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WEALTH MANAGERS

MARKET COMMENTARY

Executive Summary

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Economic data released throughout July provided further evidence that the global economy is slowing. Inflation remained front and centre, soaring to new highs despite ongoing efforts by central banks to slow the rising cost of living. Against this backdrop, and the growing threat of recession, markets increasingly moved to price in interest rate cuts from the Federal Reserve in 2023. Anticipation of a pivot to a less aggressive stance was supportive of risk assets, with growth-oriented stocks the major beneficiaries.

It was another sobering month for inflation statistics. In the UK, the Consumer Price Index (CPI) rose by 9.4% in the 12 months to June, up from 9.1% in May. The rise was driven by the usual suspects – namely housing and household services (principally from electricity, gas and other fuels), and transport (principally from fuel costs). The largest downward contribution was from second-hand cars. The Bank of England (BoE) upped its peak inflation forecast to 11%, coinciding with the Autumn increase of the energy price cap.

Record setting inflation was not confined to the UK. In the US, the annual inflation rate accelerated to 9.1% in June, the highest since November 1981. June's number surprised on the upside, coming in significantly above the market's forecast 8.8%. As in the UK, energy was the primary driver, though food costs also surged 10.4%, the largest rise since February 1981. However, with gasoline prices declining from recent highs, investors grew increasingly confident that US inflation had peaked. In Europe, Eurozone inflation came in at 8.6% in June, up from 8.1% in May. According to a flash estimate from Eurostat, July's figure is expected to be greater still, with 8.9% forecast.

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Central banks continued to increase rates, seeking to rein in rampant inflation whilst simultaneously avoiding recession. In the US, at least, a recession may already be upon us. The generally agreed upon criteria – back-to-back quarters of negative real GDP growth – have now been met. In Q2, real GDP decreased at an annual rate of 0.9%, following a 1.6% in Q1. However, a recession can only officially be declared by the non-partisan National Bureau of Economic Research, and to date, it has not done so. Fed Chair Jerome Powell certainly doesn't believe the US has entered a recession – following the Fed's July 75 bp interest rate hike, he told reporters, 'It's a strong economy and nothing about it suggests that it's close to or vulnerable to a recession.' Joe Biden shared Powell's view, though with mid-terms fast approaching, it could be argued that such comments were made at least partly in self- (or rather, party) interest. The question for investors, now, is – if we are entering a recession, to what extent has it already been priced into markets?

July was also notable for the reversal of fortunes of 'growth' stocks – i.e., those that have the potential to increase in capital value at a higher rate than the rest of the market and therefore tend to rely more on longer-term factors such as future earnings growth. Official definitions aside, global economic slowdown and the Fed's pivot to a more dovish stance resulted in a rally for riskier, long-duration assets. Aggregate global growth stocks returned 11.5% in July, whilst their value counterparts (i.e., those that are generally perceived to be undervalued versus their intrinsic value) gained a more modest 4.6%. Chief amongst the beneficiaries were the US technology giants, bolstered by a 'better than feared' earnings season. In fact, of the 56% of US larger companies reporting before the end of July, more than half had beaten analyst estimates – notably above the long-term average of 47%.

Markets

Moving on to markets, the 'risk on' attitude saw most of the major indices post positive returns in July. Aggregate world equities finished the month 7.7% up, recovering most of May/June's lost ground but still circa 5% down year-to-date. In the US, markets were up 9.1% on aggregate. Technology-heavy indices, broadly experiencing a period of negative sentiment from the investment community, posted an even more impressive 12.4%. The subtle shift in

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interest rate expectations, combined with the resilience of corporate earnings, has likely put a near-term floor under equity markets across the pond.

UK large caps have provided investors with something of a safe haven year to date, relative to their mid-cap and growth-orientated international peers. Following a tough June, the large-cap index bounced back in July, returning 3.5% over the month. The performance of the index was supported by the strong performance of oil majors, amongst others. UK mid-caps also benefited from investors renewed appetite for risk, returning 8.0% in July. In Europe, blue chips broke a run of five consecutive months of negative returns, rallying 7.3% in July, with investors at least momentarily unconcerned by the looming threat of energy rationing. Japanese equities also posted a sizeable 5.3% gain over the month.

After strong gains in May and June, Chinese equities retreated 9.3% in July. China continued to wrestle with an Omicron outbreak and a series of rolling lockdown measures implemented across various cities. Investors have been looking for signs of a potential softening of COVID policy, but July yielded little. No major announcements are expected until after the Party Congress in autumn. There was some positive news in July, as Q2 GDP surprised on the upside. Crucially for the global economy, exports significantly beat expectations, contributing to an easing of supply chain pressures. Authorities were also able to increase stimulus measures, as the Chinese economy continued to evade the inflationary pressures suffered by western economies. Real estate was the largest detractor from the index, as concerns about the property market weighed heavily on the sector.

Elsewhere in emerging markets, Indian equities returned 8.7% in July, tracking gains in the US.

Fixed Income

There was respite, too, for fixed income investors – global aggregate bonds gained 2.5% in July, buoyed by the aforementioned expectations that the Fed will begin to shift a less aggressive policy. Having suffered disproportionately year-to-date, long-duration bonds (that

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is those that are typically more sensitive to changes in interest rates) outperformed their short-duration peers. UK and US Government bond prices rallied, with the yield on a 10-year gilt falling from 2.32% to 1.86% by the end of the month. US 10-year Treasuries yields also fell.

Commodities

Following a stellar start to the year, commodities began to reflect investors' fears of a global economic slowdown. While global supply remains tight, not least as a result of the ongoing sanctions placed on Russian exports, the oil price showed signs of weakness, declining 4% in July. Industrial metals also saw price falls in line with falling projections for global economic growth. There was some good news for global food supplies, as Russia and Ukraine agreed on a deal to resume exports of grain from the Ukrainian port of Odessa. The first ship, carrying 26,000 tonnes of corn, departed port on the 1st of August. An estimated 20 million tonnes of grain remain trapped in the country, with a new harvest about to begin.

Currencies

In the currency markets, political uncertainty in the UK had little impact on the value of the sterling, which was broadly flat against the dollar. Sterling strengthened versus the euro, but lost ground versus the yen, which rallied 1.6% over the month.

| Whitechurch Investment Team | July 2022 |

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