HARTLEY ROSS

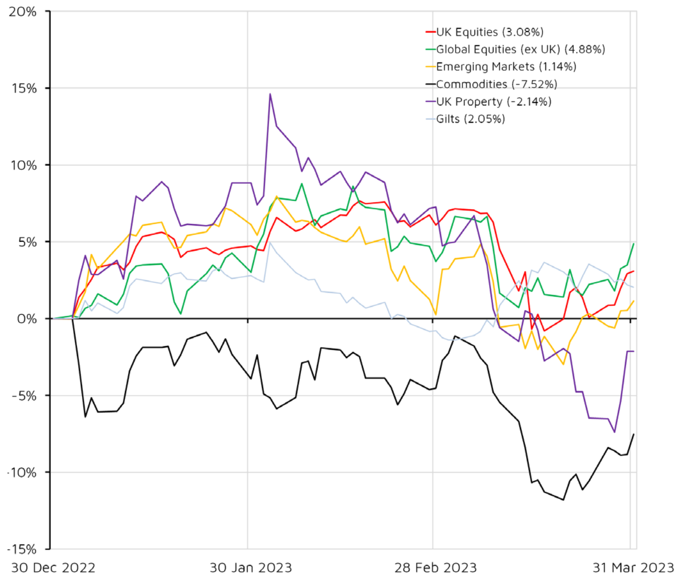
SPRING OUTLOOK

REVIEW OF THE PAST QUARTER:

The turmoil in bank stocks rattled equity markets in March. Following the failure of Silicon Valley Bank in the US and the emergency takeover of Credit Suisse by local rival UBS as the sell-off in banks stocks dragged on wider equity markets. This reversed a lot of the equity gains from the start of the quarter as the expectation that developed markets would enter recession receded as data showed economic activity remained robust. China's sudden removal of strict zero-Covid policy in December added to the more positive outlook at the start of the quarter.

Persistently high inflation has continued to shape markets. In the UK, headline and core inflation both increased in February and the Consumer Prices Index has remained above 10% for the last six months, while in the US core Personal Consumption Expenditure inflation, a closely watched indicator at the US Federal Reserve, also increased.

Bonds experienced very high volatility as investors continued to adjust their expectations for central bank interest rates. Bonds sold off in January and February before rallying strongly as investors reduced expectations for further interest rate hikes. Longer-dated bonds, those with the greatest sensitivity to interest rate movements, experienced the biggest change in value and ended the quarter with the largest gains, as markets expect central banks are getting close to the end of the rate hiking cycle.



Performance Data Calculated on a Total Return Basis

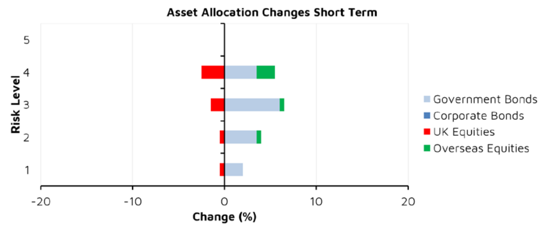
ASSET CLASS RETURNS

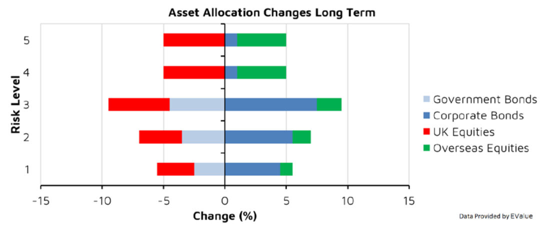
Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+0.96%	+2.05%	+4.30%	+2.38	+3.08%	+4.88%	+1.14%	-2.14%

THE ACTUARIAL VIEW:

Inflation remains higher than hoped but headline rates continue to decline and there are disinflationary pressures to come through in the spring. The outlook for UK sterling fixed-income returns are little changed but there is a shift in when they are expected to arrive, with the short-term improving at the expense of later returns. The outlook for corporate bonds has slightly improved compared with gilts. The recent decline in US Treasury yields means the potential upside for global government bonds is also reduced.

The expectation for returns from UK equities have deteriorated marginally, while US and emerging markets expectations have risen slightly. For the US and UK this is mostly driven by price movements where US equity underperformance has been enough to improve their value. Emerging markets also benefit from some clearing of the overall picture, as well as a weaker US dollar. Property is the biggest mover, with the outlook moving from low to very low driven by pressure on rents, investors raising yield targets and some negative momentum.





Data Provided by EValue

WHAT TO LOOK FOR:

- **UK:** UK unemployment rate is published on 18 April and UK inflation for March is published on 19 April. The Monetary Policy Committee (MPC) announcements and minutes are set to be released on 11 May. Preliminary GDP growth for Q1 is available on 11 May.
- **US:** The unemployment rate and change in Nonfarm Payrolls will be available on 7 April. Inflation data for the year to March will be released on 12 April. There will be interest rate decisions from the Federal Open Market Committee (FOMC) on 3 May. Minutes will be published three weeks after each decision. GDP growth for Q1 to be released on 27 April.
- **Eurozone:** GDP update for Q1 is set to published on 28 April. The European Central Bank monetary policy meeting to set interest rates is on 4 May. The inflation rate for April is set to be published on 2 May and the unemployment rate is due on 3 May.
- **Other Data:** OPEC+ meeting on 3 April. Chinese GDP and industrial production updates will be delivered on 18 April. Caixin China PMI and the JPMorgan Global Manufacturing are set to be published on 3 April.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Inflation gradually slows as rate rises continue. The UK flirts with recession amid persistently low consumer sentiment. Food inflation remains elevated and volatile, but energy costs fall. Recent trends continue as large companies protect their share price and earnings better than small and mid-sized companies and consumer-facing businesses will struggle. Overall, persistent inflation and higher interest rates weigh on global growth and lead to more volatility.

Worst Case: War in Ukraine causes food and grain prices to remain elevated. Rapid interest rate rises bring about a deep recession and stocks and bonds plummet as unemployment rises. This ends in the collapse of an unexpected area of the market leading to a run on the wider market. The UK should be relatively defensive given the lower valuations, but investors will struggle to find anywhere to hide.

Best Case: Central banks' interest rate hikes prove successful and inflation begins to fall without causing a massive change to unemployment and GDP figures. From its low valuation base, the UK rebounds with greater magnitude than other markets. A reasonable agreement for Ukraine's freedom cools food and commodity inflation. Smaller companies will stand to benefit the most from equity markets returning to sustained positive performance.

CASH

Most Likely: Yields on money market instruments should improve as the Bank of England continues its interest rate hikes. Nevertheless, interest rate increases are likely to remain behind inflation and so returns adjusted for inflation are likely to stay negative. These instruments will also suffer from negative capital returns as their price moves inversely to yields.

Worst Case: If more signs of recession appear, the Bank of England is likely to raise rates less aggressively, so limiting the upside for money market funds. This also means investors might revisit the case for UK government bonds as safe-haven assets, due to their sensitivity to interest rates. Cash instruments will therefore be a less compelling option for investors.

Best Case: The Bank of England surprises by continuing to raise rates either because inflation proves stickier than expected or to keep in line with the US Federal Reserve's tightening policy. This would improve the expected return from money market funds as managers can lock higher rates at longer maturity dates, which may offset the loss from capital return. It would also mean cash will further help investors to protect from downside.

GLOBAL EQUITY

Most likely: The US Federal Reserve hikes again but cooling inflation and jitters in the banking sector convinces it to stop there. In the US, interest rate sensitive sectors like technology and communications benefit from the Fed signalling the peak in interest rates. Chinese reopening provides support for export sectors in Japan and Europe.

Worst case: The Russian offensive in Ukraine regains momentum. Global supply shortages return and energy and food prices hit new highs, adding to inflationary pressures. Simultaneously, a global banking crisis develops, causing more banks to need rescue packages. The central banks are caught between fighting inflation and stabilising the banking sector; global markets are spooked by the uncertainty.

Best case: The war in Ukraine ends, allowing commodities from Russia and Ukraine to flow freely. China's recovery boosts the global economy and markets. Inflation cools rapidly and central banks are able to slow or halt interest rate hikes. Central banks restore confidence in the banking sector following the forced takeover of Credit Suisse. Faster economic growth boosts cyclical sectors such as industrials and consumer discretionary stocks. Technology stocks rise as the value of future earnings appears greater as inflation begins to recede.

FIXED INCOME

Most likely: Further rate hikes remain impossible to rule out until inflation falls significantly. Regulators calm investor fears over systemic financial contagion from recent bank failures, which should stabilise wider markets. However, investors remain wary of banks with tarnished reputations and bonds from lower quality companies. Government bond values hold steady in the aftermath of bank failures.

Worst Case: Inflation delivers another upward surprise. Wage growth and labour market tightness persist, driving the likelihood of further rate hikes. The premium paid by corporate borrowers stays high as banks move to further tighten their lending standards. Business investment and capital expenditure are further restricted and recession predictions move towards a harder landing.

Best case: Rate hikes by the US Federal Reserve and the Bank of England in March prove to be the peak for interest rates, following much hoped-for lower inflation. The banking system proves resilient and investor confidence is restored. Markets expect rate cuts to arrive earlier and this drives government bond yields down and increases optimism for a 'soft landing' scenario later this year. The additional premium paid by corporate issuers to borrow falls as a result.

EMERGING MARKET EQUITY

Most Likely: The end of China's Covid restrictions has been positive. Global inflation remains elevated, so countries and corporations with debt in dollars face pressure due to a strong US dollar. High inflation is a relative advantage for commodity-producing markets such as Brazil, but others such as India are exposed to higher food and energy prices.

Worst Case: China continues to experience significant headwinds from foreign regulation, domestic regulation and the struggling property market. Tensions between China and Taiwan result in a Chinese invasion. This would materially impact emerging markets, and has the potential to create a global economic shock. At present, we are considering this factor and although the magnitude of the risk is great, the probability of its occurrence is relatively low.

Best Case: The US Federal Reserve halts or even reverses some rate rises and this is extremely beneficial for emerging markets equities, due to the US dollar falling in value. The end of China's strict zero-Covid policy produces a strong tailwind for it and its trading partners. The 'nearshoring' drive by the US, coupled with an unwavering reopening of the Chinese economy, should provide a continued support for Latin America.

PROPERTY

Most likely: Favourable fundamentals and a rally in the broader equity and bond markets could allow the shares of property companies to outperform, but macro issues are likely to continue to be a challenge, particularly for sub-sectors lacking pricing power.

Worst case: Expectations for a weaker economic outlook negatively impact equity markets – including the property sector, given its dependence on the economic cycle, with the most economically sensitive sub-sectors particularly vulnerable (such as retail, offices, and leisure). Rising bond yields continue to have a negative impact on company valuations.

Best case: Property companies act as a strong inflation hedge, helped by their strong pricing power and attractive dividend yields. Fundamentals remain strong in sub-sectors such as industrials, storage and healthcare, where supply-and-demand dynamics are favourable. Equity markets rally, while government bond yields stabilise or edge down, making shares in property companies more attractive on a relative basis.

Data Sourced from FE Analytics, and FactSet