Canaccord Genuity Wealth Management

WAVERTON WEALTH PORTFOLIO REVIEW

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What happened during the quarter

It is unusual for the first quarter of the year to be covered in red ink for investors; but then, it would be an understatement to say this quarter was momentous for international events as well as markets.

The first quarter of 2022 (Q1) followed 21 months of some of the strongest returns ever seen in equities and risk investments in general. From the bottom of the markets in March 2020, global equities almost exactly doubled in value to the end of 2021. It is therefore natural for shares to give up some of their gains after such a record, but what we saw in Q1 was more than a simple technical correction. Two fundamental issues – the Ukraine conflict and rising inflation – crept into investors' psyches to make the fall more meaningful.

Firstly, inflation continued to defy gravity globally, with consumer prices continuing to beat estimates across the world. The US CPI (consumer price index) surged to 7.9%; 12 months previously, the rate had been just 1.7%. The CPI in the UK reached 6.2%. The scarier numbers were located upstream from consumer prices. Producer prices are up in double digits quite broadly: US PPI (producer price index) at 10.0%, UK input prices at 14.7%, German PPI at 25.9%. Fortunately, the Chinese PPI eased to 8.8% in February, offering some relief for supply chains.

The problem with inflation is that it currently reflects a tug-of-war between supply issues normalising (which brings prices down) and price increases spreading across the whole economy (which puts upward pressure on the overall inflation number). While we saw some supply bottlenecks being ironed out, rents and wages started their ascent, thereby spreading inflation more broadly. This was enough for central banks to change their discourse and ultimately their policy on interest rates.

The vocabulary used by the US Federal Reserve (Fed) was illustrative of that change in mood. Last year, Fed Chair Jay Powell kept using the word 'transitory' for inflation. He subsequently retired that word and replaced it with 'persistent', then 'sticky'. The latest buzzword is 'expeditiously', meaning that interest rate hikes have to happen fast in order to stem further price spikes.

Secondly, the tragic invasion of Ukraine by Russia has not only exacted a terrible toll on human life, but has also damaged many components of the financial markets. Energy prices soared, which should lead to higher inflation than was expected before the war. It's still too early, however, for CPI levels and most economic data to reflect the impact of the Ukraine conflict.

Central banks could not wait for the full Ukraine fallout and ran out of patience with inflation, embarking upon a potentially long cycle of interest rate rises. Although the Bank of England was first, the Fed made the most impact on markets by outlining a series of seven interest rate hikes this year, promptly followed by a more hawkish discourse, leading markets to expect eight hikes this year, including at least one 0.50% rate increase, as opposed to the standard 0.25%.

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Commentators started comparing this current situation to the 1970s and its trademark 'stagflation' (a combination of zero growth and high inflation). Both equities and bonds fell sharply during Q1, in line with the experience of previous high-inflation periods. Although equities recovered somewhat on expectations of a peace agreement between Russia and Ukraine, government bonds continued to fall, also dragging corporate bonds down.

The only investments benefiting from the situation were commodities, such as energy, metals, and agricultural products, as sanctions on Russia and the interruption of Ukrainian food exports curtailed global supplies of these products. Diversified commodity indices were up 31%. Gold, up 7% in US dollars, managed to provide the defensiveness that government bonds couldn't give.

Amid the downdraft in equities, there was a hierarchy of returns. Countries with a high percentage of natural resources (like Brazil, Canada and Australia) had a positive return over the quarter. The FTSE 100, benefiting from a number of major natural resource companies within its ranks, was one of the few indices to record a gain over the period. Most other stock markets fell sharply and, despite the late March recovery, are likely to finish in the red. Europe and China fared worst mostly owing to their vulnerability to energy imports.

Our view on the current situation

It is obviously not possible to make any projections for the outcome of the Ukraine war, but this issue could continue to weigh on the global economy and risk appetite.

On the other hand, the Fed has laid out a clear route for interest rates during this year and next. Markets have priced in this rate pathway and are therefore now likely to react mostly to amendments to that scenario. Such changes can come from developments in the Ukraine conflict as well as movements in inflation levels. The aforementioned tug-of-war on price increases is still present. The longer inflation stays high, the more difficult it will be to bring it down to the central banks' 2% target.

Economic growth is likely to slow down, but could be quite different by geography, with the US expected to be more resilient due to its large pool of consumer savings, the extremely tight labour market and the limited exposure to Russian energy imports. We don't think the concept of 'stagflation' applies to the current situation yet, due to the lesser vulnerability of our economies to high commodity prices vs. the 1970s.

Corporate earnings so far seem to be relatively unaffected by inflation, since many companies can pass on their increased costs in the form of higher prices to their customers.

These are uncertain times for investors, but with diligence and prudence it is possible to see a way ahead.

This commentary was written by Michel Perera, Chief Investment Officer at Canaccord Genuity Wealth Management, on 28 March 2022.

Quarter end asset allocation (%)

	Government bonds	Corporate bonds	International bonds	UK equities	US equities	European (ex UK) equities	Japanese equities	Asian (ex Japan) equities	Emerging market equities	Other international equities	Alternative assets	Cash	Total
Direct Growth MAP 2	16.50%	14.50%	20.00%	14.95%	5.40%	3.60%	1.80%	2.00%	0.60%	4.00%	11.70%	4.95%	100%
Direct Growth MAP 3	10.50%	8.75%	16.25%	20.10%	8.20%	5.65%	2.60%	3.00%	3.50%	4.50%	11.50%	5.45%	100%
Direct Growth MAP 4	6.65%	5.50%	10.50%	26.98%	10.60%	7.40%	3.20%	3.90%	5.50%	5.00%	11.00%	3.77%	100%
Direct Growth MAP 5	3.00%	3.00%	0.00%	33.91%	13.50%	9.30%	4.00%	5.10%	6.40%	5.50%	11.00%	5.29%	100%

Source: Ascentric and CG Wealth Planning Limited

Quarter end top 10 holdings

Active funds	Direct equities	Passive funds
Legal & General High Income Trust	BHP Group	iShares Core UK Gilts
PIMCO Global Investment Grade Credit Fund	Diageo	iShares UK Gilts 0 to 5yr
TwentyFour Absolute Return Credit Fund	GlaxoSmithKline	iShares Sterling Index Linked Gilts
Royal London Sterling Credit Fund	ITV	SPDR S&P US Dividend Aristocrats
BlackRock European Dynamic Fund	Legal & General Group	iShares FTSE 250 UCITS ETF
JPM US Equity Income Fund	Lloyds Banking Group	Vanguard S&P 500 UCITS
Scottish Mortgage Investment Trust	Royal Dutch Shell	iShares MSCI Japan
Federated Hermes Global Emerging Markets Equity Fund	Unilever	iShares MSCI AC Far East Ex Jpn
JPMorgan American Investment Trust	Experian	iShares MSCI EM
Aviva Investors Global Convertibles Fund	National Grid	ETFS Gold Bullion Securities

Source: Ascentric and CG Wealth Planning Limited

Quarter end performance

3 month to 31/03/2022	3 months		
Fund	**Return**	**Index**	**Return**
Direct Growth MAP 2	**-6.95%**	**CPI + 2%**	**2.24%**
Direct Growth MAP 3	**-7.89%**	**CPI + 3%**	**2.48%**
Direct Growth MAP 4	**-9.43%**	**CPI + 4%**	**2.73%**
Direct Growth MAP 5	**-10.85%**	**CPI + 5%**	**2.97%**

Source: Ascentric and CG Wealth Planning Limited

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