Wealth
Management US

VALUES WORTH SHARING

Quarterly report

Q1 2022 market review

Joseph Höger, detail from "View of Lake Gmunden near Ebensee", 1836

Landscape painter Josef Höger was closely connected with the Princely House of Liechtenstein through the numerous commissions he received from the family. As a result, an incredible body of his work in watercolour has been preserved in the collections. In his paintings, Höger documented the family's assets. He also frequently accompanied Prince Alois II von Liechtenstein on his travels, and therefore assumed a very special status. He captured the countries and landscapes through which they travelled, sometimes with astonishingly quick and fresh sketches, but sometimes also in large, detailed presentation drawings that demonstrate the full extent of his skill. Höger›s views of Salzkammergut play an important role here. In his work, the artist painted cities such as Bad Ischl, Gmunden and Hallstatt, as well as the surrounding landscapes in which everyday life in the region is always depicted.

© LIECHTENSTEIN. The Princely Collections, Vaduz–Vienna

A look inside the Princely Collections

For more than 400 years, the Princes of Liechtenstein have been passionate art collectors. The Princely Collections include key works of European art stretching over five centuries and are now among the world's major private art collections. The notion of promoting fine arts for the general good enjoyed its greatest popularity during the Baroque period. The House of Liechtenstein has pursued this ideal consistently down the generations. We make deliberate use of the works of art in the Princely Collections to accompany what we do. For us, they embody those values that form the basis for a successful partnership with our clients: a long-term focus, skill and reliability.

www.liechtensteincollections.at

Q1 2022 summary

Investment markets had a difficult start to the year with a backdrop of rising inflation and potential tightening by central banks. Some relief was provided by the quarterly earnings season, before the Russian military invaded Ukraine, weighing on markets again. Towards the end of the quarter there was some relief for equity markets as talks on settling the conflict continued, and oil prices came off their highs. Bonds have moved lower to price in steeper rate rises.

At a glance

- New 'Iron Curtain' descends as Russia invades Ukraine
- Energy and food supplies threatened
- Inflation rises further
- Central banks remove accommodation
- Markets gyrate on geopolitics and central bank rhetoric

Macro summary

Supply shortages and increased demand

Supply chain issues that were initially triggered by COVID-19 were amplified by rising demand as the world began its recovery out of the pandemic, pushing prices higher. It was hoped that this would be a temporary move and, as supply chains normalised and excess pent-up demand faded, inflation would fall back. However, the Russian invasion of Ukraine saw a huge rise in the Brent crude oil price which was down to $20 a barrel in 2020, $78 at the start of this year and peaked at $139 after the invasion. Grain exports from Ukraine have been blocked and, if the war continues and the harvest is lost, global grain prices will rise further. All this feeds through to higher prices for food and energy, with a knock-on effect as input costs are passed on to consumers. The UK consumer has so far been shielded from these effects by the energy price cap, but April will see prices rise steeply and this rise will be repeated in October unless the wholesale prices moderate. Central banks are targeting 2% inflation; however, with inflation currently well above this, they are being forced to respond. The Federal Reserve (Fed) increased its rate by 0.25% for the first time since 2015, while bringing its asset purchases to a close. The Bank of England (BoE) raised its rate by 0.50% over the quarter. The European Central Bank (ECB) is reducing its bond buying programme and is expected to raise rates later this year. The issue currently faced by central banks is that the tools available to them can impact demand but cannot ease the external supply side factors that have been pushing inflation higher.

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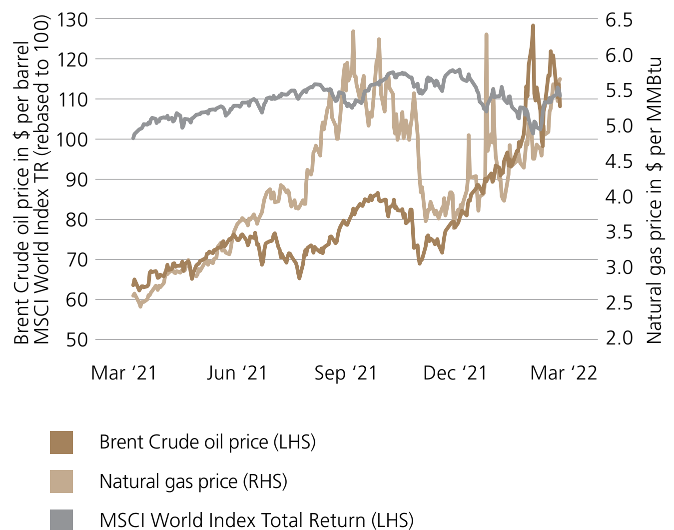
Jonathan Marriott, Chief Investment Officer

Rising oil and gas prices



Source: Bloomberg, LGT Wealth Management

Finding alternative resources

With inflation rising faster than wages, the ability of the consumer to spend is constrained, which alone may reduce demand. Increasing the cost of borrowing potentially risks driving the economy into a recession. To act on supply factors, President Biden announced that the US would release one million barrels of oil a day for six months from its strategic reserves. Talks with Iran may produce a settlement that would increase oil supply. The global supply of oil appears to be less impacted as Russia continues to supply some countries at a discounted price. Gas however is less portable and Europe, Germany in particular, is still heavily dependent on Russian supplies. The verification of the Nord Stream II pipeline has been halted. While European countries have announced their intention to move away from their dependence on Russian gas, this is easier said than done.

Although the UK has relaxed its pandemic restrictions, COVID-19 restrictions remain in place elsewhere. Fresh lockdowns have been imposed in China as they continue to pursue a zero-tolerance COVID-19 policy. Lockdowns will constrain the economic recovery in China and may delay the normalisation of supply chains. Greater economic damage was caused by the restrictions to counter the virus during the pandemic than by COVID-19 itself. Similarly, the sanctions imposed on Russia have caused greater economic damage to the country than the war. So far, the Russian aggression has gained little, yet cost the Russian economy a lot. The Russian MOEX Index fell over 30% and then stopped trading for three weeks.[1] By contrast, the US stock market, while down on the year, is higher than it was when the invasion started. Where the global impact is felt the hardest is in the inflation picture and the knock-on effects on future interest rate increases.

Prices on the rise

Norman Lamont, when UK Chancellor of the Exchequer in the early 1990s, said, "Rising unemployment and the recession have been the price we have to pay to get inflation down. That price is well worth paying". In the coming months, we will see if the central bankers of 2022 agree. However, coming into this year, the global economy was recovering strongly with plenty of job openings and a low unemployment rate. High inflation and higher interest rates are expected by markets, and it is the unexpected that causes the biggest moves. The Russian invasion of Ukraine compounded the rising inflation picture, but that is now a known factor and may be largely priced in. As the earnings season reminded us, individual companies with strong pricing power can thrive, even as prices and interest rates rise. We continue to believe in a selective approach to equity markets and, while the risk of a recession has risen and volatility is likely to remain high, we believe that in the long term equity markets will continue to provide the best returns.

1. Source: Bloomberg, LGT Wealth Management

Fixed income

While central banks would never admit that they are "behind the curve", the capitulation we have seen over the past quarter is as close to an admission that we are likely to get. This pivot in policy stance occurred despite the enormous geopolitical tensions that we have witnessed. Our thoughts are with the people in the Ukraine, whose lives were brutally disrupted by the Russian invasion. From an economic perspective, the sanctions imposed by the West are likely to dampen economic growth while putting upward pressure on prices, at a time when many are concerned about sharp increase in the cost of living. Russia is one the largest exporters of oil and natural gas while the threat to Ukraine's wheat and sunflower crops is raising food prices.

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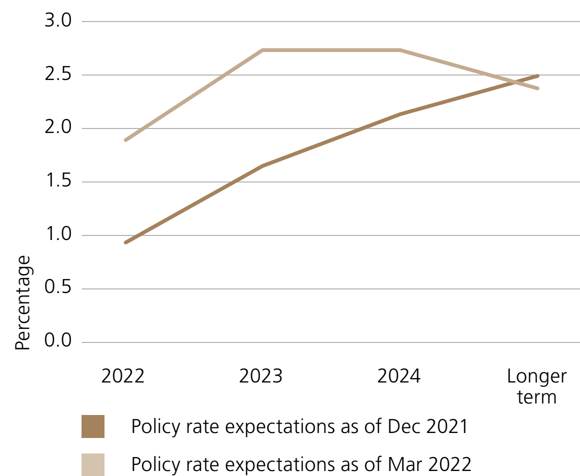
>
> Jeremy Sterngold, Head of Fixed Income

The shift in rate expectations by the Federal Reserve has been stark



Source: Bloomberg, LGT Wealth Management

The shift in rate expectations by the Fed has been stark. Given that they were still conducting bond purchases as late as March this year, it does seem like they are now stepping on the brakes rather than taking the foot off the accelerator. To elaborate further, during their December 2021 meeting, the median rate expectations of Fed members showed three hikes of 0.25% this year and a further three similar increases in 2023. Since the start of the year, various Fed members have expressed their desire to start raising rates in March and embark on a faster pace of rate increases. This drove market rate expectations higher which was cemented during the March Federal Open Market Committee. While they raised rates by 0.25%, as was widely anticipated, the Dot plot projected a further 1.5% increase this year and potentially a further 4 hikes of 0.25% next year. These projections came in the face of the ongoing war in Ukraine and its squeeze on global consumption. The US labour market continues to strengthen, with vacancies still high while inflation hit a 40-year high at 7.9%. Given expectations of inflation

rising further in light of the rise in energy prices and the supply side challenges extending as a result of China's zero tolerance COVID-19 policy, the Fed appears now to prioritise fighting inflation over growth.

Towards the end of the quarter, the closely watched spread between two- and ten-year Treasuries were within touching distance of an inversion

Source: Bloomberg, LGT Wealth Management

This change in tack has not only resulted in higher bond yields, or lower prices, but it has driven a much flatter shape of the yield curve. Towards the quarter end, the closely watched spread between two- and ten-year Treasuries flirted with inversion. In the past, this has been a good indicator that Fed policy stance is too tight and could result to a recession over the next two year. This has not caused the Fed to waver on its desire to normalise policy rates, in fact it has flagged the potential for a larger 0.5% increase in May while potentially embarking on a program to reduce its bond holdings.

The Fed is not alone in its desire to normalise. On this side of the pond, the BoE has raised rates by 0.5% over the course of two meetings. During the February meeting, several Monetary Policy Committee members wanted to raise rates by 0.5%, but this tone softened in their March meeting. As energy costs have risen substantially, the BoE now expects a larger hit to real incomes. This, paired with the increase in taxation through National Insurance contributions, means that they do not foresee a need to be quite so aggressive in terms of policy tightening. The ECB has also quickly changed its policy stance earlier this year with asset purchases due to come to an end during the third quarter, opening the door to rate hikes later this year.

The prospect of central banks moving from providing continuous liquidity to seeking to actively remove it moved risk premiums for corporate debt higher. This was a gradual process at the start of the year until investors were forced to reassess creditworthiness based on Russian exposure and its impact on earnings. This did move credit spreads meaningfully higher, but as the intensity of the conflict appeared to be more contained, investors took advantage of better yields on offer resulting in a strong recovery in spreads.

Equities

International Equities

With flaring geopolitical tensions and central banks' tightening policy, there have unsurprisingly been some very large moves in equity markets during the quarter. The S&P 500 declined 5% and the technology-heavy Nasdaq Composite Index fell 9%. The pandemic's losers became this quarter's winners, as the S&P energy sector was the only sector to rise in Q1.[2] The sector rose nearly 40%, buoyed by the highflying oil price. Beneath the surface of the headline numbers, however, masked even greater volatility in individual names. As an example, following the release of their results, Amazon's share price rose 14%, whereas the share price of Meta Platforms (previously Facebook) fell 26% on its results.

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> Robert Clarke, International Equities Analyst

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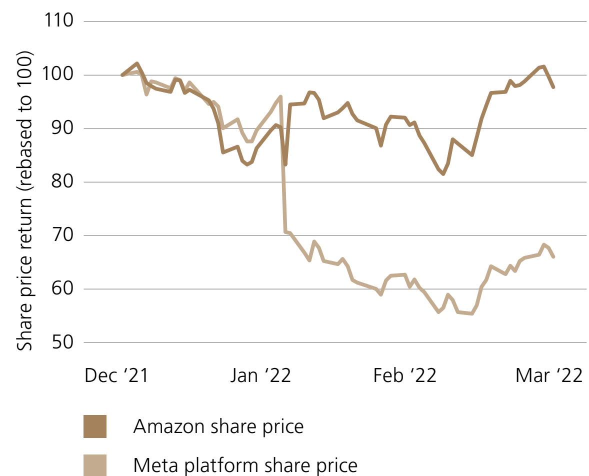


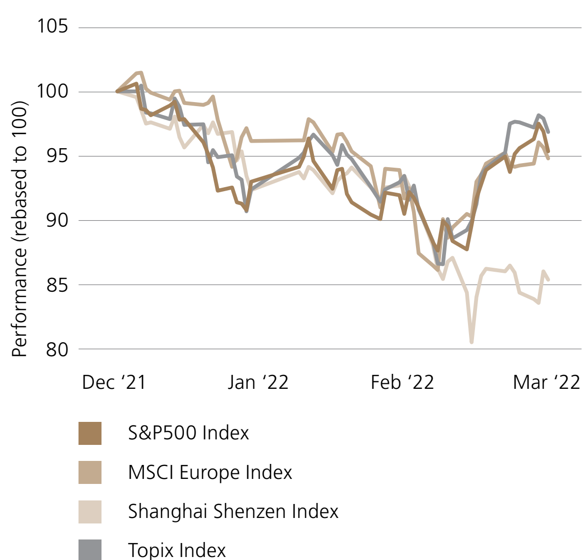
Source: Bloomberg, LGT Wealth Management

We have always said that even the most defensive stocks fall by 20% or so at some point. For some, it takes years, others only a day. Indeed, during the quarter, many other names did decline by 20% or so from their highs, yet their operating businesses remained intact. Many companies released encouraging quarterly earnings; aside from Amazon, the other big tech names like Apple, Alphabet (parent company of search behemoth Google) and Microsoft also delivered strong results, yet were all at one point or another within touching distance of a 20% decline during the quarter. We appreciate Warren Buffett's adage, "whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down"; what the market offered was the opportunity to capitalise on improved potential long-term returns for 'quality merchandise'.

2. Source: Bloomberg, LGT Wealth Management

The MSCI Europe Index held up relatively well, even though it has a higher dependence on Russian resources, declining just 5% over the quarter. Despite Asia's relative distance from the crisis, it too saw declines towards the end Q1. Sentiment took a turn for the worse on the news of regional outbreaks of COVID-19 leading to restrictions being reimposed. With lockdowns putting pressure on China's economic recovery, the Shanghai Shenzhen Index declined 15% by the end of the quarter. The main Japanese Index, the value oriented Topix Index, saw its fortunes reverse with a sharp rebound towards the end of the quarter, finishing down 3%.

Performance of various global indices over the quarter



Source: Bloomberg, LGT Wealth Management

With all that is happening, we are reminded of the old Chinese curse, 'may we live in interesting times'. To say that we are living in 'interesting' times is surely an understatement; however, we continue to take comfort in well-managed businesses, with pricing power and sensibly managed balance sheets, which lends the capacity to adapt to the fast-changing environment. We continue to recommend opportunistically taking advantage of share price weakness in attractively priced, long-term holdings.

UK Equities

Since the start of the year, UK equity market investors have been focused on a number of inter-related factors – the tragic turn of events in Ukraine, higher commodity prices, supply chain disruptions, higher inflation, and fears that global growth could stagnate. The surge in oil and gas prices that resulted from sanctions imposed on Russia – a major supplier of energy to Europe – has benefitted a number of UK stocks held in client portfolios. The largest such stocks – BP and Shell – have stated that they will disinvest from Russia, and this policy shift will naturally result in costs being incurred. Despite this, higher oil and gas prices have still supported their share prices over the quarter.

Mining groups also benefited during the quarter from the strength seen in platinum, aluminium and diamond prices (a reflection of the fact that Russia is also a major supplier of commodities other than hydrocarbons). Prospects of further stimulus in China has boosted the iron ore price. National Grid, Astra Zeneca and GlaxoSmithKline also enjoyed share price gains in the first quarter, as the relative steadiness of demand for their products meant that investors favoured them over groups whose earnings might not prove to be as resilient. The combination of good results, stable dividends, and new share buyback programmes, also ensured that a number of UK listed insurance groups held up well in the first three months of the year, but across the rest of the UK market, share prices came under pressure.

Supply chain disruptions and higher raw material costs weighed on businesses like Unilever, with investors fearing margin pressure, and the loss of customers if product prices are raised to mitigate higher input costs. Groups with a high percentage of sales in Europe (like the packaging supplier DS Smith, and the online retailer ASOS) were also very directly impacted by the war in Ukraine and fears that the conflict could spill over into adjoining territories. Higher energy costs, and a very natural reduction in demand for travel, impacted the share prices of groups like EasyJet and Whitbread, the owner of the Premier Inn chain.

Ukraine's importance as a supplier of wheat to the global market also weighed on the share price of Associated British Foods – the Kingsmill bread maker; Primark (another retailer with an extensive presence across Europe); and grocery brands such as Twinings Tea, Patak's, and Blue Dragon. However, the impact of the war in Ukraine was reflected through fears that higher energy prices will lower disposable incomes, constrain more discretionary forms of expenditure, and curtail corporate profit margins. As a result, positive thoughts on growth in corporate profitability were replaced by fears that the global economy could be on the verge of stagnating. This weighed on UK stocks such as WPP and Sage, where the fortunes of the underlying businesses are dependent on the spending plans of corporate customers.

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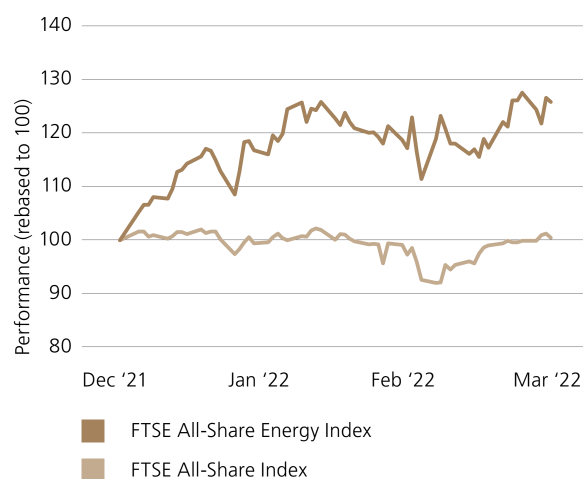
>
> James Follows, Head of UK Equities

The FTSE All-Share Index's relatively higher weighting to energy and commodity stocks meant that it outperformed other major indices over the quarter.

The surge in oil and gas prices that resulted from sanctions imposed on Russia has supported the performance of the FTSE All-Share Index over the quarter



Source: Bloomberg, LGT Wealth Management

Key market data

Key market data (as at 31 March 2022)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4188	1.3	0.5	4.7	13.0	16.8	25.8	0.5
S&P 500 (USD)	4530	3.7	-4.6	5.9	15.6	68.2	109.9	-4.6
Euro Stoxx 50 (EUR)	3903	-0.5	-9.0	-3.1	1.5	24.2	25.3	-9.0
Nikkei 225 (JPY)	27821	5.8	-2.5	-4.5	-2.8	38.9	62.1	-2.5
MSCI World (USD)	3053	2.7	-5.2	2.2	10.1	52.0	79.6	-5.2
MSCI AC Asia Pacific ex Japan (USD)	591	-0.6	-5.7	-6.4	-10.8	19.9	39.7	-5.7
MSCI Emerging Markets (USD)	1142	-2.3	-7.0	-8.2	-11.4	15.6	33.7	-7.0
10 year bond yields **								
UK	1.61	0.2	0.6	0.6	0.8	0.6	0.5	0.6
US	2.34	0.5	0.8	0.9	0.6	-0.1	0.0	0.8
Germany	0.55	0.4	0.7	0.7	0.8	0.6	0.2	0.7
Japan	0.22	0.0	0.1	0.1	0.1	0.3	0.2	0.1
Commodities (USD)								
Gold	1937	1.5	5.9	10.3	13.5	49.9	55.1	5.9
Oil	108	6.9	38.7	37.4	69.8	57.8	104.3	38.7
Currency								
GBP-USD	1.31	-2.1	-2.9	-2.5	-4.7	0.8	4.7	-2.9
GBP-EUR	1.19	-0.7	-0.2	2.0	1.0	2.2	0.8	-0.2
EUR-USD	1.11	-1.4	-2.7	-4.4	-5.7	-1.3	3.9	-2.7
USD-JPY	121.70	5.8	5.8	9.4	9.9	9.8	9.3	5.8

Source: Bloomberg, ICE, London Stock Exchange, MSCI, Standard & Poor’s, Stoxx Tokyo Stock Exchange

* Performance is given on total return indices, but the levels are for the main indices.
** Displayed as absolute changes in yields, rather than percentages.

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