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Marlborough International

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Global Investment Commentary

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- ***All markets weaker in the face of higher inflation/lower growth outlook***
- ***Recession becoming increasingly likely in most regions, but expected to be shallow***

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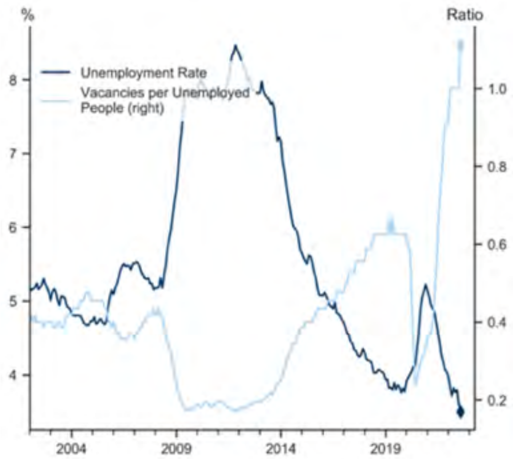
During October, hopes began to surface that interest rates might not rise as far or as fast as markets had been predicting. The Bank of Canada surprised markets with a lower-than-expected interest rate hike of 0.5%, with its governor stating that we are "getting closer" to the end of the tightening cycle. The European Central bank (ECB) said "[we have] made substantial progress in withdrawing monetary policy accommodation." The Bank of England's chief economist, Ben Broadbent, noted that the higher rate rises that the market had been anticipating would deliver a "pretty material" hit to the economy. And early in November, the US Federal Reserve raised rates by the expected 0.75% but pointed to a slower pace of rate hikes starting in December.

As a result of these comments, expectations for "terminal rates" are falling, and investors (at least in Western markets) have used this as an excuse to push equity prices higher. But the fact remains that even if inflation has stopped rising in some areas (notably the US), it is staying stubbornly high and even rising in other areas (notably Germany), despite lower gas prices, easing product shortages and lower shipping costs. There are several structural drivers at play, keeping inflation high. The first is wages. Unemployment is

UK Unemployment Rate and Vacancies per Unemployed People



Source: Source: Goldman Sachs, Haver Analytics

still at very low levels - the latest reading is 3.5% in the UK, the lowest since 1974. More strikingly, for each person looking for work in the UK, there is more than one job available. In the US, this figure is even higher at 1.7 jobs per available worker. This is leading to rising wage costs as companies compete to find staff. But when people are paid more, they can afford the higher prices being charged for goods and services, so this allows inflation to creep ever higher. When this happens, workers demand higher wages, and the risk of a wage-inflation spiral rises.

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Secondly, in the wake of the supply chain issues that reverberated around the world earlier this year, many companies are exploring "re-shoring" - bringing production back to the home country, rather than having goods shipped in from offshore. This is generally more expensive - production was moved offshore precisely because it was cheaper - and companies will seek to pass those costs on to consumers via higher prices.

Thirdly, while supply chain issues are easing, they are not gone. China's dogmatic adherence to their zero-Covid policy is leading to on-going lockdowns.

And finally, food prices have been falling, but could easily reverse course. Putin's move in October to restrict the export of grain from Ukraine through the Black Sea threatened to do so. That decision was rescinded in early November but highlighted how delicately-poised the situation is at present.

On a more positive note, though, despite all the talk of looming recession, economies are actually still in reasonable shape. GDP forecasts are falling but are still positive: expectations in the US are for 2022 to deliver 1.5% growth, and 0.5% in 2023. The economy there has been creating an average 366,000 jobs per month since the Fed started raising rates in March. The latest figure (263,000 in September) was roughly double the average pre-Covid number. Inflation aspects aside, a strong jobs market will help keep consumption up. So will the savings buffer that individuals built up during Covid - in the US this is equivalent to 10% of GDP, and in Europe about 5% - which will act as a cushion against falling real (inflation-adjusted) incomes. These factors should help ensure that any recession is shorter and shallower than feared.

UK

- ***Stability brings pros and cons***

During the period of turmoil surrounding Kwasi Kwarteng's mini-budget, markets were expecting interest rates in the UK to peak at 6.25%. But the perception that some semblance of stability has been restored, along with a commitment to reducing the budget deficit, has brought expectations for the "terminal rate" down to 4.75%.

Sterling has also rebounded strongly from its lows, but this has some negative consequences. We've noted these before, but in reverse (they were a boost when sterling was falling). Firstly, the sterling denominated value of assets held in other currencies declines as sterling strengthens. And secondly, the same is true for UK companies: their offshore earnings decline in value when converted back to GBP at the higher rate.

Despite the political issues, currency gyrations and high inflation, the UK equity market is still the best performing of the major markets this year. However, this may be tested in the months ahead as the growth outlook weakens in response to reduced fiscal support (the new government has clearly signalled its intentions to raise taxes and reduce spending) and higher mortgage rates.

We remain neutral on UK Equities.

US

- ***Equity index strength masks underlying turmoil***

The strong rebound of US equity indices in October - the S&P500 Index bounced 9% off the lows reached mid-month - masks some significant moves in underlying stocks that were the result of weaker earnings reports.

The focus was on mega-tech companies, as they pointed to declining advertising spend, sluggish e-commerce conditions, falling margins (the result of higher input costs), and the uncertain economic outlook. Declines in these stocks were sharp, and on a year-to-date basis (as at end October) Meta (Facebook) is down 72%, and Google, Amazon, Microsoft, and Tesla are each down over 30%.

But despite this, US equities rebounded strongly during the month. 70% of companies have now reported Q3 earnings, and 64% of these have beaten expectations.

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Granted, this is a lower proportion than the average 75% of companies that beat expectations, but the fact that this has happened during a period in which severe stresses are present is a positive. What's more, analysts are still expecting earnings growth in 2023 to accelerate (from 7% to 7.6%), despite the well-flagged risk of recession.

Here too we are maintaining our neutral position, with a bias towards dividend-paying companies.

Europe

- ***Recession creeping closer***

As is the case elsewhere "hard" economic data is holding up relatively well. But "soft" (sentiment-based surveys) are pointing to a steep downturn ahead. But here too, the downturn will be muted by fiscal support (for instance Germany has unveiled a EUR 200bn programme to aid households) and a sharp decline in gas prices. Cognisant of the risks to growth, the ECB has hinted at a slower pace of rate rises in the months ahead

While recession is more likely here than in other regions, this is already largely discounted. We remain neutrally positioned.

Asia and Emerging Markets

- ***China concerns mount***

China was the weakest major market in October, as investors reacted to the significant shake-up of the politburo in the 20th National Congress. President Xi has been given a third term in office, and by removing potential dissenters, now has virtually complete control of the government. The lack of checks and balances could lead to poor decisions going unchallenged; the focus on the zero-Covid policy is a case in point. Continued rolling lockdowns combined with weaker external demand will weigh on economic growth.

Fixed Income

- ***Credit markets quite sanguine***

Bonds remain hostage to the ebb and flow of the growth vs inflation debate. Overall, returns in this space were muted during October. High yield bonds - which usually tend to correlate quite highly with equities, due to the higher inherent risks - have performed quite well: expectations for default rates remain reasonable at about 2.5-3.5%. Companies are in pretty good shape: balance sheets are quite strong, cash flows are ok, and debt has been "termed out" - meaning there is not a wall of loans which need to be refinanced in the near term at rates much higher than before.

Market Round Up

Performance of major markets	October		Year to Date		12 months to 31st October	
	Sterling Terms	Local Currency	Sterling Terms	local Currency	Sterling Terms	Local Currency
UK (FTSE 100)	+2.99%	+2.99%	-0.78%	-0.78%	+1.68%	+1.68%
US (S&P 500)	+4.81%	+8.10%	-3.19%	-17.70%	+1.66%	-14.61%
Europe (MSCI Europe Ex UK)	+4.26%	+6.59%	-13.59%	-15.48%	-11.69%	-13.15%
Asia (MSCI Asia Pac Ex Japan)	-7.13%	-4.21%	-17.05%	-29.48%	-18.11%	-31.22%
Japan (TOPIX TR JPY)	-0.77%	+5.10%	-9.51%	-0.72%	-9.58%	-1.00%
China (SSE Composite)	-9.88%	-4.33%	-18.34%	-20.50%	-14.85%	-18.43%
Emerging Markets (MSCI EM)	-6.05%	-3.10%	-16.97%	-29.42%	-17.88%	-31.03%
All World (MSCI ACWI)	+2.81%	+6.03%	-7.23%	-21.14%	-4.70%	-19.96%
World Govt Bonds (FTSE WGBI)	-3.55%	-0.52%	-7.87%	-21.68%	-7.41%	-22.23%

Source: Morningstar Direct

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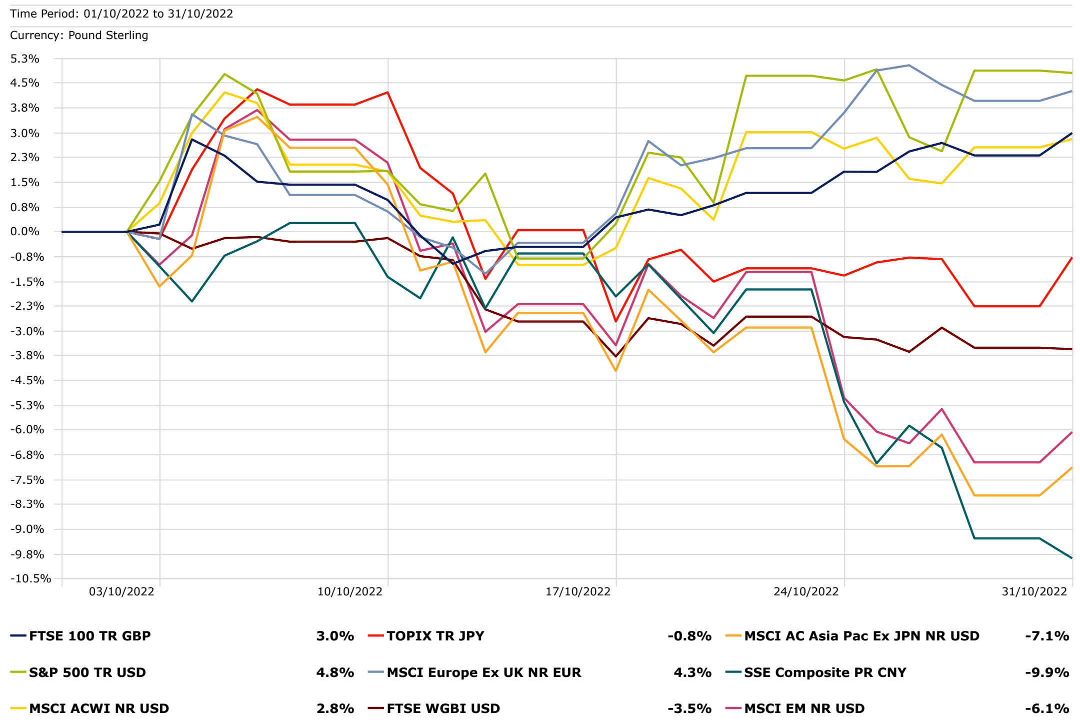
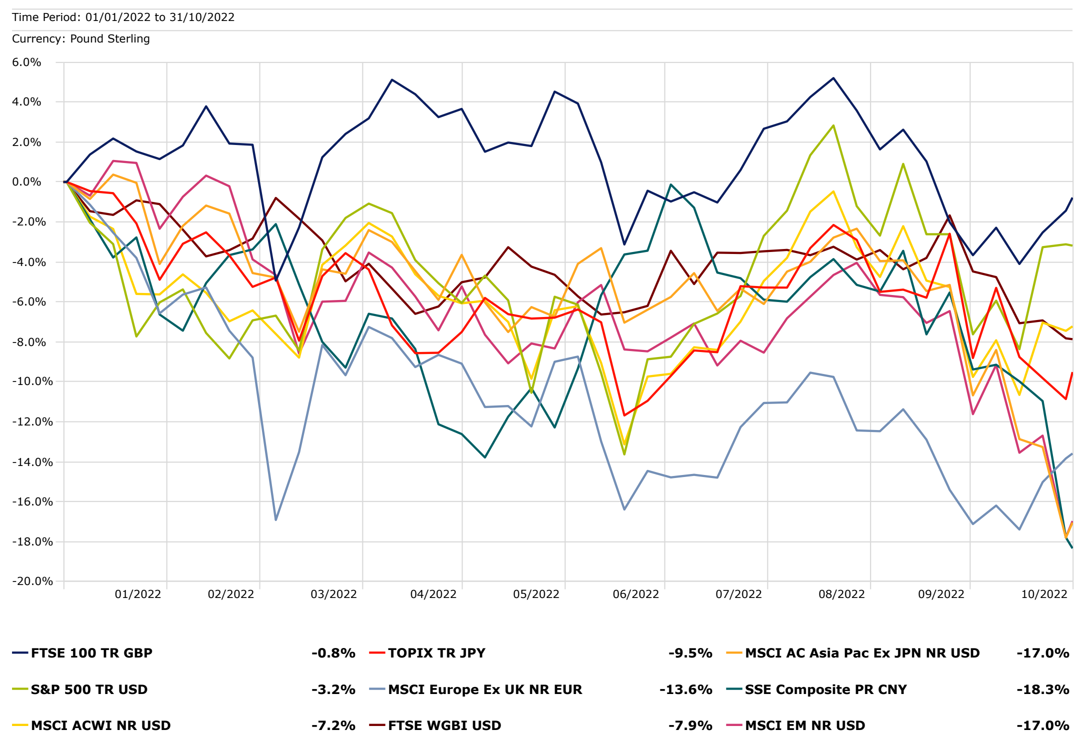
October 2022 Performance



Source: Morningstar Direct

Year to Date Performance



Source: Morningstar Direct

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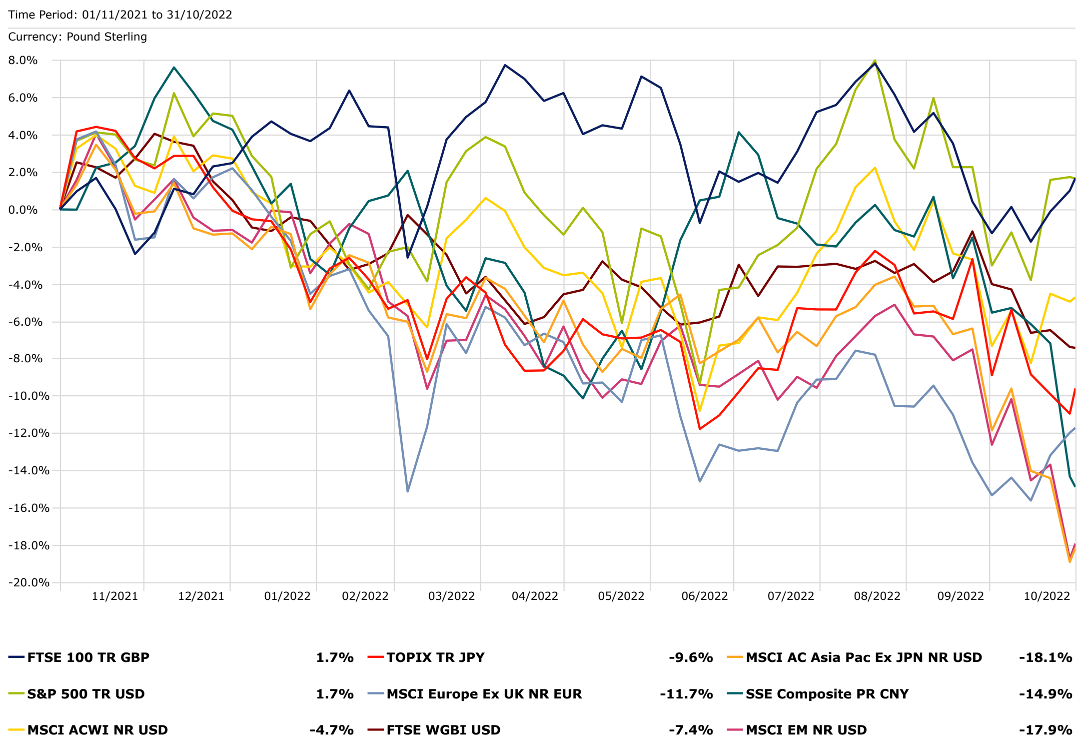
12 Month Performance



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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