CHETWOOD
INVESTMENT MANAGEMENT

INDEX PORTFOLIOS QUARTERLY REPORT '22 Q2

Quarter insights

- **Rising inflation and hawkish central bank policy has meant the first half of 2022 has been a difficult one for markets, with both equities and bonds suffering.**
- **Developed market central banks have raised interest rates consecutively and aggressively to increase the cost of borrowing to try and slow demand and cool inflationary pressures.**
- **Growth assets, most notably technology, have had a difficult year to date, as rising interest rates devalue their future earnings stream that investors, until now, have been happy to pay over the odds for in a low growth world.**
- **A highlight for the portfolios have been the overweight to Asia, especially China, where lockdown concerns have reduced, supply constraints are easing, and inflation is only 2%.**

Market review

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 materializing, 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.

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

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.

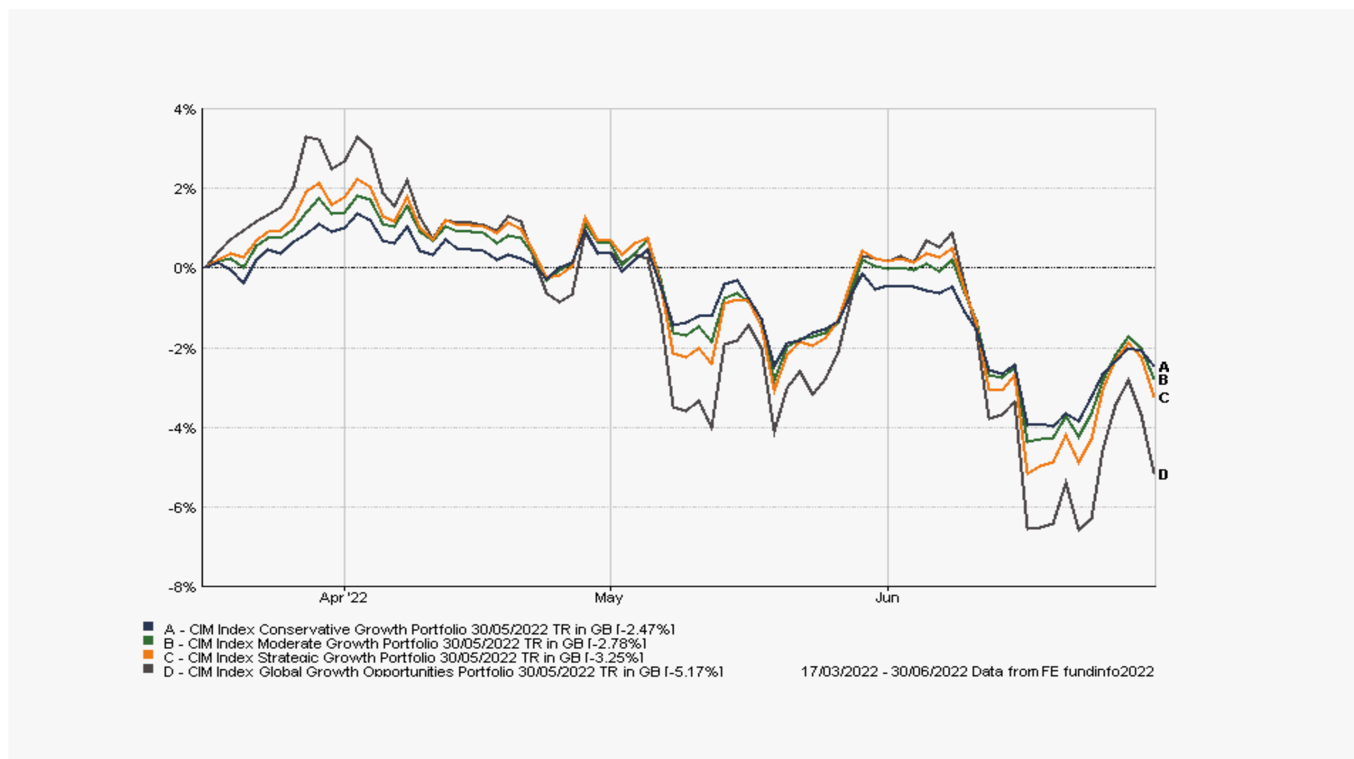
Index portfolios performance

Index Portfolios	3 months
CIM Conservative Index Portfolio	-3.35%
ARC Sterling Cautious PCI	-4.45%
CIM Moderate Index Portfolio	-4.10%
ARC Sterling Balanced Asset PCI	-6.29%
CIM Strategic Index Portfolio	-4.76%
ARC Sterling Steady Growth PCI	-7.45%
CIM Global Index Opportunities Portfolio	-7.47%
ARC Sterling Equity Risk PCI	-8.21%

Index Returns	3 months
FTSE 100	-3.74%
FTSE Actuaries UK Conventional Gilts All Stocks	-7.42%
FTSE Developed Asia Pacific ex Japan	-8.69%
FTSE World ex UK	-9.31%
MSCI Emerging Markets	-4.00%
S&P 500	-9.15%
UK Consumer Price Index	3.16%

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

Performance graph



Key Funds and Trades over the Quarter

Top 3 Model Funds	3 months
HSBC MSCI China	12.78% ▲
iShares S&P 500 Consumer Staples	3.46% ▲
iShares Core FTSE 100	-1.85% ▲

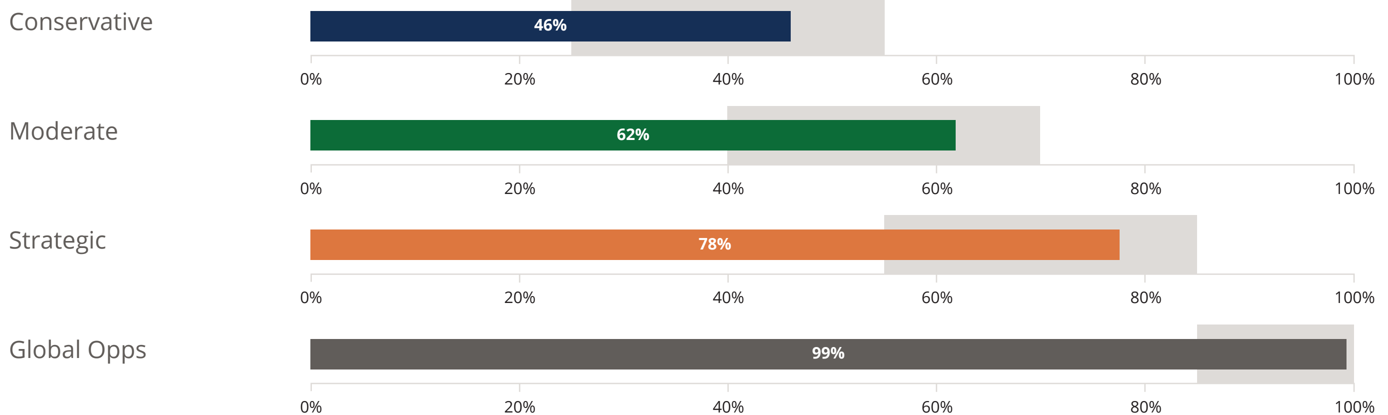
Bottom 3 Model Funds	3 months
Invesco EQQQ Nasdaq 100	-14.55% ▼
Fidelity Index US	-10.98% ▼
HSBC European Index	-10.45% ▼

Source FE Anaytics to 30th June 2022

Key fund	Commentary
HSBC MSCI China UCITS ETF	This fund was added during the quarter and gives broad index exposure to the most important companies in China. We currently favour China as the market has less of an issue with inflation, which enables it to have a more favourable monetary policy. Valuations of Chinese stocks are at attractive levels and the market has strong momentum.
iShares $ Treasury Bond 20+ year UCITS ETF	In the majority of our portfolios, this passively managed fund was brought in to offer exposure to US treasury bonds that have more than 20 years to maturity. We have introduced this fund to help protect performance of portfolios in the event of slowing growth. Yields on long-dated bonds have increase significantly in recent months and long-term return expectations are now attractive. We have intentionally purchased a fund that is unhedged from a currency perspective, meaning that it offers full exposure to the US Dollar. This attribute improves the defensiveness of the fund, given that the correlation between equities and the dollar has been very negative this year.
Fidelity Index US	This fund seeks to track the performance of an index of broad US companies. We introduced this position during the quarter to add broad US equity exposure as sentiment in markets was extremely negative. Typically when sentiment reaches these extreme levels equities tend to produce positive returns in subsequent periods.
iShares Core FTSE100 ETF	This fund seeks to track the performance of an index of the largest UK companies. We introduced this position during the quarter to add UK equity exposure. The UK market offers high exposure to sectors such as oil, resources and financials which we feel the offer relatively good value. In addition, we expect earnings for UK multinational companies to be boosted by the weakness of the British Pound.
iShares S&P 500 Energy ETF / iShares Diversified Commodities Swap	We have rotated exposure to these funds as the demand for commodities has been strong following the conflict in Europe and energy equities can provide a useful diversification benefit as, unlike most other equities, they can benefit from energy prices rises that put pressure on the wider economy.

Asset class review

Equity Exposure



Conservative

Ten largest fund holdings (%)	
Amundi Index Global Agg ETF Hedged ETF	16.8%
Amundi Global Corp SRI 1-5Y Hedged ETF	14.0%
Fidelity Index US	9.0%
Lyxor Core UK Equity All Cap UCITS ETF	8.1%
iShares Physical Gold ETC	8.1%
iShares Edge MSCI World Minimum Volatility ETF	7.5%
iShares $ Treasury Bond 1-3yr ETF	6.3%
iShares £ Index-Linked Gilts UCITS ETF	3.8%
HSBC MSCI Emerging Markets UCITS ETF	3.6%
iShares S&P 500 Consumer Staples UCITS ETF	3.5%
Assets in top ten holdings	**80.7%**

Ten largest asset class exposures (%)	
Government Bonds	20.5%
North American Equities	20.0%
Corporate Bonds	19.0%
UK Equities	11.0%
Asia Pacific ex Japan Equities	8.5%
Commodities	8.1%
Index-Linked Bonds	3.8%
European Equities	3.5%
Japan Equities	2.3%
Cash	2.0%

.Cash includes cash held in underlying funds plus GBP held in model

Moderate

Ten largest fund holdings (%)	
Amundi Index Global Agg ETF Hedged ETF	13.1%
Lyxor Core UK Equity All Cap UCITS ETF	12.8%
Fidelity Index US	12.4%
Amundi Global Corp SRI 1-5Y Hedged ETF	11.0%
iShares Physical Gold ETC	8.4%
HSBC MSCI Emerging Markets UCITS ETF	5.6%
iShares Edge MSCI World Minimum Volatility ETF	4.5%
HSBC European Index	4.5%
Vanguard FTSE Developed Asia Pacific ex Japan ETF	3.7%
iShares Core FTSE 100 UCITS ETF	3.6%
Assets in top ten holdings	**79.6%**

Ten largest asset class exposures (%)	
North American Equities	24.5%
UK Equities	16.3%
Corporate Bonds	14.9%
Government Bonds	11.9%
Asia Pacific ex Japan Equities	11.6%
Commodities	8.4%
European Equities	5.1%
Japan Equities	3.5%
Cash	2.1%
Emerging Market Equities	1.4%

Cash includes cash held in underlying funds plus GBP held in model.

Asset class review

Strategic

Ten largest fund holdings (%)	
Lyxor Core UK Equity All Cap UCITS ETF	16.5%
Amundi Index Global Agg ETF Hedged ETF	12.8%
Fidelity Index US	9.9%
L&G Global Small Cap Equity Index	8.7%
HSBC MSCI Emerging Markets UCITS ETF	8.2%
HSBC European Index	5.4%
iShares Edge MSCI World Minimum Volatility ETF	5.0%
Invesco EQQQ Nasdaq 100 ETF	4.5%
iShares Core FTSE 100 UCITS ETF	4.0%
iShares Physical Gold ETC	4.0%
Assets in top ten holdings	**79.0%**

Ten largest asset class exposures (%)	
North American Equities	29.2%
UK Equities	21.0%
Asia Pacific ex Japan Equities	14.0%
Government Bonds	12.0%
European Equities	7.3%
Japan Equities	4.4%
Commodities	4.0%
Corporate Bonds	3.8%
Emerging Market Equities	2.1%
Cash	2.0%

Cash includes cash held in underlying funds plus GBP held in model.

Global Opps

Ten largest fund holdings (%)	
Lyxor Core UK Equity All Cap UCITS ETF	16.3%
Fidelity Index US	11.1%
HSBC MSCI Emerging Markets UCITS ETF	10.3%
L&G Global Small Cap Equity Index	9.1%
Amundi Prime Global UCITS ETF	8.6%
Vanguard FTSE 250 ETF	7.8%
Vanguard FTSE Developed Asia Pacific ex Japan ETF	6.4%
HSBC European Index	6.4%
iShares Core FTSE 100 UCITS ETF	5.0%
iShares - S&P 500 Energy Sector UCITS ETF	5.0%
Assets in top ten holdings	**86.0%**

Ten largest asset class exposures (%)	
North American Equities	31.9%
UK Equities	30.0%
Asia Pacific ex Japan Equities	19.8%
European Equities	9.1%
Japan Equities	5.5%
Emerging Market Equities	2.6%
Cash	1.1%
Other	0.0%
Other Alternatives	0.0%
Commodities	0.0%

Cash includes cash held in underlying funds plus GBP held in model.

Asset Class	Portfolio Views
Fixed Interest	We remain underweight this asset class as markets have been concerned about the effect of central bank rate rises on fixed income. Having said this, we are taking advantage of an attractive entry point to gradually increase exposure.
UK Equity	We like this undervalued area of the market as it offers us exposure to favourable themes like energy and financials with a home bias. UK multinationals can also benefit from the recent weakness in GBP.
US Equity	After a strong run, we remain mindful of balancing the attractiveness of a diverse and mature market with a high valuation that could unwind if there is a central bank policy error.
Japan Equity	As the Bank of Japan remains stubbornly against changing its monetary policy, we have a neutral position here, however we continue to like the defensive nature of the Yen.
Asia and Emerging Market Equity	As China starts to remove COVID restrictions, opportunities abound in this area for the shrewd investor and we maintain an overweight in this region with a tilt toward China specifically.
Alternatives	Gold remains a favoured position in this high inflationary environment. We also access commodity exposure indirectly through some of our equity exposures.

Outlook

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. The flash June US manufacturing purchasing manager index (PMI) showed a decline in growth with the index dropping from 57.0 to 52.4. Signs of easing price pressures and slower growth are necessary to get the US Federal Reserve (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.

If the Chair of the US 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 rebound.

> 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 swiftly take advantage of discounted valuations in these areas.

Thoughts for the quarter ahead...

- **We cannot tell you when or how share prices will bounce back. Nobody can with accuracy. Stock markets are unpredictable and in the short run are affected by all sorts of human behaviours. Panic, excitement and herding, to name a few.**
- **Our investment process deliberately invests through that noise. We know that over three years and longer, market sentiment becomes much less important to investment returns. Company fundamentals and themes dominate over these longer time frames.**
- **We continue to search for those rare businesses with exceptional and underappreciated growth potential, whilst titling the shorter-term part of the portfolios to sensible assets that have some inflation protection.**
- **With discretionary permissions, we can remain nimble and aware of the market environment. Markets will recover from here and we fully intend for our portfolios to participate.**

Important information

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