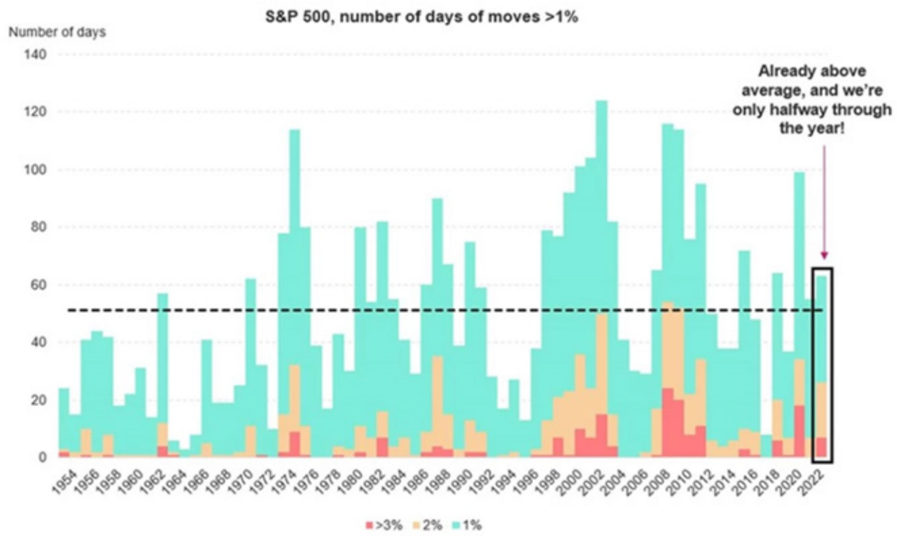
LEARN FROM THE PAST, PLAN FOR THE FUTURE

The second quarter of 2022 saw signs of a shift in investor focus, away from worries about inflation and the rising interest rates needed to combat it and toward the weaker outlook for economic growth. We are working our way through a downside adjustment. The risks that built up over recent years are materialising, meaning lower economic growth, higher inflation, higher interest rates and negative returns in the year to date from financial markets. This will not last forever, but it has not been a great quarter. The chart below from 7IM shows that we have already had a significant number of daily market moves above 1% in 2022, compared to history – pretty impressive when we are only half way through the year.



Source: 7IM, Bloomberg Finance L.P., Past performance is not a guide to future returns, chart(s)/data for illustration purposes and are not for further distribution. Returns and analysis is based on daily total returns. The chart is for illustrative purposes only.

The transition has been painful for investors in both equity and bond markets, many of which have seen their worst start to a year since the early 1970's. Covid era valuations – boosted by excess liquidity – have been beaten down and higher bond yields are pressuring equity valuations. The MSCI World equity index has already registered its third worst performance since the 1970s – only exceeded by negative performance in 2008 – when the financial system froze – and 1974 – following the oil embargo and the hangover from the Vietnam war.

It was not all bad news for global equity markets in the second quarter of 2022. You could be forgiven for not having spotted that the standout equity markets over the past quarter have been in China. The news coverage, which is sensationalist by definition, has been about COVID lockdowns and a step back from punitive measures on the property and technology market. The MSCI China Index has risen more than 10% over the past month and is currently up an approximate 5% over the past three months. That quarterly performance is roughly 20% better than the MSCI USA Index. China's official annual inflation rate is currently 2.1%, while the West is currently trying to work out how to deal with 10%. The divergence is stark. The chart below shows how badly affected by inflation develop markets are, versus China (whole line in blue).

Headline inflation
% change year on year

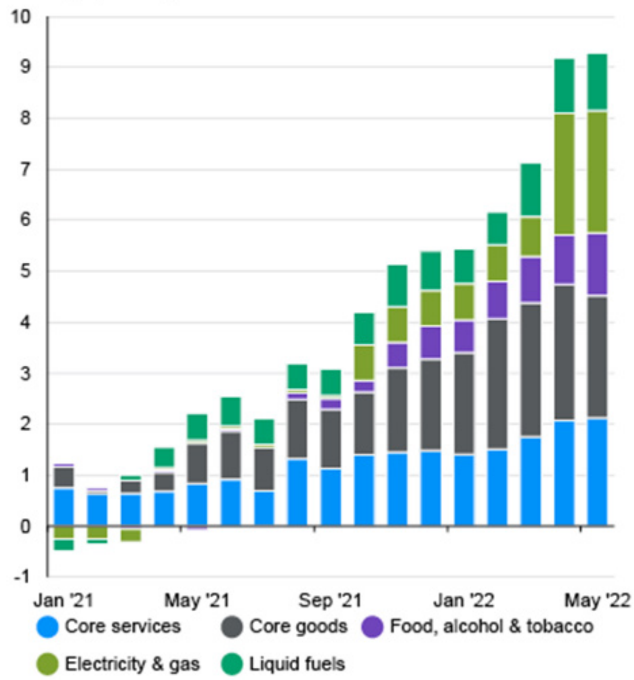
		2020							2021													2022				
		Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
	Global	1.3	1.5	1.5	1.4	1.1	0.9	1.0	1.2	1.4	2.0	2.6	3.2	3.2	3.3	3.4	3.6	4.2	4.9	4.8	4.9	5.4	6.4	6.8	7.0
	Developed	0.5	0.7	0.6	0.6	0.5	0.4	0.5	0.9	1.1	1.7	2.5	3.1	3.3	3.4	3.6	3.9	4.6	5.2	5.4	5.6	6.1	7.1	7.2	7.6
	Emerging	2.7	2.8	2.8	2.5	2.0	1.5	1.7	1.7	1.8	2.3	2.7	3.2	3.1	3.1	3.0	3.1	3.7	4.3	4.0	3.9	4.2	5.3	6.1	6.2
Eurozone	Eurozone	0.3	0.4	-0.2	-0.3	-0.3	-0.3	-0.3	0.9	0.9	1.3	1.6	2.0	1.9	2.2	3.0	3.4	4.1	4.9	5.0	5.1	5.9	7.4	7.4	8.1
	France	0.2	0.9	0.2	0.0	0.1	0.2	0.0	0.8	0.8	1.4	1.6	1.8	1.9	1.5	2.4	2.7	3.2	3.4	3.4	3.3	4.2	5.1	5.4	5.8
	Germany	0.9	-0.1	0.0	-0.2	-0.2	-0.3	-0.3	1.0	1.3	1.7	2.0	2.5	2.3	3.8	3.9	4.1	4.5	5.2	5.3	4.9	5.1	7.3	7.4	7.9
	Italy	-0.4	0.8	-0.5	-1.0	-0.6	-0.3	-0.3	0.7	1.0	0.6	1.0	1.2	1.3	1.0	2.5	2.9	3.2	3.9	4.2	5.1	6.2	6.8	6.3	7.3
	Spain	-0.3	-0.7	-0.6	-0.6	-0.9	-0.8	-0.6	0.4	-0.1	1.2	2.0	2.4	2.5	2.9	3.3	4.0	5.4	5.5	6.6	6.2	7.6	9.8	8.3	8.5
	Greece	-1.9	-2.1	-2.3	-2.3	-2.0	-2.1	-2.4	-2.4	-1.9	-2.0	-1.1	-1.2	0.6	0.7	1.2	1.9	2.8	4.0	4.4	5.5	6.3	8.0	9.1	10.5
	Ireland	-0.6	-0.6	-1.1	-1.2	-1.5	-1.0	-1.0	-0.1	-0.4	0.1	1.1	1.9	1.6	2.2	3.0	3.8	5.1	5.4	5.7	5.0	5.7	6.9	7.3	8.3
Developed	Sweden	0.9	0.7	1.0	0.6	0.4	0.2	0.6	1.9	1.8	2.1	2.8	2.4	1.8	1.8	2.5	3.0	3.3	3.9	4.5	3.9	4.4	6.3	6.6	7.5
	Switzerland	-1.3	-1.2	-1.4	-1.1	-0.9	-0.8	-1.0	-0.6	-0.4	-0.2	-0.1	0.3	0.5	0.5	0.8	0.8	1.3	1.5	1.3	1.4	1.9	2.2	2.3	2.7
	UK	0.6	1.0	0.2	0.5	0.7	0.3	0.6	0.7	0.4	0.7	1.5	2.1	2.5	2.0	3.2	3.1	4.2	5.1	5.4	5.5	6.2	7.0	9.0	9.1
	US	0.6	1.0	1.3	1.4	1.2	1.2	1.4	1.4	1.7	2.6	4.2	5.0	5.4	5.4	5.3	5.4	6.2	6.8	7.0	7.5	7.9	8.5	8.3	8.6
	Japan	0.1	0.3	0.2	0.0	-0.4	-0.9	-1.2	-0.7	-0.5	-0.4	-1.1	-0.8	-0.5	-0.3	-0.4	0.2	0.1	0.6	0.8	0.5	0.9	1.2	2.5	2.5
Emerging	China	2.5	2.7	2.4	1.7	0.5	-0.5	0.2	-0.3	-0.2	0.4	0.9	1.3	1.1	1.0	0.8	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1
	Indonesia	2.0	1.5	1.3	1.4	1.4	1.6	1.7	1.6	1.4	1.4	1.4	1.7	1.3	1.5	1.6	1.6	1.7	1.7	1.9	2.2	2.1	2.6	3.5	3.6
	Korea	0.2	0.4	0.8	0.9	0.1	0.6	0.6	0.9	1.4	1.9	2.5	2.6	2.3	2.6	2.6	2.4	3.2	3.8	3.7	3.6	3.7	4.1	4.8	5.4
	Taiwan	-0.7	-0.5	-0.3	-0.6	-0.3	0.1	0.0	-0.2	1.4	1.2	2.1	2.4	1.8	1.9	2.3	2.6	2.5	2.9	2.6	2.8	2.3	3.3	3.4	3.4
	India	6.2	6.7	6.7	7.3	7.6	6.9	4.6	4.1	5.0	5.5	4.2	6.3	6.3	5.6	5.3	4.3	4.5	4.9	5.7	6.0	6.1	7.0	7.8	7.0
	Brazil	2.1	2.3	2.4	3.1	3.9	4.3	4.5	4.6	5.2	6.1	6.8	8.1	8.3	9.0	9.7	10.2	10.7	10.7	10.1	10.4	10.5	11.3	12.1	11.7
	Mexico	3.3	3.6	4.1	4.0	4.1	3.3	3.2	3.5	3.8	4.7	6.1	5.9	5.9	5.8	5.6	6.0	6.2	7.4	7.4	7.1	7.3	7.5	7.7	7.7
	Russia	3.2	3.4	3.6	3.7	4.0	4.5	4.9	5.2	5.7	5.8	5.5	6.0	6.5	6.5	6.7	7.4	8.1	8.4	8.4	8.7	9.2	16.7	17.9	17.1

Source: Bank of Mexico, DGBAS, ECB, Goskomstat of Russia, IBGE, India Ministry of Statistics & Programme Implementation, Japan Ministry of Internal Affairs & Communication, Korean National Statistical Office, National Bureau of Statistics China, ONS, Refinitiv Datastream, Riksbank, Statistics Indonesia, Swiss National Bank, US Federal Reserve, J.P. Morgan Asset Management. Heatmap colours are based on the respective central bank target inflation rates. Blue is below target, white is at target and red is above target. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - UK.*
Data as of 30 June 2022.

J.P.Morgan
ASSET MANAGEMENT

On a very simple level, monetary policy is moving from its COVID emergency largesse to a strangled setting to break inflation. (Source JP Morgan)

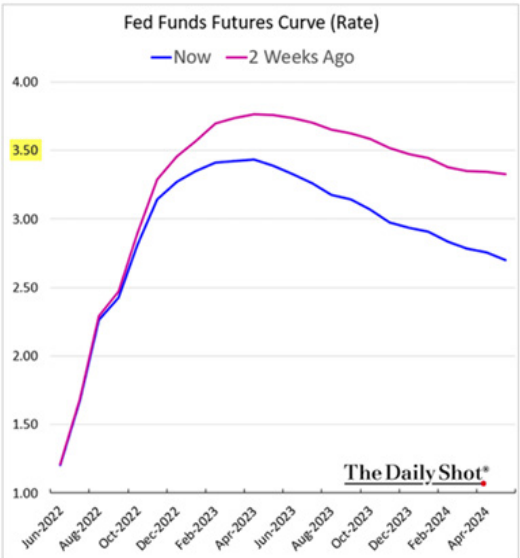
UK headline inflation breakdown
% change year on year



COVID winners have become big losers in 2022. Lockdown share prices rose exponentially for those companies catering for the stay-at-home lifestyle. Netflix and Zoom became bywords in entertainment and communication. Amazon and Ocado flourished by bringing necessities to the door. Greater digitalisation increased interest in the cloud and demand for computing power. The future was embraced with both arms. The share prices of alternative energy companies and electric vehicle providers rose on a wave of tech fervour. With market momentum behind the winners, valuations become stretched, and have subsequently suffered in a difficult market environment where future earnings streams are devalued by higher interest rates available today.

Many of these revalued growth stocks are in significantly better shape than those damaged during earlier crises. Indeed, there is a strong chance that quality growth has become dislocated in share price terms from corporate fundamentals and prospects. If this is the case, then we could be on the cusp of a significant investment opportunity.

Experience has taught us that a market recovery often arrives when we least expect it. Patience is a rare commodity in financial markets, but it pays to try and look through the immediate news. In the US, there are signs that demand is slowing and that some parts of the economy are seeing a build-up in inventories and price discounting. Purchasing Managers Index (PMI) readings for June suggested slowing growth rates and falling confidence. When added to a less concerning second estimate of US consumers' inflation forecasts in the Michigan survey for June, we have seen a rare downward revision in the market's expectations for the US Federal Reserve (FED) interest rate trajectory.



Signs of easing price pressures and slower growth are necessary to get the FED to suggest that enough is enough. Keep in mind that the FED wants to get inflation back to target over the medium term but also to achieve a soft landing. That means it will pivot at some point and cut rates once more, once the data shows the economy is slowing meaningfully.

Now that China is starting to move out of COVID induced lockdown, global supply chains are opening up and easing pricing pressure. (Source JP Morgan)

If the Chair of the FED, Jerome Powell, gets his soft landing for the economy and can step back from higher interest rates and start easing financial conditions into the latter part of the year, equity returns will re-bound. If inflation turns lower it will be growth stocks that lead the way. After all, labour market tightness, more aggressive unions, higher wages and supply chain issues make even more of a case for technology and automation.

We know that market cycles come and go. We are in the middle of a significant tightening of monetary policy to try and slow demand and therefore reduce inflationary pressures. Our investment team have plenty of opportunities in front of them, including Asian equities, consumer staples, gold, alternative assets and maybe, just maybe the bond market should the central banks rhetoric start to soften. Whatever the case, we continue to keep an eye out for any opportunities that the market offers, and we see some significant future value being created in areas of the market that we are currently underweight. When the news flow starts to change, we will look to take advantage of discounted valuations in these areas.