Strategy & Outlook

MARKET UPDATE

FEBRUARY 2023

Asset markets had a strong start to the year, global equities rising by 5.6% in euro terms, longer dated western bond yields falling by circa 30 basis points and the euro rising by 1.5% against the US dollar. A rapid China reopening, no energy crisis in Europe, falling inflation in the US have provided solid macro tailwinds. Speculation from the "Fed-whisperer" at the WSJ, Nick Timiraos that officials could soon begin debating the criteria for a pause in their rate hike cycle added to hopes that the "soft-landing" scenario may be more realistic than previously expected.

As inflation fears ease the bear case appears to be now shifting to earnings risk as we go through the Q4 reporting season, with some prominent top-down strategists concerned about risks to margins. However, from a bottom-up perspective we find it difficult to see how these margin concerns materialise and if anything, see upside risks to margins from falling energy and raw material prices, collapsed freight rates and renewed discipline around corporate hiring and spending. US earnings will also get a boost from the weakening USD, which has declined by 7% (on a trade weighted basis) since companies last guided around mid-October.

Indeed, price action to earnings has been very encouraging, a sharp difference from the volatile reactions to last year's quarterly announcements, providing evidence markets have already priced much of the more normalized company growth trajectories.

Microsoft reported slightly lower (but still very healthy) Azure growth numbers, CEO Nadella heralding "*the next major wave of computing is being born*" referencing AI and the introduction of Chat GPT. United Rentals set records for "revenue, profitability, margins and returns" an interesting report considering the cyclicality of their industry. Tesla reiterated plans to grow production at multi-year 50% CAGR and allayed concerns over lower ASPs by highlighting solid and improving operating margins. Card services gave an insight into the consumer strength with the following commentary: Mastercard "*consumer spending has been remarkably resilient*", Visa "*The pulse of the consumer is normal and healthy and very stable*," and American Express "*We aren't seeing recessionary signals...the consumer is really strong, travel bookings are up over 50% vs pre-pandemic*".

The Federal Reserve will want to maintain a hawkish narrative especially as they downshift to 25 basis point s and financial conditions have eased somewhat. With two inflation prints due prior to March meeting its likely they will wait for incoming data before guiding their next move. The Bank of Canada raised interest rates by 25bps in January and communicated they will hold rates here while assessing the impact of hikes to date. We could see similar approach from the Federal Reserve. The ECB is slightly behind, other major central banks, but they too are approaching the end of their rate hike cycle.

Continued on next page

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Positioning and Outlook

All of the above continues to leave us with a very positive outlook for asset markets. Recession is fully expected but not guaranteed this year. Inflation will continue to recede. The Fed is near the end of its rate hike cycle. China is reopening fast. The consumer, very resilient up to now, does face significant headwinds, but investment spending should drive economic activity.

The funds remain near the upper end of their asset allocation and had a very strong month in absolute and relative terms. The same themes that we have been exposed to over the last quarter continue to be the drivers of returns. Active positions in FX (dollar hedging), bonds (overweight peripheral Europe and long-dated US treasuries) and equities (long-standing overweight positions in US semi-conductors and European industrials, as well as the tactical decision to materially increase FANG and EM exposure earlier in November on a record collapse in their share prices) have all contributed strongly to performance. Over the month, we took profits on consumer cyclical exposure and further repositioned for Europe's response to US Inflation Reduction Act, namely through renewable energy and utilities. We also reduced some technology overweight positions before earnings given the very strong performance in these names over the last couple of months. As always, we continue to use option protection around key events such as key economic data releases, central bank meetings and corporate earnings.

In summary, stronger than expected global growth in 2023, faster than expected China reopening, a weaker US dollar, falling inflation and a tailwind from an end to ever more restrictive monetary policy all serve to provide an extremely positive backdrop for equities as we move through 2023.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

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