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MARKET COMMENTARY MARCH 2022



Pension
TRANSFER
Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

Ukraine crisis highlights Europe's dependency on Russian gas

[Read article here](#) 

Russia is facing the ire of the world following its invasion of Ukraine

It is, however, the second largest producer of natural gas in the world



Policymakers have ways to manage the impact of energy price inflation on the end consumer, and business, but options in the near term may be limited.



European gas price inflation - bigger spike up, but similar profile



Lines show expected path of European gas price inflation implied by "futures" markets at different points in time. Futures are tradable agreements to buy and sell a set amount of commodities at set prices at set dates in the future. Shows expected year-on-year change in euros per therm of gas. Source: Refinitiv, Schroders Economics Group, 25 February 2022.

What's the likely economic impact of the Ukraine conflict?

[Read article here](#) 

The economic outcome of the tragic events in Ukraine are likely to include:



 Higher inflation

Stagflationary global economy 

 Weaker growth

Schroders'

new global CPI forecast 2022 (year-on-year)

+4.7%

+3.8%

prior to invasion of Ukraine

Source: Schroders Economics Group as at February 2022.

Stagflation is the combination of slowing growth and accelerating inflation

Consumer price indices (CPI) are widely used to track consumer inflation

Russian aggression looks set to keep energy and food costs elevated

Fears of disruption to Ukrainian and Russian exports have seen prices of wheat and fertiliser rise sharply



The increase in wholesale food prices is less headline grabbing than oil



but food is a more significant component of consumer price indices (CPI), which are used to track consumer inflation

+20%

year-on-year gain in wholesale food prices in January 2022
(Food and Agriculture Organization (FAO) Food Price Index)



Before Russia invaded Ukraine, food price inflation had been moderating, albeit it was still elevated

Source: Refinitiv Datastream, Schroders Economics Group, as at February 2022.

Source: [Schroders as at March 2022.](#)



MULTI-ASSET INVESTMENT VIEWS

KEY

▲ Up from last month ▼ Down from last month

● Positive ● Positive/Neutral ● Neutral ● Neutral/Negative ● Negative

	Category	View	Comments
Main Asset Classes	Equities	● ▼	Russia's move into Ukraine added more uncertainty into the already volatile market. This is against the backdrop of many developed countries raising rates and tightening liquidity (when the availability of funds becomes less ample).
	Government Bonds	●	Given further supply disruptions caused by the geopolitical situation, we expect the trade-off between growth and inflation to continue to deteriorate, posing a challenge to central bank policy.
	Commodities	●	We remain positive on commodities due to heightened geopolitical risks and the imbalance between supply and demand.
	Credit	● ▲	We upgraded to neutral reflecting the widening of spreads (the difference in corporate bond yields compared to a lower risk, similar maturity government bond). We expect slight declines in spreads in Europe and emerging market investment grade credit.
Equities	US	●	The markets seem poised for the start of the quantitative tightening cycle (when central banks reduce the amount of bonds they hold) with valuations re-rating significantly. The crisis in Europe adds some uncertainty but US inflation and the quantitative tightening cycle are still the main focus.
	UK	●	The defensive and commodity tilts of the FTSE 100 mean that this market can likely better withstand geopolitical deterioration compared to others.
	Europe	● ▼	With inflation skyrocketing and sanctions on Russia seeping into the system, European equities have much more to lose in the near term.
	Japan	●	A global recovery is crucial for this market but nevertheless it should be less affected by the situation in Europe.
	Global Emerging Markets ¹	● ▼	We downgraded to neutral despite cheap valuations. The market outlook has deteriorated with geopolitical risk in Eastern Europe, lockdowns in China, energy and food price inflation and recession risk all playing a role.
	Asia ex-Japan & China	● ▼	The increasingly stagflationary environment (where growth stagnates, but inflation is rising or remains high) globally will reduce global growth, and hence Chinese exports. This will be exacerbated by the resurgent number of Covid-19 cases.
	EM Asia ex China	●	The Korean elections are imminent and removal of this political uncertainty should be a tailwind for the region.
	Government Bonds	US	●
UK	●	Gilt yields have moved significantly in recent weeks although we believe there will be fewer rate rises this year than the market expects. We expect inflation to peak in April.	
Germany	●	Given the the impact of higher energy prices on inflation in Europe, we believe the ECB will delay tightening monetary policy, leading to a steeper yield curve in Germany (where the difference between longer-dated and shorter-dated yields increases).	
Japan	●	The market continues to offer negative yields which provides poor value in a portfolio context. The Bank of Japan is not expected to intervene anytime soon.	
US Inflation Linked	●	We remain negative as the Fed's priority is to control inflation.	
Emerging Markets Local	● ▼	We downgraded to negative. The economic environment has changed significantly in emerging markets with stagflationary as well as recessionary risks mounting.	

¹ Global Emerging Markets includes Central and Eastern Europe, Latin America and Asia.



	Category	View	Comments
Investment Grade Credit	US	●	Unlike its counterpart in Europe, we think Fed policy is unlikely to support the credit market any time soon. In the absence of a catalyst to upgrade we remain neutral.
	Europe	● ▲	A combination of international and domestic pressure, paired with the rising rate environment, lead us to believe that the ECB will remain supportive for the near term.
	Emerging Markets USD	● ▲	Very compelling valuations and low default rates are making EM bonds attractive despite the macro risks.
High Yield Bonds (Non-IG)	US	●	We anticipate spreads may widen further where subdued price action year to date looks anomalous.
	Europe	● ▼	Valuations have moved a long way and fundamental momentum appears to be peaking. Earnings uncertainty is picking up and concerns about economic growth are rising.
Commodities	Energy	●	The market has further tightened since Russia's invasion of Ukraine with markets continuing to reflect a pronounced imbalance of supply and demand.
	Gold	●	We remain neutral under the current environment of rising stagflationary risk, the breaking down of the inverse relation with interest rates, and peak central bank hawkishness (when central banks are more inclined to raise rates to curb inflation). The Ukraine invasion has strengthened these trends.
	Industrial Metals	●	Ex-China demand continues to rise whilst the policy stance in China has turned more supportive. The focus on renewable energy also brings substantial long-term upside.
	Agriculture	●	Ukraine and Russia are vital to the global food supply. The pressure from the crisis adds to the already stretched global supply chain, pushing prices to higher levels.
Currencies	US \$	● ▲	We upgrade the US dollar for its safe haven currency status and the increasing divergence in monetary policy between the Fed and the ECB.
	UK £	●	The MPC delivered a rate hike with surprisingly hawkish comments, but the hiking cycle may be short-lived if downside risks to growth materialise. We keep our neutral score.
	EU €	● ▼	We downgraded the euro. Inflation risks in the Eurozone have increased due to the rise in energy prices and slowing growth momentum. Against this backdrop, we expect the ECB will be more dovish (gearing policy toward supporting the economy) with the ongoing conflict in the region.
	CNH ¥	●	We expect a slowdown in exports and interest rate cuts to lead to a depreciation in the renminbi (offshore).
	JAP ¥	● ▲	We move to neutral based on the safe haven status of the currency. In addition, a slower US interest rate cycle could strengthen the yen.
	Swiss F	● ▲	We upgraded the Swiss franc as the currency also benefits from safe haven flows. The economy is less exposed to higher energy prices with a low reliance of fossil fuels.



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Source: [Schroders, March 2022](#). The views for equities, government bonds and commodities are based on return relative to cash in local currency. The views for corporate bonds and high yield are based on credit spreads (i.e. duration-hedged). The views for currencies are relative to US dollar, apart from US dollar which is relative to a trade-weighted basket.

MARKETS REVIEW

A look back at markets in Q1, which was dominated by Russia's shocking invasion of Ukraine as well as rising inflationary pressures.

THE MONTH IN SUMMARY

Russia's invasion of Ukraine in late February caused a global shock. The grave human implications fed through into markets, with equities declining and bond yields rising (meaning prices fell). Commodity prices soared given Russia is a key producer of several important commodities including oil, gas, and wheat. This contributed to a further surge in inflation as well as supply chain disruption.

Elsewhere, Chinese equities were negatively affected by renewed Covid-19 outbreaks, leading to new lockdowns in some major cities.

THE US

US stocks declined in Q1. Russia's invasion of Ukraine drew widespread condemnation and elicited a range of strict sanctions from the US and its allies. President Biden targeted what he termed "the main artery of Russia's economy" by banning Russian oil imports.

Sanctions also struck at the Russian financial system. Assets of the Russian central bank were frozen, while coordinated steps were taken with numerous allies to seeking to deny Russia access to the global financial system. Some of Russia's wealthiest people have also been hit with asset freezes and seizures, while a slew of major international corporations have withdrawn from the country. Numerous other sanctions have been instated.

The invasion amplified existing concerns over inflation pressures, particularly through food and energy, although US economic data otherwise remained stable. The US unemployment rate dropped from 3.8% in February to 3.6% in March. Wages continue to rise, but have not yet matched the rate of headline inflation. The annual US inflation rate, as measured by the consumer price index, hit 7.9% in February.

The Federal Reserve (Fed) raised interest rates by 0.25%, with calls from within for more aggressive tightening. Further hikes are expected through the rest of 2022.

Energy and utility companies were amongst the strongest performers in relative terms over the month, outperforming a falling market with modest gains. Technology, communication services and consumer discretionary were amongst the weakest sectors.

EUROZONE

Eurozone shares fell sharply in the quarter. The region has close economic ties with Ukraine and Russia, particularly when it comes to reliance on Russian oil and gas.

The invasion led to a spike in energy prices and caused some fears about security of supply. Germany suspended the approval of the Nord Stream 2 gas pipeline from Russia. The European Commission announced a plan – RePowerEU – designed to diversify sources of gas and speed up the roll-out of renewable energy. However, in the meantime there are fears that the high energy prices will weigh on both business and consumer demand, hitting economic activity.



Over the quarter, energy was the only sector to register a positive return. The steepest declines came from the consumer discretionary and information technology sectors. Worries over consumer spending led to declines for stocks such as retailers, while the war in Ukraine also exacerbated supply chain disruption, hitting the availability of parts for a wide range of products.

In response to rising inflation, the European Central Bank (ECB) outlined plans to end bond purchases by the end of September. ECB President Christine Lagarde indicated that a first interest rate rise could potentially come this year, saying rates would rise “some time” after asset purchases had concluded. Data showed annual eurozone inflation at 7.5% in March, up from 5.9% in February.

The ongoing war in Ukraine and rising inflation led to a small pullback in forward-looking measures of economic activity. The flash eurozone composite purchasing managers’ index (PMI) slipped to 54.5 in March from 55.5 in February, though a level over 50 still represents expansion. (The PMI indices, produced by IHS Markit, are based on survey data from companies in the manufacturing and services sectors.)

UK

UK equities were resilient as investors began to price in the additional inflationary shock of Russia’s invasion of Ukraine. Large cap equities tracked by the FTSE 100 index rose over the quarter, driven by the oil, mining, healthcare and banking sectors. Strength in the banks reflected rising interest rate expectations. The Bank of England moved to hike rates ahead of other developed market central banks.

As the quarter progressed, some of the more traditionally defensive sectors advanced up the leader board. Intermittent fears of a global recession, however, drove periodic sell-offs in some of these “safer” stocks too. Market volatility rose given the additional uncertainty related to the Russia/Ukraine conflict.

The Bank of England increased its official rate by a combined 50 basis points (bps) with a further two consecutive 25 bps hikes on top of December’s 0.15% increase. Consumer focused areas underperformed, as did traditionally economically sensitive one. Those parts of the market offering high future growth potential also lagged. These factors combined drove a poor performance from UK small and mid cap equities.

According to the Office for Budget Responsibility (OBR), UK consumer price inflation is set to peak at close to 9% this year. The OBR published its new forecast for the Consumer Prices Index (CPI) alongside the Spring Statement at the end of the quarter. It now expects CPI to hit 8.7% in Q4 2022 (previous forecasts had been to peak at 4.4% in the second quarter of 2022) before falling back in Q1 2023. Chancellor Rishi Sunak announced additional measures alongside the Spring Statement designed to support the UK consumer.

JAPAN

After weakness in January and February, the Japanese stock market rose in March to end the first quarter just slightly below its end 2021 level. This was despite the change in outlook for US interest rates, the outbreak of war in Europe and sharply higher energy prices.

From the start of the year, the tone for the equity market was set by the release of minutes from the US Federal Reserve meeting,





and the associated change in expectations for US interest rates. This helped to accelerate a change in market dynamics. In Japan, this was especially evident in the outperformance of value-style stocks at the expense of growth. Much of this relative gain in value stocks was concentrated in financial-related sectors including banks and insurance

Geopolitical events then dominated equity market behaviour from February onwards. Despite the geographical proximity, Russia is a relatively small trading partner for Japan, accounting for around 1% of exports and 2% of imports. The balance is skewed by the import of energy from Russia, especially LNG, while exports are predominantly in auto-related areas and most auto makers are now moving to suspend these links.

The yen weakened sharply against all major currencies in March, reaching a six-year low against the US dollar. Although expected interest rate differentials have widened this year, the scale and timing of the yen's weakness is unusual given the currency's perceived role as a safe-haven asset at times of uncertainty.

In the last week of March, the Bank of Japan conducted fixed-rate bond purchase operations for several consecutive days. This unprecedented move was the clearest possible statement of the Bank's intention to keep bond yields within the current target range of +/- 25bps.

ASIA (EX JAPAN)

Asia ex. Japan equities experienced sharp declines in the first quarter of 2022 amid a volatile and challenging market environment as Russia launched an invasion of neighbouring Ukraine.

Share prices in China were sharply lower in the quarter while shares in Hong Kong and Taiwan also fell. The number of Covid-19 cases in Hong Kong and China spiked to their highest level in more than two years during the quarter despite the Chinese government pursuing one of the world's strictest virus elimination policies.

The city of Shanghai, China's financial capital with a population of 25 million people, went into a partial lockdown at the end of the quarter in a bid to curb a surge in Omicron Covid-19 cases, prompting fears that other parts of the country could also go into lockdown.

Share prices in South Korea were also sharply lower in the first three months of 2022 as the Covid-19 pandemic continues to affect economic activity in many parts of the Asia-Pacific region. However, despite the index falling sharply, there were pockets of growth such as Indonesia, which achieved solid gains in share prices during the quarter. Thailand, Malaysia and the Philippines also moved higher, although gains were more muted.

EMERGING MARKETS

Emerging market (EM) equities were firmly down in Q1 as geopolitical tensions took centre stage following Russia's launch of a full-scale invasion of Ukraine. The US and its Western allies responded with a raft of sanctions. Commodity prices moved higher in response to the war, raising concerns over the impact on inflation, policy tightening and the outlook for growth.

Egypt, a major wheat importer, was the weakest market in the MSCI EM index, due in part to a 14% currency devaluation relative to the US dollar. China lagged by a wide margin as daily new cases of Covid-19 spiked, and lockdowns were imposed in several cities, including Shanghai. Regulatory concerns relating

to US-listed Chinese stocks also contributed to market volatility. Poland, Hungary and South Korea also underperformed.

Conversely, the Latin American markets all generated strong gains, led higher by Brazil. Other EM net commodity exporters posted sizeable gains, including Kuwait, Qatar, the UAE, Saudi Arabia and South Africa. Russia was removed from the MSCI Emerging Markets Index on 9 March, at a price that is effectively zero.

GLOBAL BONDS

Financial markets were volatile over the quarter. Headlines were dominated by the horrific war in Ukraine and the terrible humanitarian crisis continuing to unfold. There was a short-lived rotation toward safe haven assets as the war began, but investors appeared to focus overall on inflationary pressure that is high and still rising.

Government bond yields rose sharply (bond prices and yields move in opposite directions). Central banks were surprisingly hawkish and markets priced in a faster pace of monetary normalisation. The extent of yield moves differed across markets. The US Treasury market is in the midst of one of its worst sell-offs on record, but moves were less pronounced in core Europe and the UK.

The Fed's rhetoric turned more hawkish and "lift-off" came as expected in March, with the Fed implementing a 25 basis point rate hike. Investors expect several more, at a swift pace, in 2022. The US 10-year Treasury yield increased from 1.51% to 2.35%, with the 2-year yield rising from 0.73% to 2.33%.

The UK 10-year yield rose from 0.97% to 1.61%, the 2-year from 0.68% to 1.36%. The Bank of England (BoE) raised rates a second time in February, in spite of concerns about the UK outlook and particularly cost of living pressures on households.

The European Central Bank (ECB) unexpectedly pivoted to a more hawkish stance in February. Comments from President Lagarde indicated rate rises were no longer ruled out for 2022 and the ECB confirmed a faster reduction in asset purchases.

The German 10-year yield increased from -0.18% to 0.55% and the 2-year yield from -0.64% to -0.07%. Concerns over potential tightening and monetary normalisation impacted Italian yields particularly, with the 10-year rising from 1.18% to 2.04%.

Corporate bonds saw significantly negative returns and wider spreads, underperforming government bonds. High yield spreads widened more than investment grade, although they saw less negative total returns due to income. Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

Emerging market (EM) bond returns were negative. Local currency bonds were slightly more resilient than hard currency. Among EM currencies, Latin America performed well, the Brazilian real notably, but Asia and central and eastern Europe fell.

Convertible bonds, as measured by the Refinitiv Global Focus Index, suffered disproportionately and shed 6.4% in US dollar terms compared to -5.2% for the MSCI World. Selective IT names within the universe of convertible bond issuers saw a





strong rebound. The new issuance market remained subdued as market volatility was high and companies were unwilling to issue convertible bonds at low stock prices.

COMMODITIES

The S&P GSCI Index achieved a strong return in the first quarter of 2022, driven by sharply higher prices for energy and wheat following Russia's invasion of Ukraine. Energy was the best performing component of the index, with strong price gains for gas oil, natural gas and heating oil amid rising global demand for energy and fears of supply curbs as a result of the Ukraine crisis.



Within the agriculture component, wheat, Kansas wheat and corn all recorded sharp price gains on fears that supplies could be hit by the conflict (Russia and Ukraine account for around 30% of global wheat exports). Within industrial metals, the price of nickel was sharply higher in the quarter. Aluminium and zinc prices were also significantly ahead in the period. With precious metals, gold and silver achieved small gains over the quarter.

TOTAL RETURNS (NET) % – TO END MARCH 2022

Equities	3 MONTHS			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
MSCI World	-5.2	-3.1	-2.4	10.1	16.3	15.4
MSCI World Value	-0.7	1.5	2.2	10.6	16.8	15.9
MSCI World Growth	-9.6	-7.7	-7.1	9.2	15.4	14.5
MSCI World Smaller Companies	-6.5	-4.4	-3.8	-1.1	4.5	3.6
MSCI Emerging Markets	-7.0	-4.9	-4.3	-11.4	-6.4	-7.1
MSCI AC Asia ex Japan	-8.0	-6.0	-5.4	-14.6	-9.8	-10.6
S&P500	-4.6	-2.5	-1.9	15.7	22.2	21.2
MSCI EMU	-11.1	-9.2	-8.6	-3.6	1.8	1.0
FTSE Europe ex UK	-9.7	-7.7	-7.1	1.7	7.4	6.5
FTSE All-Share	-2.3	-0.2	0.5	7.9	13.9	13.0
TOPIX*	-6.2	-4.2	-3.5	-7.2	-1.9	-2.7

Government Bonds	3 MONTHS			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
JPM GBI US All Mats	-5.2	-3.1	-2.5	-3.2	2.3	1.4
JPM GBI UK All Mats	-10.0	-8.0	-7.4	-9.6	-4.6	-5.3
JPM GBI Japan All Mats**	-6.7	-4.6	-4.0	-10.2	-5.1	-5.9
JPM GBI Germany All Traded	-7.0	-4.9	-4.3	-10.2	-5.2	-5.9
Corporate Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global Broad Market Corporate	-7.5	-5.5	-4.9	-6.2	-0.9	-1.7
BofA ML US Corporate Master	-7.7	-5.7	-5.1	-4.3	1.1	0.3
BofA ML EMU Corporate ex T1 (5-10Y)	-9.0	-7.0	-6.4	-12.3	-7.4	-8.2
BofA ML £ Non-Gilts	-8.8	-6.8	-6.2	-9.4	-4.3	-5.1
Non-investment Grade Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global High Yield	-6.0	-3.9	-3.3	-4.7	0.7	-0.1
BofA ML Euro High Yield	-2.2	0.0	0.6	-4.9	0.5	-0.3

Source: Thomson Reuters DataStream.

Local currency returns in Q1 2022: *-1.2%, **-1.7%.

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Source: [Schroders, March 2022](#): The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Past performance mentioned is not a guide to future performance and may not be repeated. The sectors, securities, regions and countries shown are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

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