Marlborough Group

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05/05/2022

April 2022

Global Investment Commentary

- ***Further upside risks to inflation due to Ukraine conflict and supply chain concerns***
- ***Central banks likely to slow the pace of rate tightening***
- ***Challenging period for economies, but risks balanced by potential rewards***

Inflation continues to be the main risk facing investors. While there may be some indications that inflation's peak is not far off, falling inflation might not be the panacea we're all hoping for: unless inflation turns negative consumers will still struggle to make ends meet until wages can catch up. That means consumers will for some time yet be forced to either defer or forego certain goods or services, or to trade down to cheaper alternatives. That translates into lower profits for companies and lower economic growth for countries.

The question of when inflation might fall is tricky: whilst the oil price is well below the peak it reached around the time of the Russian invasion of Ukraine, it is still above where it was in the second half of 2021 - that means the oil price is still pushing up year-on-year inflation readings, even as it pushes down the month-on-month figures.

Meanwhile, supply chain concerns are mounting: the chip shortage that has dogged several industries - notably cars - has reached the second derivative: there is now a shortage of chips for the machines that make chips! Furthermore, due to COVID lockdowns there are currently about 300 ships waiting outside the port of Shanghai to be loaded or unloaded, with obvious potential impacts for global trade. Despite this, container shipping costs have actually been falling; since supply has not increased, this suggests a decline in demand, which itself is evidence of a weaker growth picture.

Even though growth is under pressure, central banks still need to be seen to be taking action on inflation, and rates in the US and UK have been raised again. And higher rates will of course further dampen growth...

But there are signs of light. One is the strength of the jobs market. In the US, unemployment is running at 3.6%, and unemployment benefits claims are the lowest they've been in 50 years. The 3-month average growth in wages is 6%. So, despite the gloom on the inflation front, consumers are still in relatively good shape. Company profit margins are, for the most part, holding up; companies have been able to pass on their higher costs.

Another positive factor is the underlying strength of the global economy. Although the picture has been clouded by the unexpected decline in US growth in Q1 (see below) and the as-yet-not-fully-known impact of the Ukraine conflict, expectations are still for positive aggregate GDP for the full year. We think the economy will continue to expand despite higher interest rates, though likely at a more moderate pace than in 2021.

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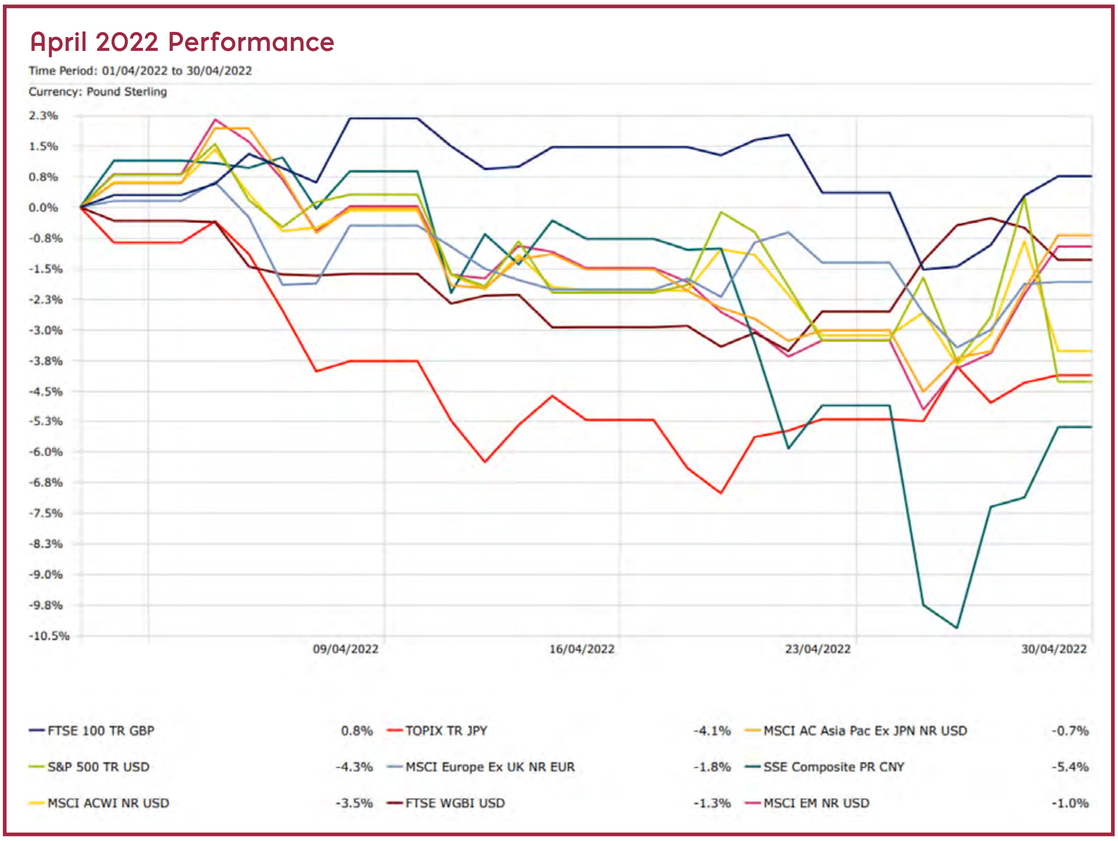
Finally, inflation itself might decline: Spain's inflation level in April dropped to 8.4%, down from the 9.8% reading in March. Could this be a hint of things to come? If inflation was to fall from here, central banks would no longer be obliged to raise interest rates as quickly, or as much. The dramatic ratcheting up of policy-tightening expectations has taken its toll on fixed-income investments, with bond returns (measured by the Barclays US Aggregate Bond Index) suffering their worst performance periods since 1990. We don't expect an immediate or complete reversal of the losses, but history shows that bonds have typically rebounded modestly after poor periods of returns. The experience in 1994 saw bonds under pressure for the first two quarters of the Fed tightening cycle, but bonds returned 3.6% over the subsequent two quarters even as the Fed increased policy rates.

Looking more broadly at a balanced portfolio, while the first quarter of this year saw both stocks and bonds come under pressure, in the last 40 years, when a 60% equity, 40% bond portfolio experienced a quarterly decline of more than 5% (which happened 12 times), the average return in the following 12 months was 11.8%.

We are still maintaining our overall neutral position in equities: while there are clear and present risks, most of these have been discounted already, and there is plenty of potential upside. On the fixed income side, our preference is still for shorter-duration exposure, to minimise the impacts of rising rates. But with the growth picture weakening, and the potential for inflation to undershoot expectations, we will be considering this carefully in the weeks ahead.



Source: Morningstar Direct

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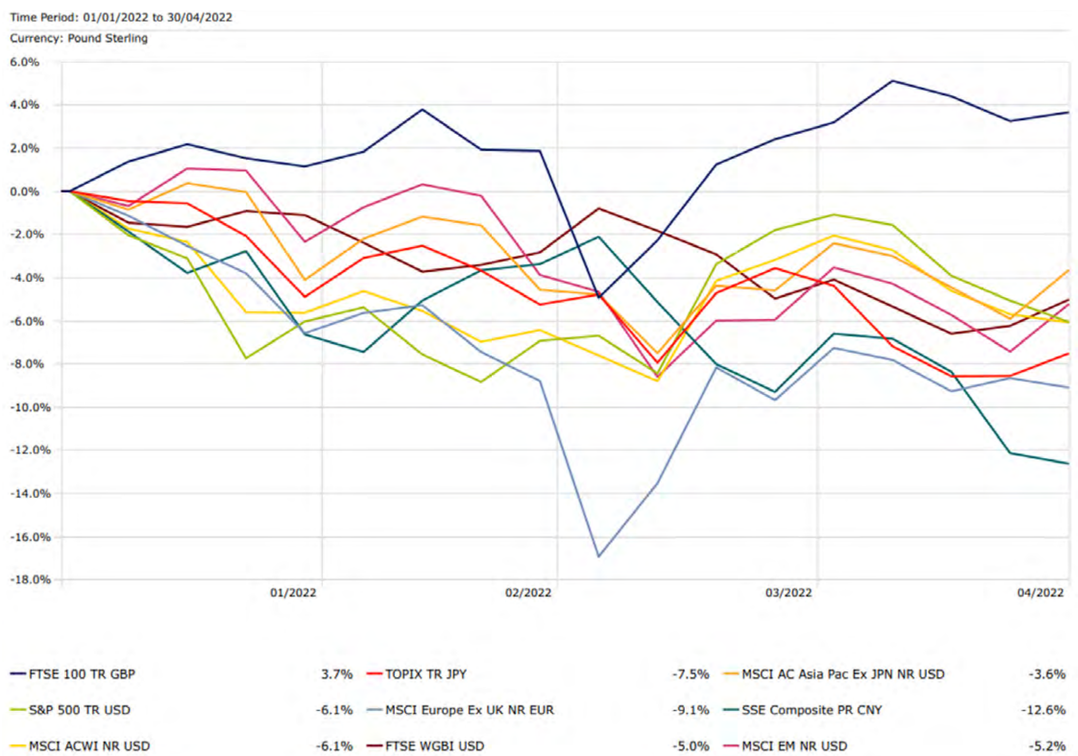
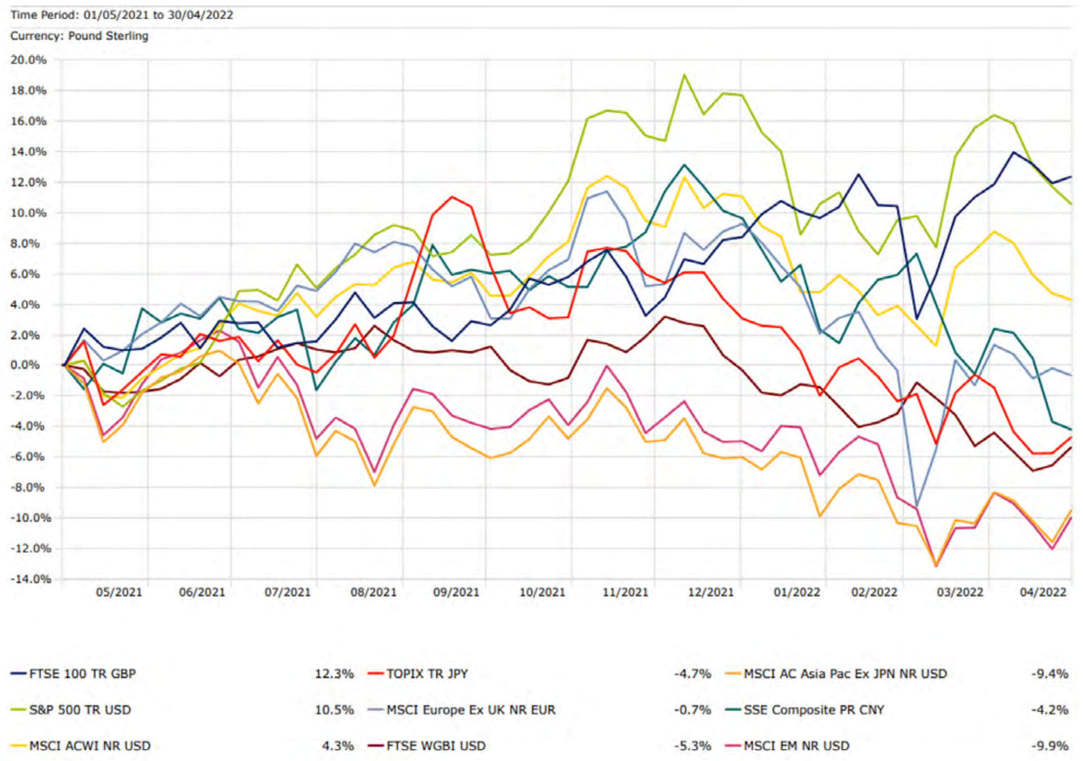
Year to Date Performance



Source: Morningstar Direct

12 Month Performance



Source: Morningstar Direct

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UK

- ***UK economy and market well-placed in the changing environment***

In a difficult month for equities around the world, the UK was the only major stock market to post positive returns. Part of this is down to the structure of the UK market, with high exposure to oil and banking stocks which are doing well in the current environment. But another factor is the weakness of sterling, especially when measured against the US dollar. 75% of the revenues of FTSE 100 companies are earned offshore and translating these foreign revenues back at a lower exchange rate boosts sterling profits.

The weaker sterling has also lessened the blow for UK-based investors in offshore markets. See the table below: in local currency terms, the MSCI World index fell by 8%, but for sterling-based investors the loss was about 3.5%. Global bonds lost almost 6%, but in sterling terms the loss was a more palatable 1.3%.

We have maintained our overweight stance throughout 2022.

US

- ***"Soft patch" in Q1, but underlying economic strength***

The preliminary estimate of first-quarter GDP showed economic growth declined by 1.4%, marking the first contraction since the pandemic. The negative quarterly growth is a bit of a technical anomaly, though, in part a cooling off after last year's aggressive inventory rebuild and widening trade deficits and other pandemic-related factors. But as we noted above, the underlying picture is still relatively strong, and we think the economy will continue to expand despite higher interest rates.

During April, companies issued their first-quarter earnings results. There were some notable surprises as several index heavyweights missed analyst expectations. This includes the likes of Alphabet (Google), Amazon, Apple, Meta (Facebook), and Microsoft, which together make up 21% of the S&P 500. Results indicated that growth is slowing, although there was also evidence that long-term trends, like digital transformation, remain alive and well. Many of these companies have used the recent earnings season to manage investors' expectations downwards, which leaves room for an upside surprise when they report their next earnings results. Netflix would be a good example: subscriber numbers fell by two hundred thousand in the first quarter of 2021. However, Netflix said they expect to lose two million subscribers in the second quarter. That's a huge decline, so there is room for a positive surprise.

During April we moved from underweight back to neutral in US equities. The sharp declines in share prices have brought valuations down from previous high levels, and the physical and economic distance from the Ukraine could make the US a safe haven in uncertain times.

Europe

- ***Gloomy economic picture, but already discounted by markets***

Events in Ukraine continue to weigh on Europe. Economic growth in Q1 2022 was a paltry 0.2% and inflation reached a new record of 7.5%. Gas supplies from Russia to Poland and Bulgaria have been cut, and EU has now laid out a plan to ban imports of Russian oil by the end of the year. A tit-for-tat response is expected. All of this is leading to higher inflation, lower consumer confidence, and lower spending - a gloomy picture. As with sterling, Euro weakness might be the saving grace for European stocks, along with the fact that much of the bad news has already been priced in. We remain neutral.

Asia and Emerging Markets

- ***Growth challenges, but monetary policy remains supportive***

We noted supply chain concerns above; China's "zero-Covid" policy, and strict lockdowns in Shenzhen, Shanghai and Beijing will exacerbate these concerns. China's central bank has reacted by easing interest rates and providing a liquidity injection. In the meantime, growth levels are holding up relatively well, with Q1 GDP growth at 4.8%.

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Fixed Income

- ***Upside risks to inflation persist, but bad news baked in***

Despite the gloomy economic outlook, yield curves have not properly inverted: shorter-dated bonds still have yields below longer-dated bonds. When the reverse is true, it is because bond investors are anticipating lower inflation in the future, which can generally only happen when growth declines. Although global growth will suffer a hit from the Ukraine conflict, we still believe a global recession will be avoided. But with a lot of bad news baked into bond prices, and the potential for inflation to undershoot expectations, the fixed income market may now offer decent value. We are maintaining our short duration stance for now, but are considering moving back to neutral.

Market Round Up

Performance of major markets	April		Year to Date		12 months to 30th April	
	Sterling Terms	Local Currency	Sterling Terms	Local Currency	Sterling Terms	Local Currency
UK (FTSE 100)	0.76%	0.76%	3.66%	3.66%	12.35%	12.35%
US (S&P 500)	-4.27%	-8.72	-6.05%	-12.92%	10.51%	0.21%
Europe (MSCI Europe Ex UK)	-1.83%	-1.27%	-9.09%	-9.16%	-0.68%	2.77%
Asia (MSCI Asia Pac Ex Japan)	-0.69%	-5.30%	-3.65%	-10.69%	-9.45%	-17.89%
Japan (TOPIX TR JPY)	-4.11%	-2.40%	-7.51%	-3.54%	-4.69%	2.45%
China (SSE Composite)	-5.38%	-6.31%	-12.62%	-16.28%	-4.22%	-11.60%
Emerging Markets (MSCI EM)	-0.96%	-5.56%	-5.23%	-12.15%	-9.93%	-18.33%
All World (MSCI ACWI)	-3.52%	-8.00%	-6.07%	-12.94%	4.28%	-5.44%
World Govt Bonds (FTSE WGBI)	-1.29%	-5.88%	-5.02%	-11.96%	-5.33%	-14.15%

Source: Morningstar Direct

Risk Warnings

The following is a summary only of some key items in the Prospectus.
Capital is at risk. Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment.
Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds.
The Master funds will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events.
It should be appreciated that the value of Shares is not guaranteed and may go down as well as up and that investors may not receive, on redemption of their Shares, the amount that they originally invested.
Investment in the Company should only be undertaken as part of a diversified investment portfolio.
Investment in the Shares should be viewed as a medium to long term investment.
Shares may not be redeemed otherwise than on any Dealing Day.
There will not be any secondary market in the shares of the Company.

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