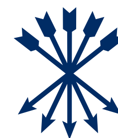

Investment review – EUR

First quarter 2022

Global stock markets suffered a volatile quarter, down -4.7% in local currency (or 2.8% in euro terms), while global government bonds saw their worst quarterly decline since 2016, returning -4.4% (in unhedged, local currency).

Investors were confronted with a challenging backdrop this quarter: shifting policy objectives, revived Covid-19 risks, and a dramatically uncertain geopolitical landscape. Other events were overshadowed by Russia's invasion of Ukraine, with global stock markets falling by a tenth as tensions escalated through February and into March, with the VIX nearly doubling to 36. However, those moves were unwound into the quarter end.

The human costs of the conflict are tragic and the economic risks are still unfolding. Russia's actions have galvanised a sharp response from the global community – the severing of financial ties through sanctions, a suspension from the Swift payments system and partial energy embargoes. Alongside this, 'self-sanctioning' has prompted many international businesses to shutter operations and ostracise Russia from global commerce.

The economic consequences for Russia will be severe, and its defensive measures, including capital controls and higher policy rates, will further weaken economic activity. The wider international community faces the prospect of another negative supply shock – through higher energy, food and metal prices – which is set to push inflation higher, and growth lower. Echoes of the 1970s – war and 'stagflation' fears – are distinct, and adding to the wall of worry.

Headline consumer prices are expanding at their briskest pace in over four decades in the US (7.9% year-over-year), with Europe (7.6%) and the UK (6.2%) not far behind. Those headline rates were widely expected to peak at the end of 2021 in Europe and the US, and in the spring for the UK (once the energy cap was lifted). This assumption of an imminent peak – like the similar assumptions made during 2021 – was already looking premature, even before the invasion.

While the inflation threat persists, it is doing so alongside respectable growth, at least so far. Most economies finished 2021 on a strong note and this momentum has continued despite the crisis. Initial post-invasion data points to ongoing robustness in business activity: the widely followed manufacturing US ISM survey dipped modestly but remained firmly expansionary in March. Even in Europe, despite its closer economic ties to Russia, weak consumer sentiment has so far been balanced by relatively upbeat business surveys. The most encouraging development has been the ongoing strength of the labour market on both sides of the Atlantic: US unemployment (3.6%) has almost fully retraced its pandemic losses, while Euro area unemployment has touched an all-time low (7.1%). Though the rising cost of living will have an uneven impact – hitting poorest households hardest – some of the overall

During the quarter, the prospect of sharply tighter monetary policy moved into focus.

financial pain is mitigated by the starting point of strong employment growth and healthy consumer balance sheets.

During the quarter, the prospect of sharply tighter monetary policy finally moved into focus. Geopolitical uncertainty failed to deter the US Federal Reserve (Fed) from initiating its first interest rate hike since 2018. With inflation well above target and the labour market close to full employment, expectations have repriced sharply since the start of the year – policymakers at the Fed have signalled a further six interest rate hikes this year, possibly taking the Fed Funds rate to nearly 2% by year end (from 0.25-0.5% today). The Fed is also set to start scaling back its bloated balance sheet ('quantitative tightening') perhaps as soon as early summer. The Bank of England (BoE) delivered a third interest rate rise in March, taking UK base rates to 0.75% (therefore back above pre-pandemic levels). Even the dovish European Central Bank (ECB) has begun to waver in the face of inflationary pressures, accelerating the tapering of its asset purchase programme and signalling a higher deposit rate later in the year.

Elsewhere, economic and geopolitical risks of a different variety continue to plague China. Renewed Covid-related lockdowns, regulatory skirmishes, a contracting real estate sector, alongside the threat of Western economic retaliation should it further align itself with Russia, have together prompted renewed volatility in Chinese stocks – particularly the internationally-investable cohort dominated by many technology-related companies. The hit from the virus, and from further regulatory intervention, poses a more material threat to growth and investment. That said, the impact may be muted by the strong upward momentum that the economy enjoyed in the first couple of months of the year and by Beijing's policy response – policymakers are considering further monetary easing and targeted measures for the enfeebled property sector.

MARKET REVIEW

Global equities fell in the first quarter of this year, alongside bonds. In contrast, commodities, particularly energy, performed well.

Both developed markets and emerging markets fell over the quarter (by –4.3% and –5.7% respectively in local currency). Unsurprisingly, weakness was evident in countries in close proximity to Russia and Ukraine: emerging EMEA, of which Russia (no longer investable) was the largest constituent, declined –9.1%, and Europe, excluding the UK, fell –7.8%. The notable outperformer in the quarter was emerging Latin America (which rose +14.7%).

In terms of sectors, energy outperformed (+32.4% in local currency over the quarter), followed by materials (+4.2%). The prospect of higher interest rates prompted weakness in technology (-10.0%), closely followed by consumer discretionary (-9.8%), though these sectors erased some of their earlier losses towards the end of the quarter.

In fixed income, bonds saw their sharpest quarterly sell off in decades, with benchmark 10-year bond yields touching their highest levels since 2018 (2019 in the case of Treasuries). The US 10-year yield hit a high of 2.56% in March, driven by expectations of both higher inflation and tighter monetary policy ahead, whilst the UK 10-year yield touched 1.71%. Meanwhile, the yield on the German 10-year bond moved back into positive territory, touching highs of 0.64%.

The commodity market was volatile in the first quarter of this year. Oil spiked amid fears of restrictive sanctions on energy exports from Russia and further supply constraints – Brent crude touched a 14-year high ($128/bbl) before easing off and ending the quarter +38.7% (WTI +33.3%). The most noticeable move was the spike in natural gas prices (European contracts and US contracts were +75.4% and +51.3%, respectively), reversing last quarter's declines. Elsewhere, gold performed well amid ongoing geopolitical uncertainty and higher inflationary concerns, ending the quarter +5.9% – its largest quarterly gain since the pandemic.

In currencies, the yen continued to depreciate against a basket of most major currencies (-5.6% on a trade-weighted basis), followed by sterling (-2.2%). The only currency to end in positive territory was the US dollar (+0.8%).

Data sources: Bloomberg, Rothschild & Co.

Notes

At Rothschild & Co Wealth Management we offer an objective long-term perspective on investing, structuring and safeguarding assets, to preserve and grow our clients' wealth.

We provide a comprehensive range of services to some of the world's wealthiest and most successful families, entrepreneurs, foundations and charities.

In an environment where short-term thinking often dominates, our long-term perspective sets us apart. We believe preservation first is the right approach to managing wealth.

Birmingham
67 Temple Row
Birmingham B2 5LS
United Kingdom
+44 121 600 5252

Dusseldorf
Heinrich-Heine-Allee 12
40213 Dusseldorf
Germany
+49 211 8632 17-0

Frankfurt
Börsenstraße 2 – 4
60313 Frankfurt am Main
Germany
+49 69 40 80 260

Geneva
Rue de la Corraterie 6
1204 Geneva
Switzerland
+41 22 818 59 00

Guernsey
St. Julian's Court
St Julian's Avenue
St. Peter Port
Guernsey GY1 3BP
Channel Islands
+44 1481 705194

London
New Court
St Swithin's Lane
London EC4N 8AL
United Kingdom
+44 20 7280 5000

Manchester
82 King Street
Manchester M2 4WQ
United Kingdom
+44 161 827 3800

Milan
Via Agnello 5
20121 Milan
Italy
+39 02 7244 31

Zurich
Zollikerstrasse 181
8034 Zurich
Switzerland
+41 44 384 7111

This document is produced by Rothschild & Co Bank AG, Zollikerstrasse 181, 8034 Zurich, for information and marketing purposes only. It does not constitute a personal recommendation, an advice, an offer or an invitation to buy or sell securities or any other banking or investment product. Nothing in this document constitutes legal, accounting or tax advice. Although the information and data herein are obtained from sources believed to be reliable, no representation or warranty, expressed or implied, is or will be made and save in the case of fraud, no responsibility or liability is or will be accepted by Rothschild & Co Bank AG as to or in relation to the fairness, accuracy or completeness of this document or the information forming the basis of this document or for any reliance placed on this document by any person whatsoever. In particular, no representation or warranty is given as to the achievement or reasonableness of any future projections, targets, estimates or forecasts contained in this document. Furthermore, all opinions and data used in this document are subject to change without prior notice. Law or other regulation may restrict the distribution of this document in certain jurisdictions. Accordingly, recipients of this document should inform themselves about and observe all applicable legal and regulatory requirements. Neither this document nor any copy thereof may be sent to or taken into the United States or distributed in the United States or to a US person. Rothschild & Co Bank AG is authorised and regulated by the Swiss Financial Market Supervisory Authority FINMA.