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With inflation showing no signs of abating and labour markets strengthening, central banks must now act to stop inflation getting out of control. After a first rate hike in December and a second in February, the Bank of England raised rates for a third time at its March meeting to 0.75%. The Bank described geopolitical risks as having accentuated prior expectations for weak growth and high inflation this year. The ECB confirmed that tapering of its asset purchase programme will end in June and left the door open for a first rate hike later this year. The closely watched US Federal Reserve (Fed) also raised rates by 0.25% in March, their first rate rise since 2018. Although the move was well flagged, Chairman Powell sparked new concerns in a statement afterwards saying the Fed are prepared to raise rates more quickly if necessary. Economists are worried that a more rapid approach in raising interest rates could lead the economy into a recession if consumer demand is slowed down too much.

With the rate rising cycle underway, bond markets were firmly in focus. Government bond yields rose sharply (meaning prices fell) as central banks appeared more hawkish and markets priced in a faster pace of monetary normalisation. The movement in yields over the month was significant and we have not witnessed such sharp movements since rates were substantially higher in the 11-15% range. Corporate bonds saw significantly negative returns and wider spreads, underperforming government bonds. High yield bonds performed slightly better than investment grade thanks to their higher income.

Investors have faced a difficult first quarter as stocks, government bonds and corporate credit have all come under pressure from growth slowdown concerns and the escalation of geopolitical risks. However, despite the bleak outlook, there are a couple of areas of relative strength that are worth highlighting. Firstly, consumers are in relatively good health as reflected in strong personal consumption data showing we are returning to pre-pandemic spending patterns which is a positive for growth. Of course consumers face a squeeze on their incomes as inflation continues to bite but, broadly speaking, they have emerged from the pandemic in a strong position. Secondly, corporate earnings, which were a key driver of stock market returns last year, are expected to remain strong. Those companies that can demonstrate pricing power and pass on higher costs to consumers and maintain their profit margins are likely to be the key winners this year. First quarter earnings season kicks off in the coming weeks and will be closely watched by market participants.

The prevailing backdrop, with indiscriminate selling and stocks and bonds falling in tandem, highlights the importance of building resilience into portfolios. We believe this is best achieved through diversification and a focus on quality – particularly stocks of companies with strong balance sheets and healthy free cash flow characteristics. At the same time, investors should prepare for a regime shift as the once familiar low growth, low-rate environment transitions to a new world order that may warrant greater selectivity and a rebalance towards value.

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Portfolios

Developed market equities recovered some of their losses in March. The best performing market was the US where the S&P 500 returned 5.6%, driven largely by a rebound in the mega-cap technology names. In the UK, the FTSE All Share returned 1.3% while European indices also delivered positive returns, with the FTSE World Europe ex UK up 2.1%. Emerging markets fared less well, impacted by weakness in China, with the MSCI Emerging Markets index down 0.4%.

All of the Beckford James portfolios delivered positive returns in March and outperformed their respective benchmarks. With risk appetite back on the agenda, the Ethical portfolio was the best performing portfolio (up 3.16%), followed by Growth 10 and Income which delivered near identical returns of 2.69% and 2.61% respectively. These were followed in descending order of risk down to Growth 3 which returned 1.56%. Most portfolios, with the exception of Income, have delivered negative returns for the first quarter but are in positive territory on a twelve-month view.

The best performing funds in the portfolios were Baillie Gifford Positive Change (Ethical), Foresight Global Real Infrastructure (Growth) and Natixis Loomis Sayles US Equity Leaders (Growth). There were also strong performances from some of the equity income funds held in the Income portfolio including Artemis Global Income, BlackRock Continental European Income and Unicorn Income. The weakest performances unsurprisingly came from bonds and emerging markets with Baillie Gifford Emerging Markets Growth and Vanguard UK Short-Term Investment Grade Bond Index being notable laggards.