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Marlborough
International

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September 2022

Global Investment Commentary

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- ***Summer rally ended by central bank hawkishness in the face of cost-of-living crisis***
- ***Recession becoming increasingly likely in most regions, but expected to be shallow***
- ***Currency moves a blessing in disguise***

There are plenty of reasons to be hopeful that the worst is over, for economies and particularly for markets which tend to look beyond current conditions. There are still some lingering benefits from the post-pandemic re-opening - so effectively illustrated by the rush for summer holidays this year - and jobs markets remain very strong in many regions. For example, in the US, there are 5.6 million more job openings than there are unemployed people. And as noted above, some inflation measures have fallen from their peaks - US headline inflation levels fell to 8.5% in July, down from 9.1% in June. In July, the oil price declined by 11%, which will feed through into lower transport costs.

But there are just as many reasons to be nervous. As individuals, we are all feeling the pinch as the cost-of-living crisis deepens. In the UK, the energy price cap will rise again in October, piling on further pressure, eating into consumers' disposable incomes. Indeed, the UK's "Misery Index", which considers the dual hardships of inflation and unemployment to measure the economic distress felt by the average citizen, is now almost as high as it was in the Global Financial Crisis a decade ago.

VIEW FACTSHEET

DEFENSIVE

CAUTIOUS

BALANCED

ADVENTUROUS

UK Misery Index

Source: Bloomberg

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To combat rising prices, further interest rate hikes are inevitable, and a global recession is now the most likely scenario. In fact, a recession is potentially the only way to break the self-fulfilling spiral of higher inflationary expectations. Central bankers are talking tough; they need to do so, to make businesses and consumers take them seriously enough to adjust hiring, wages, and consumption.

While this may sound quite depressing, a shallow recession now is better than a deep recession later, and equity prices may already have fully discounted the economic weakness ahead.

But uncertainty remains, and with it comes volatility so the cautious stance we have implemented in portfolios remains in place. Equity exposures are still biased towards lower-risk, defensive funds investing in companies that can deliver stable earnings and dividends. And on the fixed income side, we have continued slowly to increase exposure to secure sovereign debt which would perform well in a recessionary environment.

UK

- ***Inflation still a threat, but economy holding up well***

UK inflation levels reached double digits for the first time since the 1980s. This has increased rate rise expectations, and rates are now expected to peak in this cycle at 4.3%, 1.5% higher than expectations at the start of the month.

But there are still plenty of positives to be found: wage growth is positive, household savings balances are robust and housing wealth is high, mortgage and credit card lending is strong, companies still have excess cash, and PMI readings are coming in higher than expected. Additionally, we can also expect fiscal support from the new PM.

Sterling has been weakening. Although this increases the cost of imports (and going on holiday abroad is effectively an import), the weaker currency is positive from an economic perspective: over 70% of the FTSE100's aggregate earnings are derived overseas, and when these are translated back at the weaker exchange rate, sterling-denominated earnings improve. The same is true for investors: sterling returns on offshore assets are boosted when sterling weakens.

We had previously positioned portfolios with an overweight to UK equities. This aided relative performance throughout this year, but we have now decided to cash in those chips and move back to neutral.

US

- ***Tough talk on inflation, but we could be over the worst***

As noted above, the US Fed is talking tough. In 1975-6, the central bank missed their chance to kill off inflation: they eased rates too soon and only a deep recession in 1981 eventually did the trick. Clearly, they do not want a repeat of that and are determined to stay the course this time around. Investors had clearly begun to price in fewer rate hikes than previously anticipated, so Fed Chair Powell's speech stopped the summer rally in its tracks: from an economic perspective, higher rates dampen growth, and from an investor perspective, higher rates lead to lower share price valuations.

The US appears to be further along the inflation track than other major regions; indeed, some inflation measures have already begun to fall. We are maintaining our neutral position, but here too have tilted exposures towards funds favouring dividend-paying companies.

Europe

- ***Gloomy economic picture, but equities holding their own***

At the Jackson Hole symposium, in the wake of a 9.1% inflation reading, the European Central Bank's tone was also hawkish, indicating that they need to take the "path of determination" to deal with the severe inflationary pressures being experienced. As a result, most market participants now expect a 0.75% interest rate increase in September, and a total of 1.6% by year-end.

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Like sterling, the euro has also been weakening; the common currency dropped below parity to the dollar in July and reached a 20 year low in August. On the one hand, this is positive as it makes European exporters more competitive on the global stage, but on the other hand it makes the cost of imports more expensive, and Europe tends to import quite a lot of its raw materials, especially gas and oil.

All of this means that Europe is the region most likely to suffer a recession. But despite this European share prices did not decline by much more than US shares in August, and on a year-to-date basis the MSCI Europe index is slightly ahead of the US S&P500 index. The starting valuations of European equities were lower than in other regions, and this has helped cushion the impact of the gloomy economic outlook. We remain neutrally positioned.

Asia and Emerging Markets

- ***China growth picture is gloomy, but stimulus will help***

China was one of the few countries to buck the hawkish trend with a rate cut in August. This was in response to rising systemic risk from the fragile property market as well as the weakening economic growth picture: the post-pandemic re-opening boom is fading, the costs of the zero-Covid policy are being felt, and a regional drought is leading to power curbs and shipping reductions. As indicated by the rate cut, though, China is one of very few countries where the authorities have room to manoeuvre and can provide stimulus without risking rampant inflation.

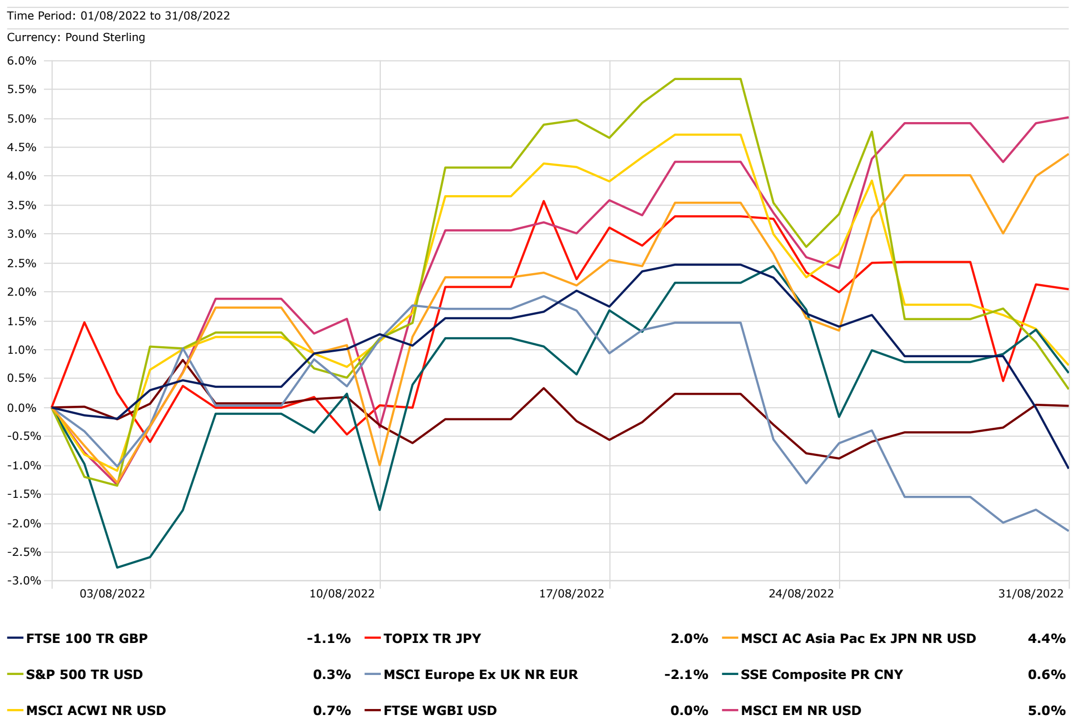
Fixed Income

- ***Bonds in bear market territory***

All year, bond markets have reflected the see-sawing prospects for inflation (higher inflation is bad for bonds) versus growth (weaker growth is good for bonds as authorities eventually need to cut rates to boost the economy). This month, inflation fears weighed more heavily, and bond prices fell sharply. In the first few days of September, global bonds - as measured by the Barclays Global Aggregate index of government and investment grade corporate bonds - fell into bear market territory (a drop of more than 20% from its peak) for the first time in over 30 years.

We had maintained an underweight position in bonds for most of the year. We began to move portfolios back towards neutral a few months ago, but most are still slightly underweight.

August 2022 Performance



Source: Morningstar Direct

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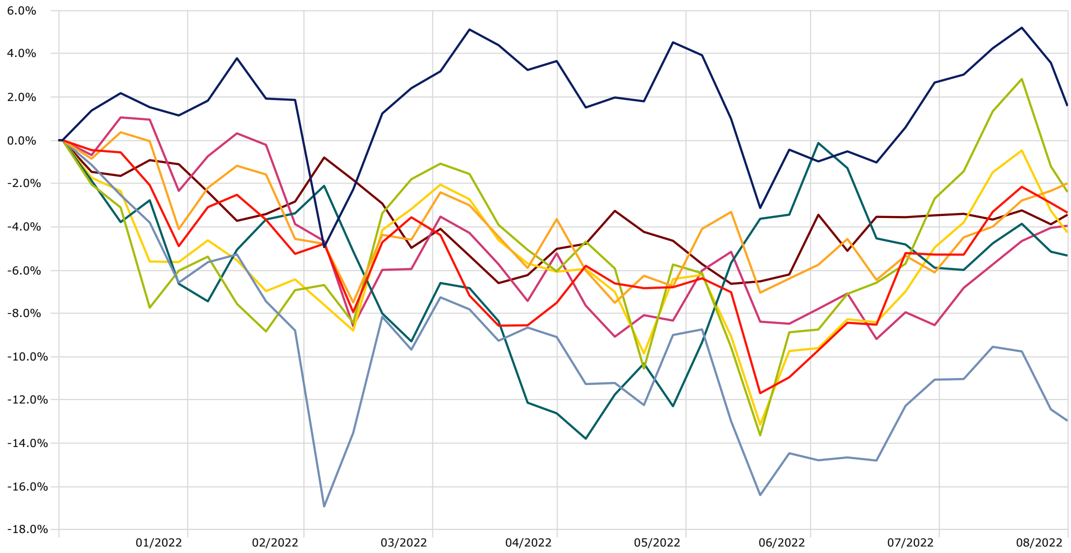
Year to Date Performance

Time Period: 01/01/2022 to 31/08/2022

Currency: Pound Sterling



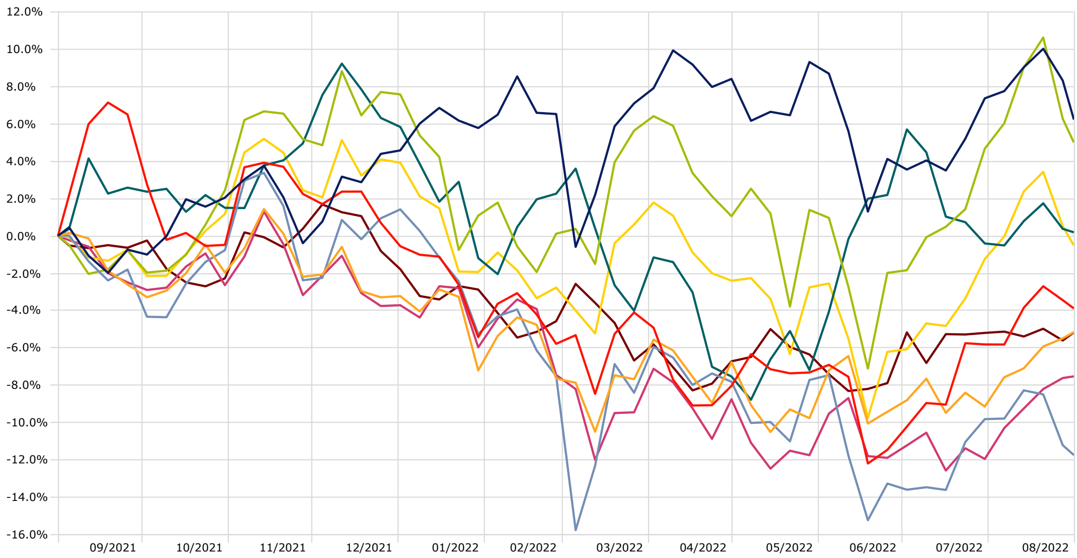
FTSE 100 TR GBP	1.6%	TOPIX TR JPY	-3.3%	MSCI AC Asia Pac Ex JPN NR USD	-2.0%
S&P 500 TR USD	-2.4%	MSCI Europe Ex UK NR EUR	-13.0%	SSE Composite PR CNY	-5.3%
MSCI ACWI NR USD	-4.3%	FTSE WGBI USD	-3.4%	MSCI EM NR USD	-4.0%

Source: Morningstar Direct

12 Month Performance

Time Period: 01/09/2021 to 31/08/2022

Currency: Pound Sterling



FTSE 100 TR GBP	6.2%	TOPIX TR JPY	-3.9%	MSCI AC Asia Pac Ex JPN NR USD	-5.1%
S&P 500 TR USD	5.0%	MSCI Europe Ex UK NR EUR	-11.7%	SSE Composite PR CNY	0.2%
MSCI ACWI NR USD	-0.5%	FTSE WGBI USD	-5.2%	MSCI EM NR USD	-7.5%

Source: Morningstar Direct

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Market Round Up

Performance of major markets	August		Year to Date		12 months to 31st August	
	Sterling Terms	Local Currency	Sterling Terms	Local Currency	Sterling Terms	Local Currency
UK (FTSE 100)	-1.06%	-1.06%	+1.58%	+1.58%	+6.22%	+6.22%
US (S&P 500)	+0.32%	-4.08%	-2.39%	-16.14%	+5.00%	-11.23%
Europe (MSCI Europe Ex UK)	-2.13%	-5.11%	-12.96%	-15.43%	-11.73%	-12.38%
Asia (MSCI Asia Pac Ex Japan)	+4.38%	-0.19%	-1.99%	-15.80%	-5.15%	-19.80%
Japan (TOPIX TR JPY)	+2.04%	+1.21%	-3.35%	-0.04%	-3.88%	+2.55%
China (SSE Composite)	+0.60%	-1.57%	-5.33%	-12.02%	+0.19%	-9.64%
Emerging Markets (MSCI EM)	+5.02%	+0.42%	-3.95%	-17.49%	-7.51%	-21.80%
All World (MSCI ACWI)	+0.73%	-3.68%	-4.26%	-17.75%	-0.51%	-15.88%
World Govt Bonds (FTSE WGBI)	+0.03%	-4.35%	-3.44%	-17.05%	-5.16%	-19.82%

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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