INVESTMENT MATTERS

JULY 2022

ECONOMIC AND POLITICAL BACKDROP

Although geo-political events were no less troubling this quarter than they were last, it was the macro-economic landscape that dominated market movements. Concerns about inflation were at the forefront of investors' minds as measures of price rises rose further, labour markets remained tight and supply chain disruption persisted. This backdrop took its toll on risk assets once again, as bond and equity investors fretted about the impact of higher interest rates and the risk that tighter financial conditions would tip economies into recession.

Economics

With inflation running hot and global economic indicators showing weakness, concerns about the growth outlook and the risks of recession mounted and, not surprisingly, confidence amongst businesses, consumers and investors took a further knock. At the same time, labour markets remained tight; indeed, the unemployment rate in the UK fell to its lowest level since 1974, although wage increases still lagged inflation. Structural issues within the UK employment market, exacerbated by the consequences of the pandemic and Brexit, were brought into sharp focus by travel chaos at the airports. Strikes and threats of industrial action over the summer added to the negative picture for the UK. As the cost-of-living crisis tightened its grip, consumers showed signs of cutting back on their spending, while manufacturing production was held back by price increases and supply chain shortages. More broadly, global supply chain issues continued to be a major concern, with China's COVID-19 lockdown and the war in Ukraine causing further disruptions.

Russia and Ukraine

The conflict drew on, with Russia gaining territory in eastern Ukraine and its forces causing misery and destruction in its wake. An attack on a shopping mall brought international condemnation. EU leaders voted to ban Russian oil imports by sea by the end of the year and also to reduce gas imports but was unable to agree on an outright ban. The US declared a complete ban on Russian oil, gas and coal imports, while the UK planned to phase out oil imports by the end of the year. There was great concern about Ukraine's stockpiled grain, which could not be shipped because of Russia's port blockades.

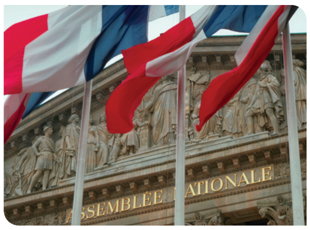
Monetary policy

Central bankers pushed on in their efforts to fight inflation, seeking to pare overall demand without triggering recession. The UK base rate was raised to 1.00%; with further hikes in the pipeline, the market priced in the likelihood of a 2.00% base rate by the year end. The US Federal Reserve raised rates twice, by 0.50% in May and a further 0.75% in June, the largest increase since 1994. The European Central Bank (ECB) reinforced the case for rate hikes as inflation simmered across Europe. With the ECB's bond buying programmes coming to an end, there was pressure on the bonds of weaker EU countries, triggering an emergency meeting and plans for a new mechanism to address the risk of fragmentation. China cut the borrowing rate again as authorities struggled to stabilise the property market and deal with the economic consequences of COVID-19 lockdowns.

ECONOMIC AND POLITICAL BACKDROP (CONTINUED)

UK politics and events

As the nation celebrated the Queen's Platinum Jubilee, discontent amongst Tory MPs mounted as a result of further "Partygate" revelations and disappointing results in local elections. Prime Minister Johnson won a vote of confidence, but only by an uncomfortably narrow margin. The foreign secretary announced that a new law would be introduced to change the post-Brexit trade deal for Northern Ireland, with a view to freeing up the movement of goods. This engendered fury from those who saw this as a breach of international law, bringing with it the threat of a trade war with the EU. Meanwhile, Scotland's First Minister, Nicola Sturgeon, prepared to set out her case for a second independence referendum. The government's pilot scheme to re-locate asylum seekers crossing the English Channel to Rwanda faced legal challenges. Chancellor Sunak yielded to pressure and announced a windfall tax on energy firms as the cost-of-living situation continued to dominate the headlines.



Global politics and events

Emmanuel Macron defeated Marine Le Pen and was re-elected to the French presidency in a closely fought election campaign. However, subsequently, he lost his majority in the National Assembly, curtailing his ability execute his political agenda. Finland and Sweden submitted applications to join NATO and Ukraine and Moldova were granted EU candidate status. In Australia's election, the incumbent Liberal/National coalition was defeated, and the Labor Party's Anthony Albanese was sworn in as the new Prime Minister. COVID-19 lockdowns in China were eased.

MARKET REVIEW

Equity Markets

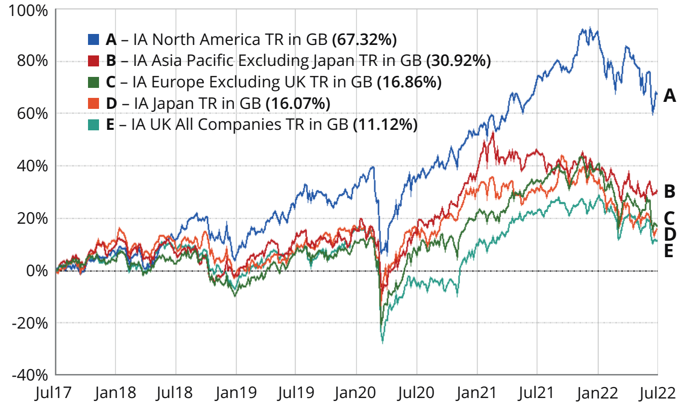
Global stockmarkets experienced elevated volatility over the quarter, with significant falls seen on some days amid widespread weakness across most sectors. The prospect of interest rates moving up rapidly to ward off runaway inflation was the key worry, but of course heightened geo-political tensions and disruption to commodity supply chains added to investors' frayed nerves. Latterly, the idea that much higher interest rates might tip economies into recession took hold.

US markets suffered deeper falls than many developed market peers and formally entered bear market territory. The UK fared better, with energy stocks and more defensive areas offsetting weakness in consumer-related and industrial sectors. Small and mid-cap stocks were relatively weak as they were perceived to be less resilient in the face of ongoing supply problems, the impact of rising costs and the challenging outlook for consumers.

It is noteworthy that it has been a tough year for actively managed funds compared to indices. This is particularly true of funds managed with a "growth", rather than a "value" approach; the most highly valued growth shares (where the share price today reflects expectations for growing profits into the future) have seen significant falls in some cases, as the uncertain outlook has knocked investors' forecasts. Conversely, companies with more defensive business models and stable cash flows have fared better, for example, healthcare and tobacco companies.

With sanctions on Russia remaining in force, any Russian assets held within funds could not be traded. Fair value pricing committees at fund management firms discounted Russian assets to reflect this illiquidity, particularly impacting funds dedicated to the region and emerging market funds more broadly.

Average total returns of funds in IA equity sectors over 5 years to June 2022 (in UK sterling terms)

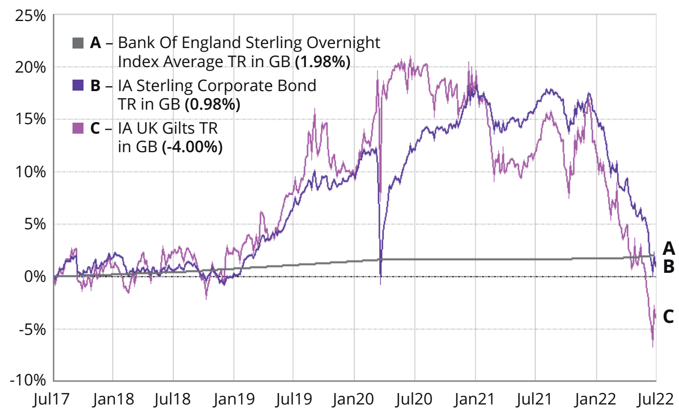


Source: FE. Please note that the value of investments and the income from them can fall as well as rise.*

Bond Markets

Government bond yields rose over the quarter as the price of debt fell to account for higher interest rates and the risk of sustained inflation. Yields on core government bonds moved up rapidly (prices fell) to levels not seen for several years, resulting in negative total returns for investors. In tandem, corporate bonds also registered sharp price declines.

Average total returns of funds in IA bond sectors over 5 years to June 2022 (in UK sterling terms)



Source: FE. Please note that the value of investments and the income from them can fall as well as rise.*

* These graphs reflect the average performances of funds that feature in different IA (Investment Association) sectors. The performances are in sterling terms, which means that the effects of changes in the value of sterling versus other currencies are incorporated in the performance figures. Performances are calculated on a bid to bid basis, which means that any costs associated with the purchase or sale of shares/units are not included.

MARKET REVIEW (CONTINUED)

Other Assets

The oil price rose earlier in the quarter but the deteriorating outlook for global growth weighed upon sentiment towards the commodity, despite the ongoing supply disruption caused by the war in Ukraine. Industrial metals prices also fell.

Gold struggled to make headway, belying its safe-haven credentials. The precious metal is priced in US dollars and the strength of the currency held the price back, as did higher yields from government bonds, a competing "safe" asset.

Sterling weakened further and now counts as one of the worst performing major currencies over this year so far. On the positive side, this has been to the benefit of investors holding foreign currency denominated assets in their portfolios. Cryptocurrencies fell sharply as the so-called algorithmic stablecoin, TerraUSD, together with its sister token, Luna, both collapsed. The chaos led to fresh scrutiny from regulators.

And Finally

So far, 2022 has been a difficult year for most investors as bond and equity markets have both experienced material drawdowns and there have been few places to take refuge. Investors holding an allocation to bonds for the purposes of risk reduction have had to endure equity-like drawdowns as markets have adjusted to a higher interest rate regime. Indeed, the first half of 2022 has been one of the worst periods on record for a balanced portfolio of 60% equities / 40% bonds. If we factor the effects of inflation into this result, investors' returns in real terms are worse still.

A shifting macro-economic and monetary policy backdrop was always going to result in nervous times for markets. If we layer on political troubles, ongoing COVID-related disruption and a war in Europe, the drawdowns we have seen this year are, if painful, not a surprise and part of an inevitable adjustment process. A number of the extreme bubbles in markets have already burst, with the eternal riches promised by some profitless companies and cryptocurrencies now recognised as the falsehoods that they always were.

Given the significant rise in yields, opportunities are emerging in fixed income markets, while caution is warranted in equities, with income strategies still preferred. Whilst expectant of continued volatility, fund managers are using the opportunities afforded by weak days in markets to build up positions that they regard as solid investments for the long term.

By Gill Hutchison, Research Director, Embark Group

FUNDS

What's changed?

Fund Suspension and subsequent closure

GB00BYP82D37 – Janus Henderson UKPrpPAIFFd I A – dealing suspension effective from 4 March 2022. Fund closed on 28 April 2022

Janus Henderson stated the below in their fund communication:

"On 28 April 2022 the Board of the Funds' Authorised Corporate Director (ACD)/Manager exchanged contracts with the selected single purchaser of the Fund's direct property portfolio. The sale price is above the most recent independent valuation used to price the Funds. Janus Henderson believe this provides a good outcome for investors given the ongoing uncertainty faced by daily dealing property funds (as explained in our notice of 4 March 2022).

Putting the Funds into termination now is necessary to protect the Fund's PAIF status and to allow completion of the property sale and preparation of the payment of proceeds to investors. There are a number of activities that need to take place between exchange of contracts and completion of the sale and precise timing of completion is therefore uncertain. Janus Henderson currently expect the property portfolio sale process to complete in the week commencing 30 May 2022. Janus Henderson hope to be in a position to instruct the payment of proceeds roughly two weeks after the completion date and currently estimate this to be in the week commencing 13 June 2022.

This payment will be made up of the net proceeds from the property sale and the remaining cash held by the Fund. The costs involved in selling the direct portfolio of properties will be borne by the Funds and estimated costs for this are already reflected in the 'bid' price (the published price at which shares/units are redeemed). The administrative costs of terminating the Funds will be borne by Janus Henderson."

Embark have received the proceeds from Janus Henderson and this has been paid into your account.

Fund name changes

GB00B3Z9PT62 – Fidelity Moneybld Income W Dis£ fund name changed to **Fidelity SusMnybldInc W Dis£**, effective 26 May 2022.

For information on the panel funds currently available through the ISA and Investment Account, please contact your adviser or go to **client.embarkplatform.co.uk** where you can download the Sterling Panel Funds Guide.

Keeping in touch

Please tell your adviser if you change your postal address, telephone number or email address.

If you no longer have an adviser, please contact us direct to ensure Embark holds your up-to-date contact details.

It's especially important that we are able to send you information by email.

Digital communication is fast, secure, environmentally friendly and costs less than print.

Please let your adviser or us know if you have any problem receiving or reading digital communications like email or on-screen literature.

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