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INVESTOR INSIGHT

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A look at the markets by RSMR in association with...

GRAYSIDE FINANCIAL SERVICES

Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

Ken Rayner, CEO, RSMR

The global economy: What's going on?

Russian invasion triggers economic upheaval

As one may expect, the biggest difficulty facing global economies is Russia's invasion of Ukraine, which disrupted bond and equity markets – and no one knows how great the impact will be or how long it will last.

After weeks of war, volatility has settled and markets have made a tentative recovery.

In January the only major concern was how central banks would manage high, and more persistent, inflation amid forecasts of rapid interest rate rises.

> "After weeks of war, volatility has settled and markets have made a tentative recovery."

The war means UK inflation is likely to hit 8%, or more, this summer. The US Federal Reserve (Fed) and Bank of England (BoE) have raised rates but now the BoE appears to favour a softer approach as consumer confidence plummets due to a cost of living crisis created by huge energy price prices and tax increases.

As existing inflation concerns were linked to supply chains following voracious consumer demand after the pandemic lockdowns, Russia's aggression could not have come at a worse time as oil prices soar, prolonging higher energy costs and harming consumer confidence.

A long, drawn-out war will damage global growth and accelerate any recession from the already difficult inflationary conditions.

The asset classes – a quick round-up

EQUITY MARKETS

The first quarter was not great for investors but the Ukraine crisis could have made it far worse. Initial concern about inflation has shifted to the war, sanctions and implications for supply chains, especially energy. This has led to varying performances for equities in different sectors.

Before the Russian invasion, energy stocks were doing well and the UK market was stronger than most because of its traditional industry and energy bias. The US was weakening with technologies performing badly and fears about runaway inflation and rapidly rising interest rates reducing profit expectations.

Volatility created by the crisis will affect markets and investor confidence for some time.

War makes economic data harder to interpret. While the cause may be temporary there may be long-term ramifications. Market valuations will take account of this. War and economic uncertainty go hand in hand. The US is insulated to a degree but is a major energy consumer and is influenced by rising costs.

Commodity returns have been strong, particularly oil and gas and Russian gold and nickel as reflected in higher valuations for these companies across markets.

FIXED INTEREST

While the challenges remain unchanged – volatility and inflation – the Ukraine crisis made investors switch to safer assets to protect capital, and yields fell for a short period as a result. Now central banks must tackle rising prices without stymying growth.

Stagflation – sluggish economic growth, high unemployment and rising costs – was dismissed as a scare story but current pressures make this more likely.

Bonds have struggled with many of the most popular down 5-7%, caused by yields rising by around 1% since January (source: Financial Express).

The Fed and European Central Bank (ECB) aim to tackle inflation rather than growth and may not rush to support markets if recession looms.

European short-term borrowing costs fell as reliance on Russian energy supplies saw demand increase for assets with more consistent dividends and stable earnings. While rates have risen this may be the last for some time. Another threat, given escalating sanctions, is a Russian default on repayments on around $500bn of debt.

For now, short-term assets maybe best for investors, others being emerging markets where some central banks have hiked rates to make them more attractive, which should also help control inflation.

PROPERTY

After a strong 2021 performance with decent portfolio gains, there has been a clear demarcation between returns for physical property and those for shares. Physical property rose around 1-1.5% (source: M&G), driven by higher rental values, while equity markets fell due to the effects of the war.

Most positive have been the existing trends of warehousing and housing where demand outstrips supply, although higher interest rates would make homes more expensive to build and buy which could restrict availability.

All rental property should enjoy strong growth with distribution warehouses and London's industrial sector set to see the highest returns during the next five years, at 11.6% and 9% respectively (source: Schroder Investments).

Shopping centres, which have suffered through fewer visitors during the pandemic, may start to recover. Retail still hasn't fully emerged from the lockdowns and some underperforming units are being adapted for other uses, including homes. Offices have seen confidence return and a partial recovery is expected, tempered by home working and flexible employment, which are changing their use.

As before, investors are likely to focus on core, well-located retail space with secure long-term income, underpinned by high-quality tenants.

RSMR Global round-up

- The war has led The Office for Budget Responsibility (OBR) to downgrade UK growth from 6.5% to 4% in the year to October 2022.
- US inflation, which hit 7.9% in February, is the main concern for policymakers.

- The Organisation for Economic Co-operation and Development (OECD) has predicted a 1.4% point hit to Europe's economy in 2022.
- Japan's new University Endowment Fund has helped local equity markets.
- China is to focus on the quality, not quantity, of economic growth
- Brazil's market has been volatile as rising inflation resulted in significant 2021 interest rate rises.
- Bank of Japan will continue to support bond buying despite the yen being under heavy pressure.
- Chile has suffered political turbulence and the election of a left-wing regime
- India had shown signs of a long period of economic growth until Putin's war led to huge oil price rises.

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SO, WHAT'S NEXT?

Investors must analyse three main influences on financial markets: economic stability, now less supportive; valuations, which were high after the pandemic lockdowns; and investor confidence.

The biggest influence this year will be inflation, especially in the US where it may have reached 8.5% when data is finally published. It is expected to fall to around 2% in 2023.

UK prices rose more than 6% in the year to February and the BoE has warned inflation could hit double digits due to soaring energy prices. Even the EU, a traditionally lower inflation economy, has inflation above 6%.

Investor confidence plummeted following Putin's invasion. An eventual peace settlement is likely to create an equity market rebound but, once any euphoria fades, investors must refocus on underlying economic stability and valuations.

Valuations suggest greater caution with lower returns than the previous decade as asset prices adjust to higher inflation and more intense international political tensions during the next few years.

Global economic growth has been downgraded but, so far, the effect on the financial system is limited with equity indices higher than pre-war levels.

However, some nasty surprises still may still be lurking in the gloom and it's probably too early to declare victory over volatility.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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