Commentary on Responsible Futures MAP Performance

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The impact of recent equity market volatility on your investments

Global stock markets are experiencing a period of heightened volatility leading to a temporary fall of more than 10% in the value of your portfolio since 31 December 2021. Growth stocks and technology companies that have delivered strong returns over the past few years have been sold off the hardest. Under EU Regulations (MIFID II) we are required to notify you of this fall within 24 hours and we believe it's also good practice to maintain regular contact with clients. Equity market volatility is not unusual – in 95% of calendar years, there is at least a 5% downward move in shares; and in 63% of the years, there is a more than 10% market correction.

What are the reasons for the current market volatility?

What we are seeing now is a reaction to a strong 2021, in particular for US indices, which went up last year and are indeed falling more than other markets. In addition to the technical correction, there is a fundamental reason for market volatility. The US Federal Reserve has announced a tighter monetary policy. The minutes of the December meeting have shown the Federal Reserve's willingness not only to raise rates as soon as quantitative easing (QE, i.e. buying assets) is over, which is slated for March - but also to initiate quantitative tightening (QT, i.e. selling those assets back to the market). Markets have therefore started repricing shares to reflect future rate rises.

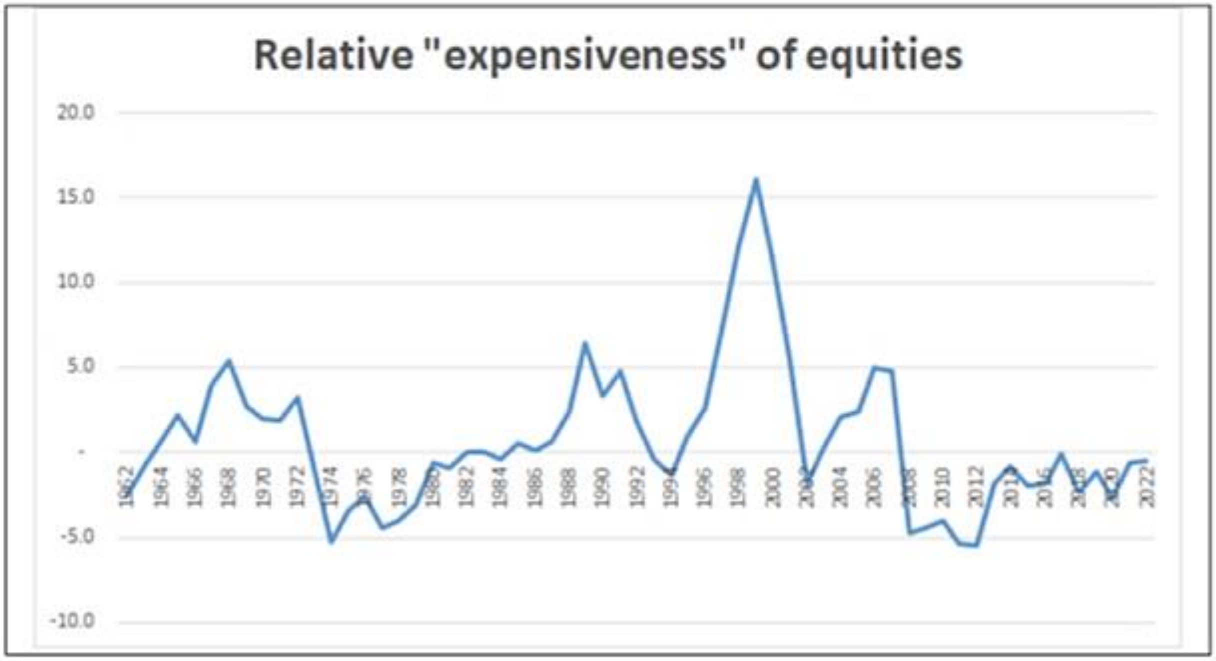
Corporate Earnings supportive

Corporate earnings have been very strong over the last two years and show no sign of exhausting themselves. The risk of a recession, which is what normally hits earnings and triggers bear markets, is low. This is because the growth momentum coming out of post-COVID-19 fiscal and monetary stimulus is still strong. Interest rates after inflation, known as real rates, are sitting at a historically negative level, whereas restrictive real rates (higher than inflation) are generally required to halt economic growth and cause a recession.

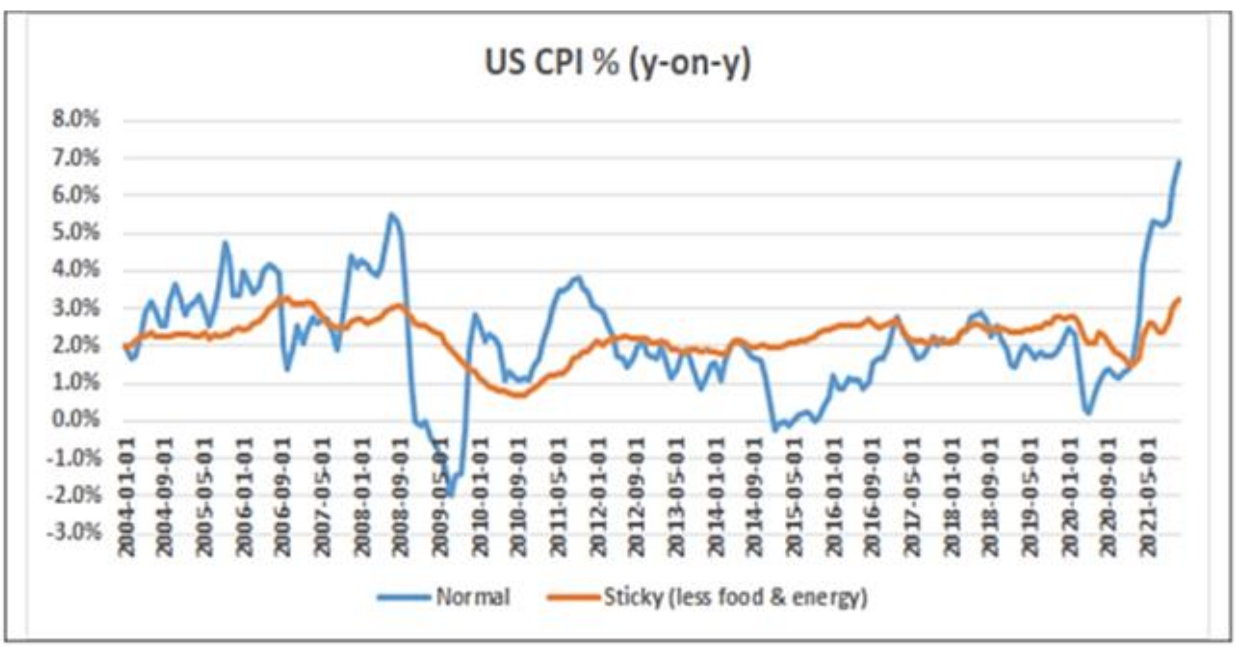
At this stage, we would suggest that the worst asset class to sit on is cash, whereas equities are likely to provide the long-term returns expected of them, although volatility is part of that return.

Macro

In our opinion, the equity market in general is not significantly overvalued. This is based on our observations about current market levels, bond yields and future growth. We can show this over time in a somewhat crude but informative graph. This chart shows the difference between the current Price/Earnings ratio, based on the next 5 years expected Earnings Per Share, and a normal Price/Earnings ratio based on current bond yields and average returns. The higher the number, the more expensive the market is.



What we have seen this year is a style rotation, very similar to what happened in Q1 2021. Deep cyclical value stocks have risen and high growth quality stocks have fallen. This began after data showed the Omicron variant of COVID, whilst more contagious, to be less harmful than the Delta variant. With booster jabs, recovery from illness appeared to be quick. Confidence grew amongst investors that this could lead to a return to normal and a lasting economic recovery. Added to this, we have seen inflation data spike up sharply to levels not seen for many years, reflective of the global bottlenecks building in the system. This has spooked investors, who are not used to dealing with a +6% CPI. This is an extreme event and is the reason for heightened anxiety amongst investors. There is a strong case to argue that this headline inflation is temporary. There has not been such a rise in “sticky” inflation.



Style

The performances of different sectors shows the extent of the style rotation. The top sectors have all risen by as much as 6% and the bottom sectors have fallen by over 6%.

Top	Bottom
Autos +6%	Healthcare -5%
Energy/Oil +6%	Semis -5%
Banks +7%	Software -4%
Metals/Mining +6%	Retailing -4%

Responsible Futures philosophy

We are a growth strategy. We invest with a view to supporting themes that are geared towards achieving long term growth. These include: cloud computing, cyber security, robotics & automation, oncology, batteries, water, and clean energy. Other than in special circumstances, the RF portfolios do not invest in any of the deep cyclical sectors listed above.

Our investment philosophy is also focussed on supporting managers who buy high quality companies that exhibit strong structural growth. This balances out the more small cap oriented themes in which we target. These companies, which have been driving most of the gains in stock markets for many years, have suffered in 2022 due to this style rotation. Many of these companies are found in the bottom sectors listed above.

We prefer to use listed investment trusts to access certain managers. We do this because they offer attractive long term return profiles, good liquidity and competitive charges. In the short term volatility is higher in these vehicles because of moves in the discount/premium.

Growth

Whilst this has been a sharp and acute style rotation in favour of value, we believe that the most important driver of long-term returns is growth. So far, we have not seen any indication that the strong growth from our portfolio of companies within the funds we own is about to slow. The weighted aggregated revenue growth forecasts for the companies within our equity funds over the next 4-5 years as determined by our Morningstar is over 15% CAGR. If this proves to be correct, it will provide a strong driver to investment returns going forwards.

Valuation

We have carefully reviewed the valuation cases for all our funds in the portfolios. In aggregate we are happy with the valuation of the portfolio. It is possible that some of the strong performers in Q4 2021 (e.g. Baillie Gifford Positive Change) may have produced stretched valuations. However, recent share price declines have improved the outlook.

Risks

The market is focussed on the direction of inflation. If inflation persists, then it is possible that the current style rotation could continue as the major beneficiaries to inflation are banks and commodity related companies. However, we believe that much of the true value differential between the deep cyclical stocks and the high-quality growth stocks has now been corrected. Markets need time to pause for breath at times, particularly after a strong period over the past two years. As long term investors, this is welcome. We continue to expect exciting growth from the RF strategies.

Disclaimer