KING & SHAXSON
Asset Management I Rewarding your Values

QUARTERLY REPORT
QUARTER TWO

Fund Managers Report

Fear and Hope (Greed)

Financing the right things.

Making investment decisions is a complex long-term consideration. It is made even more so when, in addition to the important financial criteria, the investments are in companies and organisations that work to solve serious social and environmental issues, or at the very least do things better. The City of London's heritage is financing projects around the world, where it remains a global leader, managing over £8.5 trillion of global assets making up the pensions, savings, charity and government funds for millions of people around the world.

Over the last six months it has been important to bare this in mind as volatility and market fluctuations have been the result of the year's global turmoil. Whether we refer to Keynes theory of "Animal Spirits" or the old saying "Markets are driven by fear and greed;" fear has been the dominant factor in market movements this year.

As with science, turbulence in markets is still the result of calmer forces being disturbed by chaotic and capricious factors. We have certainly seen chaos with the Russian attempt to invade Ukraine and its fallout in the energy sector in particular; and the capricious reaction stems from the rising inflation and slowing economic activity that demand conflicting actions from central banks and all at time of near global political paralysis. Even though most events took place in the first quarter and were covered in our last report to March 2022; markets have remained volatile, fear driven and negative.

This has resulted in two phenomena: the continued pressure on fixed income; and the wide divergence in equity sector performance. At the end of the last quarter, we had started to increase our exposure to fixed income and we continued to add into the weakness that prevailed in the second quarter - during the second quarter fixed income fell more than UK and global equities as markets continued to fret about inflation and interest rate rises. The fact fixed income fell harder than equities has impacted low and lower risk portfolios harder as they have higher exposure to what should be a lower risk asset. The iBoxx bond index returned -6.16% in the last quarter and -13.18% year to date. Although we have added to fixed income, we have done so from a very low base and we hold floating rate notes and short dated paper which have fallen less in value.

We feel interest rates are one of the two pivotal factors to market sentiment changing from fear to hope (or greed to use another term). Recently the concerns about a slowdown have morphed to concerns about a recession, which may be technically correct. The result being a tempering of

some of the rhetoric from the Bank of England and the European Central Bank in particular. In Europe, where interest rates are still negative and they look to start raising interest rates to curb European inflation, the difference between core and peripheral markets has hit highs not seen for a long time, reigniting market tensions.

The need to combat inflation is pressing, and rightly or not, the issue is falling on central banks. The US will go further as their economy is behaving in a more textbook fashion and at 1.5-1.75%, the very strong US Dollar will have an impact on their economy and expectations of further US rate rises to 2.5-2.75% are priced in. As for the UK, we see the interest rate scenario levelling out at 1.25% or maybe one more rise to 1.5% until the impact is assessed. Although gas and oil are significant swing factors, as well as the cost of labour, we are seeing improvements in efficiency. Some of the early supply chain issues, such as the supply of microchips, are now reversing as new production capacity ramps up.

As evidence of an economic slowdown begins to emerge, bond markets are likely to calm down and we even see room for some further upside. This is why we have continued to add high quality bonds into portfolios.

Quality is the second pivotal issue, be it the quality of debt for fixed income, the quality of a government or a company's balance sheet and the quality of their earnings. The quality of earnings also needs to take into account the business cycle and whether or not a company can pass on or manage inflation or see its margins erode as a result. We have seen a wide range of returns across global equity markets - sterling returns have ranged from -3.37% to -9.03% for the quarter and -4.22% to -16.78% for the first half of 2022[1].

The high exposure of portfolios to renewable energy infrastructure investment trusts was one positive in the negative period. This helped mitigate the effects of not holding fossil fuels that performed well. These investment trusts hold working assets, have responsible debt levels and have a rising inflation linked income. The main pain was felt with the more growth focussed renewable, electrification, and electric vehicle infrastructure sectors, which were under pressure due to interest rates and raw material costs eating into older contracts - we added into the weakness here as we see the uncertainty clearing.

We expect more clarity for equities with the second quarter and interim reports that start in mid-July, when companies will provide more of an outlook. We will pay particular attention to banks and provisions for bad debts. We anticipate a downbeat outlook as no CEO would want to over promise and the current backdrop allows them to under promise.

Both the pandemic and more recently Russia's attempted invasion of the Ukraine highlighted key ESG and Impact issues, whilst the period in-between saw a reflation of other sectors, we have seen a return to Impact investments as both the environmental and social costs of energy, food and urbanisation are taken into consideration. The threats have not changed since the first quarter, the weaknesses and fears are currently in the limelight and the opportunities are out there.

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[1] Total returns in Sterling for MSCI Impact, MSCI ESG Leaders, FTSE All Share and Eurostoxx 600 respectively, source Bloomberg and KSAM.

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