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Portfolio Review *August 2022*

While summer is nearly over, volatility it seems is certainly not. The past few months have brought heatwaves and droughts to many parts of the world, but the global economy has continued to cool. Against this, stocks have enjoyed a less-than-pleasant round-trip this summer. Many major indices entered bear market territory in June only to be followed by a sharp rebound in July. Although August began with so much promise, just as investors started to believe the worst of the bear market was over, stocks reversed course and indices dropped again, leaving them pretty much back where they started off the summer. This sort of volatility has been a reliable theme so far in 2022.

The economic narrative behind such market gyrations is by now very familiar to us all. Most recently, key among this has been the soaring cost of living as energy prices have continued to rise. Natural gas prices surged to record levels in August after Russia's state-owned natural gas producer Gazprom announced further maintenance-related closures of the Nord Stream 1 pipeline to Europe at the end of the month. Wholesale gas prices have surged 145% in the UK since early July as a result of these restrictions and the risk of further curbs, leading the UK regulator Ofgem to announce a second rise in the energy price-cap this year from £1,971 to £3,549 due to be effective from 1 October without intervention.

However, whilst government action had been delayed by the Conservative leadership election, the new Prime Minister's announcement of a cap at £2,500 for the average household should mean that we will pass the peak in UK inflation in the next few months, rather than reaching the 15-20% levels that some investment banks have recently predicted. We are still awaiting the detail as we write and in particular with regard to business support but this policy should also have important implications for calming wage demands, associated industrial action, consumer confidence and monetary policy.

Inflation in the UK reached double digits for the first time since 1982 as the CPI hit 10.2% in July, with energy, food and transport accounting for the largest contributors to the rise. The Bank of England raised interest rates by 50 basis points to 1.75%, the biggest increase in 27 years. It also projected that inflation would hit 13.3% by October due to surging energy prices and will remain at elevated levels throughout much of 2023, before falling to its 2% target in 2025. As a consequence, the Bank now projects that the UK will enter recession from the fourth quarter of 2022, which it expects to last for five quarters.

Also dominating market direction in August were comments from US Federal Reserve Chair Jerome Powell at the recent Jackson Hole economic symposium. Powell delivered a concise and pointed message for markets that the Fed is committed to raising rates, and keeping them elevated, until inflation comes down in a meaningful way. After suggestions of a potential pivot in Fed policy direction in July, markets reset their expectations for interest rates which precipitated a sell-off in

equities and pushed bond yields considerably higher. Prior to Powell's speech, markets had been pricing in Fed rate cuts starting in mid-2023; however, expectations now call for a Fed pause, but no pivot in 2023.

Developed market equities and bonds resumed their declines in August as it became clear that further substantial interest rate rises will be needed to tame inflation. Fears around the outlook for the UK economy were reflected in a very poor month for sterling, flattering returns from elsewhere, while political uncertainty weighed on sentiment as questions remained over how any new PM might support consumers and businesses amid the intensifying energy crisis. The FTSE All Share index fell 1.70%. A number of large cap equities held up reasonably well, led by the energy and banking sectors, but this was offset by consumer-focused areas which underperformed amid fears that rising energy prices and interest rates will severely pressure the consumer as UK households face an income squeeze on multiple fronts.

Emerging Markets were the best performing indices, significantly outperforming developed markets, as the relatively better economic momentum in many countries was balanced by the difficulties encountered by China, both in its real estate sector and also due to the major heatwave and drought. Japanese stock markets also gained and outperformed most markets, helped by weakness in the yen. Eurozone shares fell sharply amid ongoing worries over inflation, particularly in the form of high gas and electricity prices. Recession risks in Europe remain elevated, as shown by the weakness of the euro which dropped to parity with the US dollar last month. Meanwhile in the US equities declined following Powell's Jackson Hole speech, dashing market hopes that further interest rate rises would be more modest. The benchmark S&P 500 fell 4.1% in dollar terms during a volatile trading month.

In fixed income markets, higher sovereign yields led to negative returns for all fixed income sectors last month. UK government bonds, measured by the FTSE Gilts All Stocks index, declined 7.64% their biggest monthly fall for almost 30 years as rising energy prices, higher inflation and interest rates and the possibility of more government borrowing to pay for the cost of living crisis took their toll.

Markets are now entering the historically volatile months of September and October. Investors will be squarely focused on the macroeconomic picture, most notably incoming inflation readings which will determine the path of central banks globally. It is no secret that markets are pricing in a mild recessionary outcome as expectations have run ahead of economic signals. While there are multiple potential paths for equities over the remainder of the year and into 2023, factors such as a UK policy response to the energy crisis, a clear peaking in US inflation (and then elsewhere) and an end to the war in Ukraine are potential catalysts for markets to recover some ground and for lower volatility.

Portfolios

The Beckford James portfolios fell into negative territory in the last few days of the month, largely in line with global stock and bond returns. Due to the significant falls in fixed income assets during the month the lower risk profiles fared the worst, whilst the higher risk profiles with more equity exposure held up better. The Income and Ethical portfolios also delivered negative returns.

Within the Growth portfolios, the strongest fund performances came from Emerging Markets, Asia and Japan, with the most notable performances coming from Baillie Gifford Emerging Markets Growth and Fidelity Japan returning 7.27% and 3.46% respectively. At the other end of the spectrum some of the UK funds were among the weaker performers, particularly those with exposure to the small and mid-cap areas of the market that came under pressure from the outlook for the UK consumer. The Amati UK Smaller Companies and UK Buffetology were among the greatest detractors to performance, down 6.62% and 5.57% respectively.

The Income portfolio followed a similar pattern, ending the month down 0.98%. The best performing funds were Artemis Global Income, up 3.66%, and Fidelity Asian Dividend, up 3.14%, however with a bias towards UK equity income funds that came under significant pressure last month these positive returns were not enough to offset negative returns from elsewhere in the portfolio. Notable detractors included Unicorn UK Income, Chelverton UK Equity Income and GAM UK Equity Income.

Finally, the Ethical portfolio fell 1.59% in August. Similarly funds in Asia held up well with the Stewart Investors Asia Pacific Sustainability fund delivering 7.48% and Alquity India up 7.39% but these were again offset by weakness in some of the UK holdings such as the Liontrust Sustainable Future UK Growth and Unicorn UK Ethical Income falling 6.31% and 5.64% respectively.

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