QUILTER CHEVIOT

INVESTMENT MANAGEMENT

INVESTMENT REVIEW Q1 2022

OVERVIEW

The Russian invasion of Ukraine dominated investors' minds in the first quarter of 2022, with its implications reverberating across financial markets. Concerns surrounding key international supply chains sent several commodity markets soaring, adding additional upwards pressure to inflation metrics that were already running hot and exacerbating the challenges currently facing central banks. That said, the outsized initial knee-jerk reaction in most of the effected markets faded during March, laying the foundations for a solid rebound of nearly 5% in global stock markets for the month, led by the resurgence of US equities.

WORLD MARKETS 01 JANUARY 2022 - 31 MARCH 2022	OPENING LEVEL 01/01/22	CLOSING LEVEL 31/03/22	% CHANGE
MSCI UK	1148.066	1154.789	**0.59%**
MSCI EUROPE EX UK €	195.372	179.007	**-8.38%**
MSCI NORTH AMERICA $	4794.856	4549.701	**-5.11%**
MSCI ASIA PACIFIC EX JAPAN	1452.984	1490.361	**2.57%**
MSCI JAPAN Y	1229.97	1199.28	**-2.50%**
US $ TO UK £ (WMR)	1.35445	1.31665	**-2.79%**
CRUDE OIL BFO M1 EUROPE FOB $/BBL	78.40	107.46	**37.07%**
GOLD BULLION LBM $/T OZ DELAY	1822.39	1941.15	**6.52%**

Source: Refinitiv DataStream. As at 31 March 2022.

After soaring on the outbreak of the conflict, the oil price pared its gains, ending March closer to its monthly starting point than its peak. Meanwhile, central banks stepped up their actions to combat persistently high levels of inflation, with the Federal Reserve hiking rates for the first time since 2018 and the Bank of England delivering its third increase in the base rate in four months.

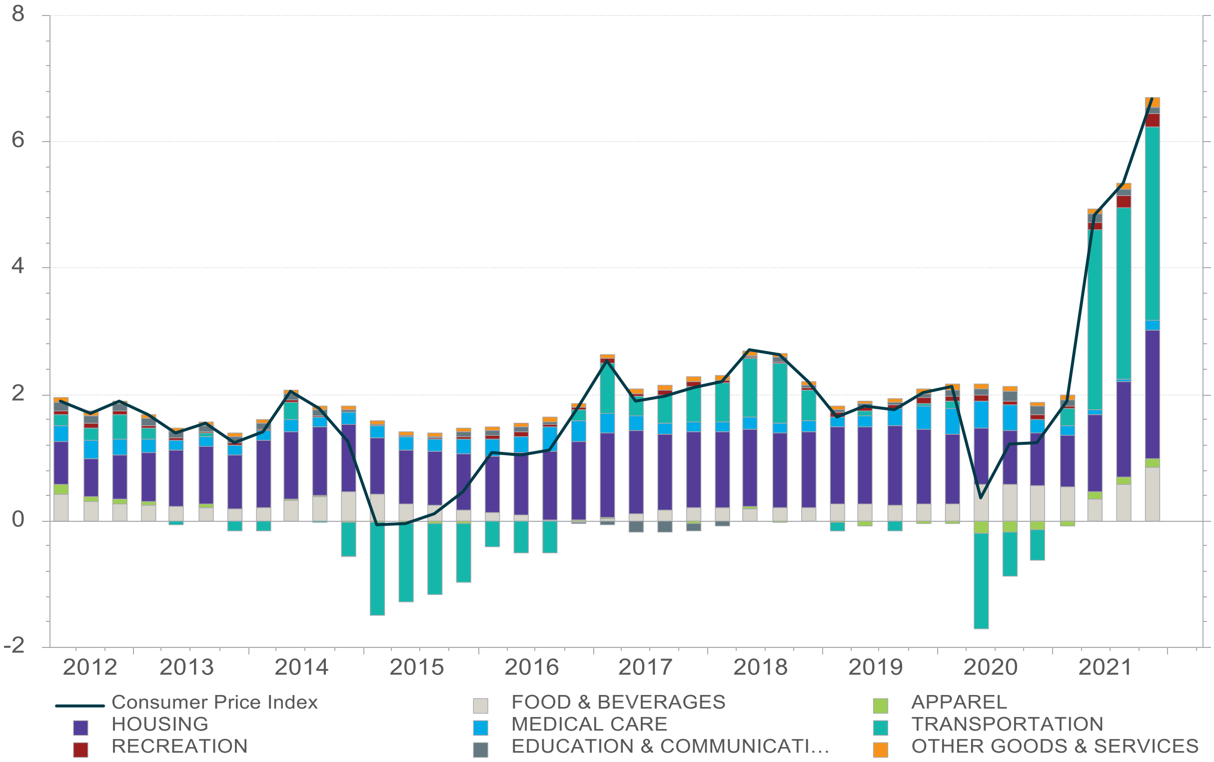
US indices finished March on the front foot, up by more than 5% in GBP terms for March, displaying resilience and recouping some of the losses from a negative first quarter. UK large-cap equities were up modestly for the month, exhibiting less volatility than both their US and European equivalents as significant weightings to oil and gas stocks cushioned broader market declines on widespread risk-off sentiment.

Unsurprisingly, given the proximity to Ukraine, European bourses fared worse than their US counterparts, though they still managed to end the month little changed in GBP terms. A drop in sterling provided a tailwind, amounting to around 1% against the euro and 2% against the US dollar, for GBP-denominated returns on the Continent and across the Atlantic.

Energy markets jumped initially, but these gains were pared back in volatile trade. Brent crude, the international oil benchmark, ended March with a single-digit percentage gain having traded up by more than 30% at one point as the price of a barrel of oil rose to just shy of US$140 a barrel - its highest level since 2008. Brent crude ended the first quarter with a gain of more than 40%.

The invasion of Ukraine and concomitant commodity shock provided an additional problem for central banks already struggling to reign in elevated levels of inflation. Both the Federal Reserve and Bank of England raised rates in March while the European Central Bank is headed in a similar direction. Though the Bank of England raised the base rate to 0.75% by implementing the second 25bp hike in as many months, lift off from the Fed was arguably the bigger story. A 25bp increase in the fed funds rate to 0.5% was well telegraphed but reaffirmed the commitment of central banks to continue to pursue aggressive tightening paths for monetary policy despite recent geopolitical events.

USA CONTRIBUTIONS TO CONSUMER PRICE INFLATION

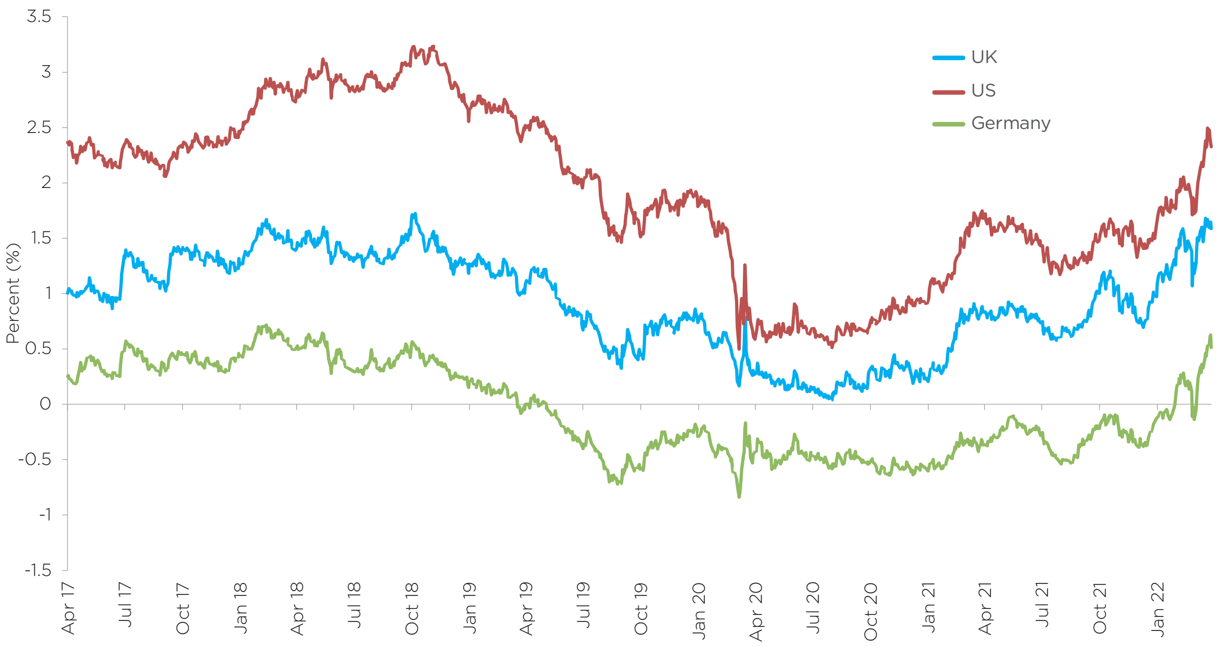


Source: Refinitiv DataStream March 2022.

Bond markets sold off strongly and yields jumped higher. The US 10-year rose to its highest level in almost 3 years at 2.35%, up by around 45bp on the month. It was a similar story in the UK with the 10-year Gilt yield rising approximately 20bp to move above 1.6% and trade close to its highest levels since the start of 2018. The moves at the short end were even larger as markets began to price in a hiking cycle that will be aggressive for the next couple of years before levelling off.

2-year Treasury yields rose above the 10-year for the first time since 2019, a signal to some as a harbinger to recession. Five- and 30-year yields also inverted, for the first time since 2006. Every US recession in the past 50 years has been preceded by yield curve inversions, though there are mitigating circumstances to suggest that this time it could be different. That said, the stigma attached to an inversion could in itself weigh on sentiment and becoming a self-fulfilling prophecy.

GOVERNMENT 10-YEAR BOND YIELDS

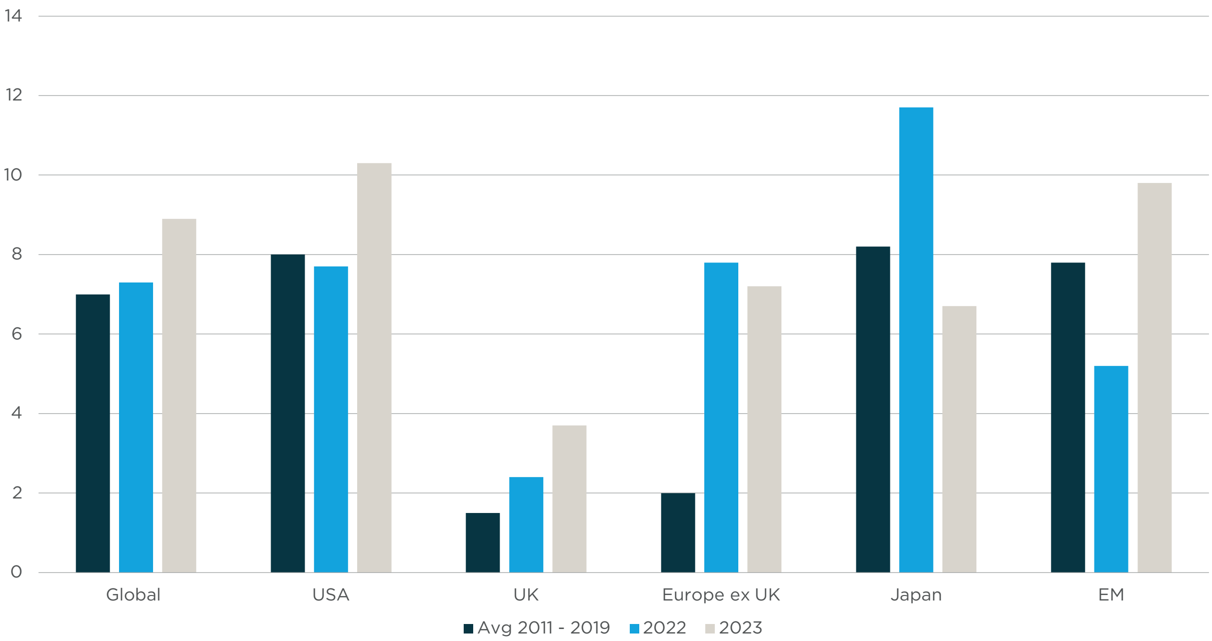


Source: Refinitiv DataStream. As at 31 March 2022.

The latest inflation data releases continued to attract plenty of interest as the US consumer price index hit a new 40-year high of 7.9% and the eurozone equivalent came in at 7.5%, its highest level on record. Though the UK print of 6.2% is a little lower it still came in significantly higher than consensus forecast, is a 30-year high and also well above the BoE's 2% target. The labour market remains tight with the unemployment rate below 4% in the US and the UK, the lowest levels since the onset of the pandemic. Near-term gauges of economic activity, such as purchasing managers index readings, also remain solid and clearly in expansionary territory, even if they did take a hit from further Chinese lockdowns due to its zero-Covid policy.

The prospect of slowing growth, rising input costs and higher interest rates meant the outlook for corporate profits in 2022 was always likely to be more modest compared with last year. Initial estimates of 10% growth in earnings per share were predicated on global GDP growth of around 4% but with recent downgrades - on the back of China, Europe, oil and more front-loaded monetary policy tightening - an outcome nearer 3% is now more likely.

CONSENSUS ESTIMATES FOR GLOBAL EARNINGS PER SHARE % CHANGE YEAR ON YEAR



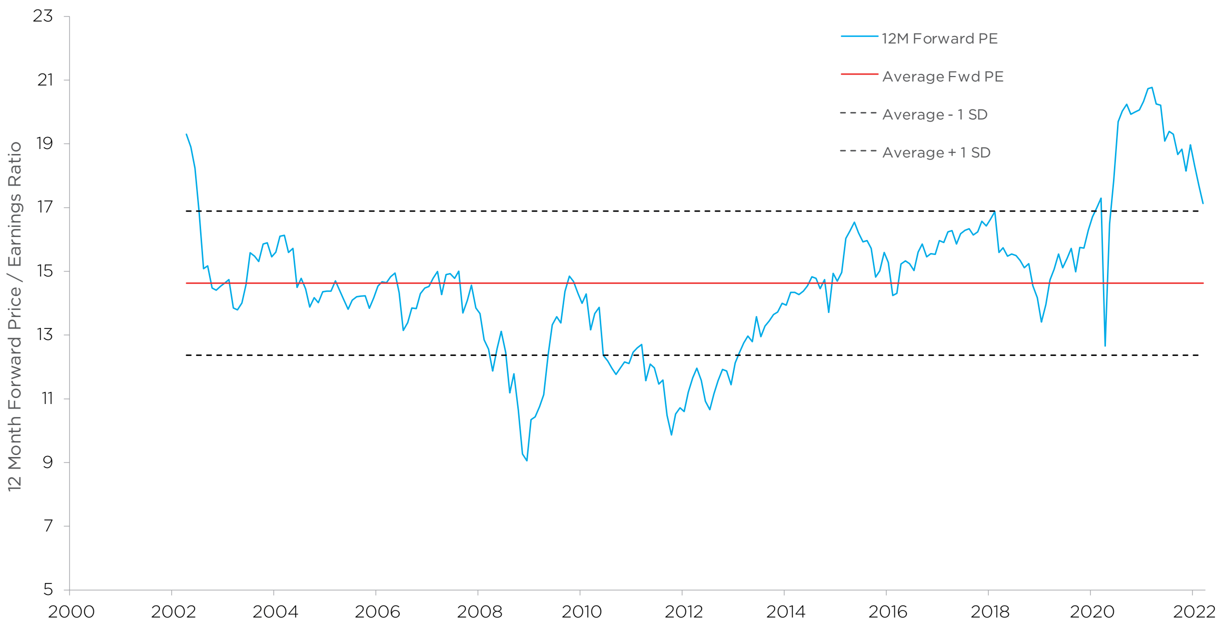
Source: Refinitiv DataStream March 2022.

With geopolitics cited as the number one risk for investors, EPS will likely be guided lower as Q1 results are announced over the next few weeks, although visibility of earnings remains particularly difficult for some companies. One exception is the energy companies which even after their strong Q1 performance don't look expensive by historic standards and typically perform well even after the first interest rate rise. For others hoping pandemic supply chain disruptions were beginning to fade, there is a new challenge around widening commodity supply disruption and/or sustained cost input inflation. The proximity to Ukraine means European companies are most likely impacted but some speciality metals are also used worldwide.

Companies reported reasonable success late last year in passing on higher input costs – as is typical mid-cycle - but as inventories are rebuilt and new sales growth becomes more challenging, margins may be squeezed. And just when you thought it was safe to go out the resurgence in COVID infections – while thankfully less fatal – is causing staffing disruptions into a now tight labour market.

We still believe the investment cycle has further to run and, in the absence of an escalation in the Ukraine situation, we expect modest single digit corporate profit growth. Forward valuations have eased since the start of the year and outside the US they are below their 10-year averages. With bond yields still normalising, we remain modestly optimistic about the prospects for equities.

DEVELOPED MARKET EQUITY VALUATIONS



Source: Refinitiv DataStream March 2022.

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