Everything Ethical Newsletter – December 2022

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Market Commentary

December saw no let-up in important economic data being released alongside a flurry of central bank activity as investors looked to form outlooks for the new year. It has become clearer that the key debate of 2023 will be recession versus inflation, with labour and wage data being critical in determining where we stand in this.

Markets began the month latched onto hope of a Federal Reserve (Fed) pivot following Chairman Powell's comments at the end of November that they will slow down the pace of interest rate hikes. However, these dovish hopes were dialled back somewhat as data showed that job creation and wage growth was stronger than had been expected in November. This was further compounded by the release of US Producer Price Inflation which also came in stronger than had been expected. Sentiment then flipped once again as US CPI came in weaker than had been expected, including core CPI, which fed into the idea that the worst of US inflation had passed.

It was then time to hear from Fed policy makers themselves who, as expected, raised rates by 0.5% to 4.25% - 4.50%. However, this was accompanied by a hawkish news conference where Powell said there was more work to be done and would not shy away from their fight to bring inflation down. The Fed dot plot suggested rates would peak around 5.1% and that rate cuts are not expected until 2024. Investors, on the other hand, began to bet that the central bank would have to execute a U-turn and cut rates next year as the economy falters.

Following a similar trend, UK CPI also came in lower than had been expected, with a lot of the declines coming from fuel and transport costs. This was followed by a Bank of England (BoE) rate decision that interestingly saw a three-way division. The decision was, as had been expected, to raise rates by 0.5% to 3.5%. However, one member voted for 0.75% and two voted for no change as they saw increasing signs of a cooling labour market and weakening economy. The Bank sees inflation remaining very high in the short term but they expect it to fall sharply from mid-2023.

Many commentators believe inflationary shocks will persist in the UK for longer than elsewhere which will force the BoE to keep interest rates high. There are a variety of reasons cited for this such as a tight labour market, poor productivity, weak business investment, government neglect of public services and the damage done by Brexit to trade and the workforce. This is likely to intensify the squeeze on household incomes, as higher borrowing costs add to the pain already caused by soaring prices, which will see people further rein in their spending. It will also mean continuing disputes over pay in the public sector as workers demand fairer compensation from government.

The European Central Bank followed suit in raising rates by 50 basis points to 2% and were very hawkish in their comments, saying that they expect to raise rates significantly further at a 50-basis point rate. Quantitative Tightening (reducing liquidity and money supply) will also begin in March at a measured and predictable pace. They also increased their inflation expectations and reduced their GDP forecast. Off the back of this, the German – Italy 10 year spread widened (a gauge of risk sentiment in the bloc). Their aggressiveness was a bit of a shock, but they are playing catch-up when compared to the Fed or BoE.

European natural gas prices fell to levels not seen since before Russia's invasion of Ukraine as warmer weather helped the continent to preserve their reserves. This came as EU nations also managed to reach a deal at which to cap natural gas prices after months of political wrangling over whether to intervene in the energy crisis. Other inflationary drivers reached lows such as wheat and oil as the G7 introduced a price cap for which countries could pay for Russian oil as part of their continued sanctions upon Moscow.

Perhaps the biggest surprise to markets came from the Bank of Japan as the governor unexpectedly adjusted the central bank's yield curve control programme to allow yields to rise around 0.5% from the previous upper limit of 0.25%. Dramatic policy decisions were also being made in Beijing as China began dismantling their strict Covid restrictions. This has led to a surge in new cases and put severe pressure upon the Chinese health services. It is likely that in the short term this transition will be very disruptive, but in the longer term this should improve the outlook for China and by extension global trade.

Model Portfolio transactions in the month:

There were no changes made to portfolios during December.

Performance:

Funds Model Portfolio	December 2022
Defensive	**-0.81%**
Cautious	**-0.99%**
Income	**-1.34%**
Balanced	**-1.17%**
Balanced Growth	**-1.27%**
Growth	**-1.28%**
Adventurous	**-1.67%**

Direct Equity Model Portfolio	December 2022
Cautious Green	**-1.78%**
Light Green	**-1.88%**
Mid Green	**-2.09%**
Dark Green	**-2.10%**

MPS Stock pick feature:

Agronomics is a London-listed holding company focused on investing in cellular agriculture – the production of agricultural products (particularly cultivated meat) directly from cell cultures rather than via traditional agriculture methods. The business aims to address, and capitalise on, the need to transform the global agri-food system to produce the 50% more food needed for the 10bn global population forecast by 2050, and to address the 18% of emissions caused by livestock and their by-products. Agronomics estimates that the production of meat globally will double by 2050 to >500bn kg per annum. This is unsustainable using today's farming methods in multiple ways, including land required, biodiversity loss, pesticide and fertiliser consumption and application, build-up of antibiotic resistance, and emissions. The company invests in emerging technologies that address this challenge and others associated with agriculture.

Ethical News

The government's decision to approve plans for the **UK's first new deep coal mine in 30 years** has brought widespread condemnation from many in the green movement. My favourite quote from many I have seen is "like celebrating the opening of a Betamax factory", for those of us old enough to remember that particular flop. The decision has jeopardised the UK's net zero goals and done huge damage to the reputation of the Conservative Party, and much more importantly, the UK, for a project very unlikely to meet its goals.

Imperial College London analysis for 2022 points to a **record-breaking year for green energy**, but stresses the need to 'break our addiction to fossil fuels'. Britain generated record-breaking levels of green energy in 2022, but the spiralling cost of fossil fuels led power prices to almost double during the period, their research revealed. Other record-breaking highlights from the analysis showed renewables providing a record 72.8 per cent of power to the grid at one stage during May, when wind farms generated a landmark 20GW of electricity for the first time ever. The maximum output from wind farms is now up by a third compared with four years ago, the researchers added. There was also a major breakthrough in the field of **nuclear fusion**, a fuel which in theory would be infinite, carbon free and extremely cheap. After decades of trying, scientists have managed to get more energy out of the process than they had to put in.

The first ever net zero transatlantic flight will take off from the UK this year, with Virgin Atlantic receiving government funding to fly across the pond using solely sustainable aviation fuel (SAF). One of Virgin Atlantic's flagship Boeing 787s, powered by Rolls-Royce Trent 1000 engines, will take off from London Heathrow and make the journey to New York's John F Kennedy Airport – a journey made by thousands of people for business, family and leisure every week. But this will be no ordinary journey.

When fully replacing kerosene, SAF can slash lifecycle carbon emissions by over 70% compared to conventional fossil jet fuel. This flight is expected to be fuelled by SAF made primarily from waste oils and fats, such as used cooking oil. The use of 100% SAF on the flight, combined with carbon removal through biochar credits – a material which traps and stores carbon taken from the atmosphere – will make the flight net zero. Not only will SAF be key in decarbonising aviation, but it could create a UK industry with an annual turnover of £2.4 billion by 2040, and which supports up to 5,200 UK jobs by 2035 according to government.

The United Nations Biodiversity Conference (COP15) took place in Montreal and was chaired by China. In what was a spiky affair at times, where divisions over money were the main sticking point in echoes of COP27, nearly 200 governments signed a deal to halt the destruction of the Earth's ecosystems. The deal included 23 targets which are not legally binding, and noticeably the United States and the Democratic Republic of Congo (home to one of the world's largest rainforests) did not sign. Targets included protecting 30% of the planet for nature by the end of the decade; reforming $500bn of environmentally damaging subsidies; and restoring 30% of the planet's degraded terrestrial, inland water, coastal and marine ecosystems.

Here's to a happy and healthy 2023!

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