QUARTERLY NEWSLETTER

Q2 2022

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INTRODUCTION

Welcome to our first quarterly newsletter.

The articles have been sourced and written specifically with our clients in mind and we hope that you find them informative.

We would be delighted to hear your feedback on the content and if you have any questions on the subjects or products discussed in this edition of the newsletter then please don’t hesitate to get in contact.

We look forward to seeing you at our next meeting.

CONTENTS

4

Q1 2022 MARKET UPDATE

6

3 BENEFITS OF IMPROVING YOUR FINANCIAL WELLBEING

8

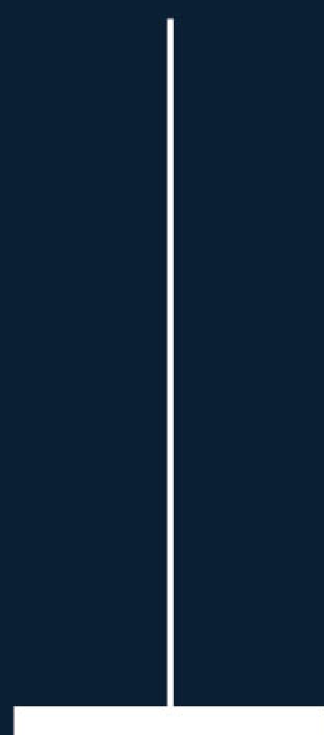
THE GROWING PAINS OF ESG INVESTING

10

INFLATION AND INTEREST RATES

13

MAKING THE CASE FOR A SUSTAINABLE INVESTMENT



Q1 2022 MARKET UPDATE

The first quarter of 2022 was quite extraordinary in many ways. It started with increasing concerns by central bankers about the level of inflation caused by the easy monetary environment that had been in place during the worst of the COVID pandemic, coupled with continued supply chain problems. Inflation in the UK is now running at over 6%.

Consequently, we saw bond yields rise steadily and equity prices decline, barring the shares of those companies expected to benefit from higher inflation and interest rates, such as commodity companies or banks. Particularly hard bit were those growth companies, such as Netflix, whose valuations would be challenged by higher interest rates, continuing the trend that had started in Q4 of 2021.

Then, at the end of February, we witnessed the invasion of Ukraine by Russia which, aside from the devasting humanitarian impacts, led to a huge spike in commodity prices, particularly fuel and food.

This in turn led to a temporary reversal of the trend in rising bond yields and a further sell-off in equity markets, especially those most at risk from the consequences of the invasion such as those in Europe.

Then, as fears subsided about the length and scale of the war in Ukraine, we saw volatility decline and equity markets recover rapidly, to either the levels seen prior to the invasion or higher. In bond markets, however, investors' concerns returned to the now increased inflationary pressures, causing the trend in rising bond yields to continue.

Chart: FTSEurofirst Index 1st Jan -31st Mar 22

Source: FT

Outlook

Immediately following the invasion of Ukraine, the increased volatility across asset classes meant it would have been imprudent to have made any decisions about asset allocation, as there was little visibility around the outcomes and the eventual effects on economies and markets.

At the time of writing, markets seem to have discounted some sort of resolution and we hope they are correct. Volatility, which it should be said never really exhibited the levels seen in previous 'risk off' events, has declined to pre-Ukraine war levels. So, at least investors are now able to make some decisions based on the improved visibility that we have now.

Despite the 'relief rally' in equities and the positive economic backdrop of positive GDP growth and high employment, investors to be mindful of several things:

- Commodity prices, particularly those traded in Europe, remain high and are vulnerable to a revision in the prospects for a resolution to the war in Ukraine, or Russia's actions over supplies.
- The US Federal Reserve is still striking a hawkish tone about inflation and we expect 3-4 interest rate rises there this year. The Bank of England is also cautious, but their actions my be tempered by the effect on demand of higher energy and food prices.
- Equities are perceived as a better alternative to bonds, as companies can raise prices in line with inflation. However, their ability to continue to do so might be challenged if inflation continues and consumers rein in spending as a consequence
- Equity markets, particularly the US, are not cheap in an historical context and may be vulnerable to stagflation or recession.
- We expect increased volatility in Q2 as a consequence

Ultimately, we hope that demand side impact of the combination of higher interest rates and prices leads to a swift decline in inflation and a return to a more accommodative environment generally. Meanwhile, investors remain vigilant to change.

3 BENEFITS OF IMPROVING YOUR FINANCIAL WELLBEING

At Aegon, want people to feel confident and empowered when managing their money – so to help we're showcasing 3 benefits from our Financial Wellbeing Index. These benefits should show you how improving your financial wellbeing can positively impact your situation in some way.

What is financial wellbeing?

When we talk about financial wellbeing, we refer to how you feel about the control you have over your financial future – and your relationship with money. Those with healthy financial wellbeing can meet their long-term financial goals and make informed choices that allow them to enjoy a meaningful life, both now and in retirement.

To help break it down further, you can think of financial wellbeing in two parts:

Money – having enough to pay for what you need now and in the future.
Mindset – paying attention to what really makes you happy.

So, what are 3 benefits of improving your financial wellbeing?

1. **Feeling more in control of your finances**

Financial wellbeing is created by knowing the basics – bills, expenses, savings, insurance, debts – are all under control and taken care of as part of your financial plans. It's also about opening more choices for you and your life by taking control of your money matters.

As we all have different expenses to juggle, it's easy to focus on paying for the here and now rather than saving for the future. If you feel that you need to find a happy medium with your spending now whilst trying to save for the future – try 'mindful spending'.

Mindful spending is a more thoughtful, intentional approach to using money rather allowing our emotions to control our spending. It means spending in a way that aligns with your goals and values and makes you feel happier and more purposeful[1].

To work towards becoming a mindful spender:

- Start by setting goals.
- Track your spending with intent.
- Implement a pre-purchase waiting period.
- Remove the ease of buying things.
- Create a budget.

2. **Feeling more in control of your finances**

Financial wellbeing allows you to enjoy the here and now, but it also helps you work towards the future you have in mind.

Our research found that happy people live their lives doing two types of activities, in a roughly equal share – those that make you feel happy and those that make you feel useful.

Focusing on those two feelings should help you to set short and long-term goals. it's useful to have a concrete picture of your future self as you're more likely to stick to your long-term plan.

3. Having a long-term financial plan in place

Ultimately, it all comes down to having a financial plan for life in place. It can't be reiterated how vital it is to take the time to sit down with your finances and understand how to get them in order. Consider these key points when you're writing your long-term plan:

- How you want your life to look like in the short-term, and the long-term. For example, 'In 10 years I want to be able to work part-time so I can begin writing novels'.
- What your money goals are.
- What you want to tackle and in what order. Is paying off debt or your mortgage your priority? By how much do you want to boost your rainy day (freedom) fund?
- Think about using a personal statement to focus your mind on what you want to be and do in the future. This might look like, 'In retirement I want to have enough saved to see more of the world and live closer to family'.

THE GROWING PAINS OF ESG INVESTING

The origins of ESG (environment, social & governance) investing can be traced back to the early 20th century, when faith based investors began excluding sectors of the market deemed not ethical – arms, alcohol, gambling and tobacco.

The watershed moment came in the early 1970s with the launch of the first modern ethical fund in the US. The UK has led on ESG investing as it now referenced since the 1980s and the last decade has seen an increasing number of new entrants and products, providing access to investors who want to be engaged on how their capital is being invested for the long-term good.

Whilst competition and interest are clearly good, the number of new entrants into the ESG sphere has been unprecedented, with investment houses of all sizes rushing to market new or repurposed products, whilst claiming to be experts in the field. The "everyone is now an expert" factor is one of the growing problems alongside relabelled products that have not changed their philosophy or process. How can investors navigate this "greenwash"?

AVOIDING GREENWASH

Investors need to choose a Fund Manager with a specialist offering built around ESG, who have not just applied an ESG framework as an afterthought, but developed it through long-term experience in the field.

They need to have demonstrable in-house expertise, and be able to articulate a process that is robust and well-articulated.

This tends to favour smaller investment houses which have a heritage in this space and the proven ability to meet the specific needs of ESG investors. Whilst there will always be a place for larger incumbents, discerning investors need to be aware that ESG investing remains a specialist field.

KNOW YOUR FUND MANAGER

Then there is an exercise in understanding how your ESG fund manager actually integrates ESG into their process.

Simply relying solely on external ESG ratings agencies, which have come in for criticism, is a strategy that has proven recently to be fallible for asse managers, and can expose their clier to unnecessary risks, financial and reputational.

The commitment of specialist houses can be evidenced by the presence of long tenured in-house ESG team, whi is integrated into the investment process.

Looking for examples of how the ass manager engages and conducts prox voting on issues is also an excellent v of evidencing how investments are h to account via your Fund Manager. Tl majority of asset managers publish proxy voting records on a quarterly basis, which are easy enough to find online. Specialist houses with a focus on ESG will seek to engage and influence companies across a myriad ESG issues, either directly or in collaboration with other.

AUTHENTICITY MATTERS

As investors seek to avoid the greenwash which is becoming more and more evident in ESG, choosing the right Fund Manager remains one of the best ways to navigate what is becoming a highly contested field.
ESG has come a long way since the early days of the 1980s, with greater choice for investors, but also comes with the usual warning: investors need to engage with their asset managers to make sure that they are getting exactly what they have paid for.

There are plenty of people jumping on the bandwagon, but the specialist investment houses are the ones that have the experience and skill-set to deliver in the long-term for ESG clients.

INFLATION & INTEREST RATES

BACKGROUND

It is probably clear to all and sundry that inflation is definitely not 'transitory', as it was previously described by many central banks.

Indeed, since the invasion of Ukraine by Russia, it is pretty evident that inflation expectations have become worse, with many price increases 'baked in'. This is due to both the price increases in energy related commodities, metals, and grains, which are supplied by either Russia or Ukraine.

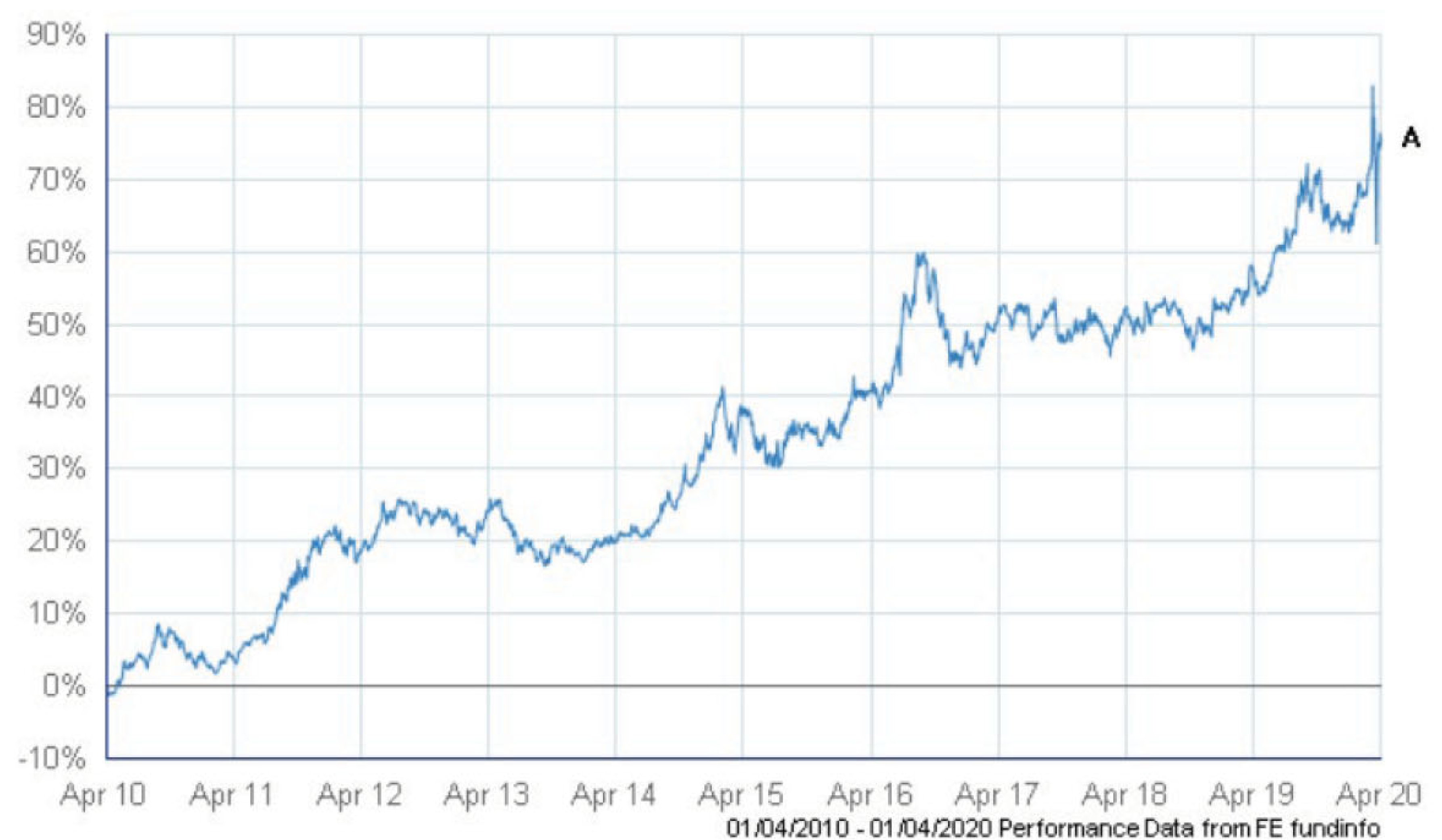
This puts central bankers in a dilemma, as they are tasked with keeping inflation low whilst recognizing the negative demand effects of higher prices for everything. Increasing interest rates is primarily a mechanism for dealing with demand led inflation, not supply side.

However, having recognised the threat of spiraling inflation, they have started the process of pushing interest rates up, the question is by how much?

Regardless of the outcome of this quandary, the fact is investors are having to become adjusted to higher interest rates, so this article sets out the implications for us as investors.

HIGHER INTEREST RATES AND BONDS

Bonds are primarily a diversifier of risk in a portfolio, with most of the returns expected to be delivered by equities. However, the decade leading up to and just after the COVID crash of 2020, was incredibly favourable for bonds and one would be forgiven for thinking that the levels of return and low volatility from bonds would negate the need for equity exposure, as the chart of the return from gilt funds below shows.



Source Trustnet. I A UK Gilts

It should be pointed out that these levels of returns were pretty exceptional in an historical context and were driven by declining interest rates, quantitative easing and disinflation; the opposite of what's happening now.

Bonds usually provide diversification during period of exceptional stress for equities, as they demonstrated admirably during shock events, such as the COVID crash or, more recently, the invasion of Ukraine, when they tend to provide a buffer to stock market declines.

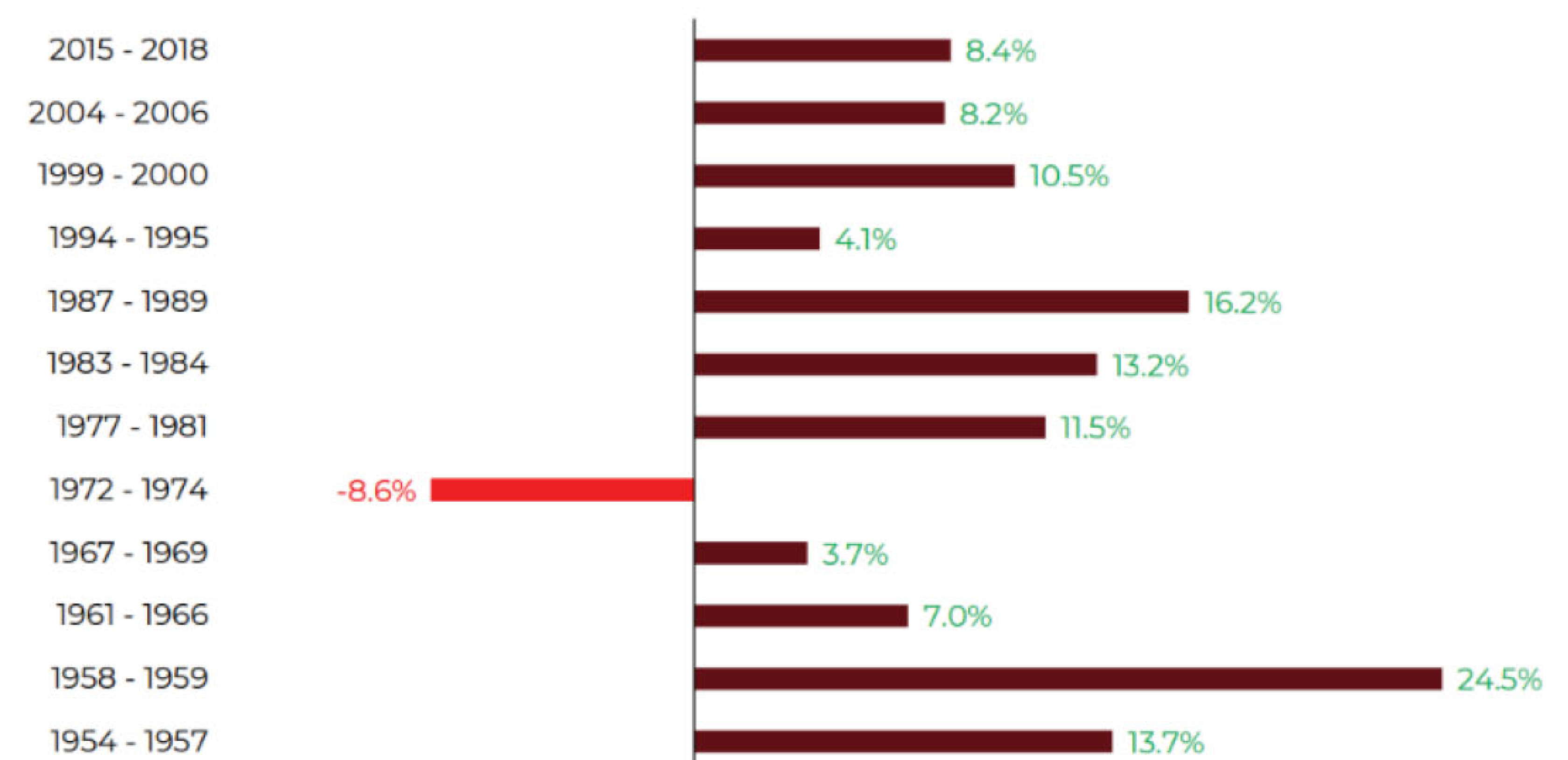
However, the returns since 2020 overall have been very disappointing, with declines seen across bond markets generally. This is due to bonds being very sensitive to rising inflation and subsequently higher interest rates. This has made for these disappointing levels of returns recently and may lead us to question their position within a portfolio, as we face even higher rates and inflation. However, we need to remember their ability to provide diversification of risk. So, how do we square the circle of the need for diversification with the short-term prospect of lower real returns?

Fortunately, as investment managers, in the short-term, we are able to dampen some of the impact by reducing our bond portfolio's sensitivity to interest rates. It should be remembered that eventually rates will peak, and new bonds issued at higher rates of return to compensate us. It is our job to minimize the negative effects in the interim.

However, we should recognize that it is likely that equities will have to do more of the 'heavy lifting' in terms of delivering returns in future, as bonds' ability to do so will be reduced.

HIGHER INTEREST RATES AND EQUITIES

Equity prices are also sensitive to interest rates. This is because investors use interest rates as part of how they value a company. However, history teaches us that a broad equity portfolio is still able (and more likely) to deliver positive returns during periods of increasing rates, as in the case in the US below:



Source: Kleinwort Hambro/Bloomberg: Investment Handbook February 2022

SUMMARY

So, with external pressures bearing down on our diversified portfolio, we will need to be more selective about the nature of both our bond and equity exposure over the next few years. However, retaining a diversified portfolio is vital, as trying to call which individual asset class will outperform is very difficult, as the chart below demonstrates, but cash is definitely not the winner over time, especially after we adjust for inflation.

Performance of various asset classes, including a normally diversified portfolio (Asset Allocation):

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%
Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%
DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%
Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%
Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.4%
Large Cap 5.5%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%
Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%
High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%
Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%
REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%

Stacey Ash
Rockhold Asset Management, March 2022

1. Moneysavingexpert.com top term rate 23/3/22
2. UK CPI 23/2/22

MAKING THE CASE FOR A SUSTAINABLE INVESTMENT

The last few years have been pivotal for sustainable investing, in which its role in shaping our economic and financial futures became more urgent. The Covid-19 outbreak and lockdowns around the world have sharpened the focus on companies' societal responsibilities.

The CEOs of many of the largest corporations, some of which appear almost to rival governments in their reach and influence, have said that running them solely for the benefit of equity owners is no longer an option. This doesn't mean that shareholders' interests are not important – they will obviously continue to matter – but they are no longer the only considerations. This is no brief moment in the spotlight, but a serious reappraisal of capitalism, of how enterprises are run and for what purpose.

As investors, we should therefore consider how best to embrace this new landscape and the opportunities it brings.

ALIGNING INVESTMENTS WITH PERSONAL VALUES

Before the pandemic hit, the biggest issue for many was the impact of climate change and how to address it.

Covid-19 has brought the 'S' in ESG to new prominence with a much greater focus on the societal responsibility of businesses.

Priorities – for corporations, households and governments – are changing dramatically.

At Fidelity International, we integrate sustainability analysis into our investment process – alongside traditional financial metrics – in recognition that companies with strong sustainability credentials are most likely to survive and thrive in the long run.

RESILIENT RETURNS

A growing body of evidence indicates that companies with high ESG standards are more resilient, typically have a lower cost of capital, and may offer high quality, long-term returns. Fidelity research has shown that both before and during the crisis, companies with higher ESG scores have outperformed the laggards.

LOOKING TO THE LONG-TERM

Covid-19 and climate change are both events that directly challenge and impact the way we live. This has presented an opportunity for companies and investors to embrace sustainable capitalism, think longer-term and reset incentives for senior executives that are tied to achieving specific ESG goals.

Sustainability factors are fundamentally a proxy for quality management. Corporate leadership teams that prioritise broader stakeholder outcomes are likely to be best placed to survive and thrive in the long-term, ultimately offering the most stable and sustainable returns for shareholders.

Making a sustainable investment
The length of time you invest for is the single biggest factor that influences the opportunity for growth – the longer the better, although of course there are still no guarantees. The quality and integrity of a business model and the team responsible for it are paramount. This means avoiding companies with subpar checks and balances on their accounts, or those risking the reliability of long-term quality growth in favour of chasing short-term profits.

In this sense, sustainable investing is all about identifying trustworthy and dependable, quality companies that are built to last and with an interest in transforming the world around them. In the long term, what is good for stakeholders will be good for shareholders too. This is not a zero-sum game.

There is a wide selection of sustainable funds to choose from so it is really important to discuss with your financial adviser what your financial goals are and the outcome you are trying to achieve. Your adviser will also help you assess your risk appetite and capacity for loss based on your investment goals and time-horizon.

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