DART CAPITAL

Market Commentary

April 2022

Rising interest rates and geopolitical events have caused a significant increase in volatility across markets so far this year, with declines across both equity and bond markets as prices re-calibrate to a more normalised monetary policy environment. Whilst our emphasis on profitable companies trading on reasonable valuations has served us better than most over this challenging period, there have been few places to hide for investors. Looking ahead, we are seeing increasingly attractive valuations within areas of equity markets which had been previously trading on elevated valuations, and we have been selectively topping up these holdings now that valuations have declined to far more reasonable levels. Somewhat counter-intuitively, periods of greatest uncertainty often lead to the strongest future returns, and we believe portfolios are well positioned to deliver over coming years.

US

The initial estimate for the first quarter indicated that the US economy contracted in real (inflation-adjusted) terms over the period, declining 1.4% on an annualised basis as supply side constraints, elevated inflation and a widening trade deficit pushed growth into negative territory. April saw little change in the inflationary backdrop, with March's CPI reading coming in at 8.5% year-on-year, although March core CPI (which excludes food and energy) only increased slightly to 6.5% year-on-year as new and used car prices moderated from their explosive growth of a year ago.

Against this backdrop, the Federal Reserve are set to raise the Fed funds rate by 50 bps to 1% in their meeting in early May, with a further 150 bps of rate hikes priced in for later in the year, which would bring the Federal Funds rate up to c.2.7%. US Treasury yields moved higher over the month, with the yield on the 10 year Treasury increasing 59 basis points to end the month at 2.94%. The real world impact of rising Treasury yields fed through to the housing market, with the interest rate on new 30 year fixed mortgages rising to over 5%, having been below 3% as of August last year. The Federal Reserve's more rapid pace of rate hikes drove the US Dollar up against most major currencies, appreciating 4.8% and 4.3% against the Euro and the Pound respectively.

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The US equity market remained volatile over the month, with the significant underperformance of high valuation stocks continuing as investors shunned companies most at risk from Federal Reserve monetary tightening. Corporate earnings releases for the first quarter were broadly mixed. There were some notable disappointments, led by Amazon, which was hit by supply chain related challenges and higher raw material costs which offset some of the strength in its cloud computing division, which was further compounded by a write-down on their stake in EV maker Rivian. Netflix reported its first decline in subscribers in over a decade, and the company has forecast for 2 million lost subscribers over the current (April-June) quarter. Amazon and Netflix ended the month down 24% and 49% respectively in Dollar terms. In contrast, the likes of Apple and Microsoft were resilient, with the former seeing particular strength from their services division which includes Apple Music and iCloud, whilst Microsoft's Azure cloud computing offering continuing to gain market share and benefit from customer adoption. The S&P ended the month down 8.8% in US Dollar terms, although the strengthening of the US Dollar cut this decline to 4.3% in sterling terms.

UK

Although set to tighten policy at a slower pace than the US Federal Reserve, the Bank of England's Monetary Policy Committee (MPC) are expected to agree to a 25 bps increase in the base rate at their meeting in early May, which would bring the base rate up to 1%. Having previously outlined plans to reduce the size of their balance sheet, in a process known as Quantitative Tightening, once the base rate reaches 1%, the MPC are expected to provide further detail on this balance sheet reduction in the minutes released following the meeting.

The inflation figures for March, which were released over the month, exceeded economist expectations, with the year-on year increase in the CPI index increasing to 7%, with a further increase in the figures expected for April as the increase in energy tariffs is reflected feeds through into the figures. The heavyweight companies in the FTSE 100 have generally delivered resilient results, with pharmaceutical firms AstraZeneca and GlaxoSmithKline both beating expectations, with the latter in particular benefitting from strong growth in its speciality medicines division, whilst BP announced very strong growth in cash flow, driven by the rapid rebound in the oil price over the last 12 months. Lower down the market cap spectrum we have generally seen solid corporate results, with little sign of abating demand from households and corporate customers. MSCI UK All-Cap ended the month up 0.1% in capital return terms.

Europe

Owing to the proximity of the conflict in Ukraine and reliance on energy imports from Russia, Eurozone inflation climbed higher, closer to US inflation over recent weeks, with the year-on-year increase in the CPIH index for the currency bloc increasing to 7.4% in March. Despite this, survey data across the currency bloc has remained reasonable, with still modest expansion in both the manufacturing and services sectors. The European Central Bank (ECB) are expected to return to positive interest rates over the next year, although their tightening of policy will certainly lag behind that of the Federal Reserve, as they remain wary of raising borrowing costs too significantly for the more highly indebted southern European economies within the currency bloc. This policy divergence has led to the Euro weakening against the US Dollar, ending the month at $1.05. MSCI Europe ex-UK ended the month down 1.8% in local currency terms.

Asia

The Chinese government's "zero COVID" policy has come under increasing pressure, as the required lockdowns to contain the infectious omicron variant impact both the domestic and global economy. Chinese technology stocks stabilised over the month following a weak first quarter, with positive government comments around the overseas listing of Chinese technology companies helping to drive a rally late in the month. MSCI China H ended the month down 3.9% in local currency terms. The Bank of Japan's (BoJ) meeting late in the month saw no change to their bond buying programme or indication that they plan on allowing their bond yields to move higher, with the news driving the Yen down against most major currencies to a 20 year low relative to the US Dollar. News flow from corporate Japan has been far more positive however, with a number of companies held in our favoured Japan fund raising guidance for profits and dividend distributions. MSCI Japan ended the month down 2.7% in Yen terms.