RESPONSIBLE AND SUSTAINABLE GLOBAL EQUITY FUND

COMMENTARY FOR QUARTER TO END MARCH 2022

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	-8.57%	-6.23%	2.59%	36.65%	41.37%	131.07%
FTSE World TR GBP	-2.01%	4.77%	14.92%	51.15%	72.21%	243.75%
IA Global	-5.02%	-0.58%	8.15%	42.44%	59.32%	181.28%
Sector Quartile	3	4	4	3	4	4

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

REVIEW

Global equities delivered a total return of -2.0% (in Sterling terms) over the first quarter as diplomatic efforts earlier in the period failed to de-escalate tensions on the Russia/Ukraine border. The full military invasion of Ukraine led to a sharp sell-off in equity markets. Alongside the atrocious humanitarian cost, there have been a number of financial market implications as a result of the invasion. Given the commodity market share of both Russia and Ukraine, shortages across oil, gas, grain, fertiliser and other commodities further contributed to the global inflation dynamic already witnessed in early 2022. The additional inflationary pressure led central banks to signal greater and earlier hikes in interest rates driving a growth correction with MSCI World Value returning 2.5% and MSCI World Growth returning -6.9%.

European energy security has been a central topic of debate in the face of war in Europe led by its main supplier of fossil fuels. Two-fifths of gas burned by Europeans and a quarter of imported crude in 2021 came from Russia. Dependency upon Russia for these resources have blunted a robust sanction response, as many European countries have limited alternative but to continue to buy Russian natural gas, highlighting the importance of energy security, independence and diversity. In response to the conflict the ‘RePower EU’ plan was launched, accelerating existing ‘Fit for 55’ programme which aims to reduce carbon emissions by 55%, supporting renewable energy expansion of solar, wind and development of green hydrogen to help replace Russian natural gas. Globally the inflation in energy prices and security of supply dynamic provides a long-term opportunity for sustainable companies focussing on the renewable energy and energy efficiency supply chains.

Looking to equity market performance, US equities fell only 2.5% in Sterling terms, with significant disparity between indexes as the tech-heavy NASDAQ declined 6.2% while the S&P 500 declined only 1.7% over the quarter. The lower dependency of the US on Russia for energy and less proximity to the conflict enabled equity markets to remain more resilient than its European counterparts. Data over the period was mixed, encouragingly US unemployment rate declined 0.2% to 3.8% in February, as wage inflation also picked up to 5.1%. This still however lags the new 40-year high level of inflation of 7.9% and indeed consumer sentiment dipped over the period as consumers felt the pinch. The Fed raised rates for the first time since 2018, up 0.25%, but with inflation running even hotter and wide belief that the Fed is behind the curve, a further 7-8 hikes are forecast for 2022.

Europe ex UK equities were the regional laggard, declining 6.8% as greatest proximity and impact from the conflict weighed on the region. European dependency upon Russia as a source of gas and oil made the region particularly vulnerable to fears of shortages, energy price inflation and a resulting economic downturn. Whilst the RePower EU initiative will support energy security and diversification in the long term, immediate options remain limited. EU inflation data sharply accelerated from February’s 5.9%, to 7.5% projected for March. In a similar step with the US, the war and surging inflation dented consumer confidence over the period. Rate hikes are expected to be at a slower pace in Europe, with the ECB anticipating the first rate hike only “some time” after ceasing its bond buying programme, which is expected to conclude in the third quarter. The conflicting messages from the ECB are notable, with bond markets taking a more hawkish stance, projecting 6-7 hikes by year end.

The UK was the best performing region rising 1.8%, with the FTSE 100 up 2.8%, aided by the high energy and mining sector representation. Whilst the UK is less dependent on direct Russia oil and gas imports than Europe, it remains vulnerable to the global inflation arising from higher freight and importing bottlenecks from dislocated supply chains.

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Energy bill inflation was in political focus, as the Chancellor unveiled a new fiscal package to help households deal with higher bills.

Asia ex Japan equities gained 1.4% over the quarter although there was notable variation amongst the indices. China is currently experiencing a significant slowdown, some of which is self-induced as authorities place numerous major cities in lockdown. Chinese credit impulse has remained in strict negative territory for several months, while March new home sales fell 45% illustrating the ongoing challenges in the property sector continue despite supportive policy steps. The Hong Kong Hang Seng Index hit a six year low at one stage, with Chinese technology stocks hit particularly hard, as US listed Chinese companies face being removed from US exchanges. Japanese equities declined 3.5%, with the yen depreciating significantly against the US dollar. Whilst geographically close to Russia, import/export relationship with Russia is limited, most notable exposure is natural gas imports into the auto sector which already face disruption from COVID and semiconductor shortages.

PERFORMANCE & ACTIVITY

The EdenTree Responsible & Sustainable Global Fund declined 8.6% in Sterling terms over the quarter. Against the IA sector group, the fund is ranked third quartile for Q1 2022. From an allocation perspective, the Europe ex UK overweight of 15% was the primary headwind given the region was the by far the global laggard over the period. This was further exacerbated by the fund's exposure to European industrials which suffered both from the input cost inflation and deteriorating growth outlook. In terms of sectors, the obvious significant headwind for the fund was the zero weighting to Oil & Gas, which was the best performing sector, up 33.5% as commodity prices rose. This sector alone contributed 1.1% of underperformance against the benchmark. Additional headwinds came from the market's move to reflect the ongoing Ukraine war, with strong performance from similar sectors that fail our responsible & sustainable screening process, namely industrial metals & mining (+28%) and precious metals & mining (+22.3%), Aerospace & Def (+13.6%), and Tobacco (+8.2%). Generally speaking the period favoured defensive companies, with the funds healthcare companies delivering 0.7%, outperforming the benchmark by 1.4%, with US medical technology names Medtronic and Boston Scientific rising 11% and 7% respectively and European pharma leaders such as Novartis gaining 7%. The overweight position to the cyclically exposed Industrials group was a detractor with the fund's holdings retracing 12.6%, contributing 2.6% to underperformance as inflation and supply chain dislocations weighed on growth outlook.

Stock selection over the quarter proved challenging over the period with US & UK stock selection the primary detractors. The funds US holdings underperformed the benchmark by 8.3%, with Paypal the largest detractor, falling 37% after a Q1 2022 guidance miss and strategic pivot to prioritise increasing engagement rather than simply net new account growth. In terms of positive gainers, recent addition Hannon Armstrong (see activity below) gained over 24%, while cyber security leader Palo Alto gained 16% on the back of increased security spending expectations arising from Russian invasion. UK stock selection was challenging given the index's high commodity and oil & gas weightings, however the fund's holdings fell 12.6%, led by IP Group retracing 27.3%, despite the recent successful IPO of Oxford Nanopore.

In terms of investment activity, over the period we have sought to decrease the portfolio's cyclicality in industrials and technology sectors, favouring more value oriented defensive names. In terms of reduced industrials exposure, we sold Danish stone wool insulation provider Rockwool. The fundamental outlook for the company looks particularly challenging given production is materially exposed to substantially higher energy and natural gas prices, in addition to a having mid- single digit proportion of sales and production in Russia. Longer-term, we would expect Rockwool to benefit from the increased energy efficiency and insulation expenditure, but the short-term margin pressure and demand destruction wasn't reflected in the valuation at point of sale. In the US, we initiated a new position in Hartford Financial Services, which the team view as a leading ESG performer in the US insurance sector, in addition to being positively exposed to the US rate cycle. Another new addition was Hannon Armstrong Sustainable Infrastructure, which provides specialist financing exclusively for climate solutions including renewable energy projects and energy efficiency, areas of enormous opportunity for a low carbon world and particularly in light of recent inflation in oil & gas.

OUTLOOK

The outlook for the remainder of 2022 is particularly challenging given the quantum of inflation and the risks of executing the tight monetary policy signalled by central banks. Given the proximity to the Russian invasion, Europe appears to have the most challenging macro backdrop, reflected in the ambiguous, conflicting guidance from the ECB. The EU energy crisis is likely to lead to 10% of GDP being spent on energy vs. 2% previously. More broadly, inflation at such high levels is likely to result in some demand destruction, and could slow top-line growth from a volume perspective, while margins, which are close to long-term highs, could well reverse, not least from a timing perspective. Putting these factors together, implies a more challenging outlook for earnings growth in the remainder of 2022. China continues to show signs of slowing growth, with COVID induced lockdowns potentially impacting supply chains even further. Any further deterioration in the macro outlook in China should be met with further incrementally more positive policy responses.

In the US, the well followed 2s-10s Treasury yield spread briefly inverted, providing an early indication of potential recession. With only one exception, every time the yield curve has inverted, the US economy has entered a downturn within 18 months. The extent to which the economy slows will clearly be determined by how much the Fed follows through on their projected rate path, but history suggests the economy doesn't react well to prolonged tightening spells. With the Fed already behind the curve, and needing to catch up through successive 50 basis point hikes, it feels as though the propensity for policy error and delayed impact from tightening will also impact the outlook for 2023. The market's willingness to pricing in eight to nine interest rate hikes in 2022, highlights the challenge the Fed faces in managing the pace of tightening. As highlighted last quarter, there remain several hurdles to clear in order to get back to more neutral monetary conditions, namely removing QE through faster tapering, raising rates (at least to 2.5%) and then, potentially, quantitative tightening. The quantum of the Fed balance sheet reduction in itself is staggering at $1.1 trillion per year, or just under 5% of the US GDP in 2021. However, in the context of the Fed's $9 trillion balance sheet, there remains a long way to go. The upside scenario is essentially the Fed successfully engineering a soft-landing while year on year base effects could see inflation start to slow this quarter. Stepping back, central bank liquidity has long been recognised as a key factor underpinning equity markets since 2008, and particularly supporting long duration assets such as high-growth equities. Given the material PE expansion witnessed since the end of the GFC, it would be imprudent to expect this trend to continue. As central banks look to wind down their asset purchase programmes, equity markets will need support from secular economic drivers, which include addressing the numerous sustainable challenges currently faced. For example, longer term, the political repercussions from the Russia invasion provides strong justification for energy security of supply within the West. This should be particularly constructive for sustainable companies providing renewable energy, energy efficiency and transitional solutions for the path to net zero. As significant incremental capital is channelled towards sustainable challenges, coupled with the reversal of highly accommodative monetary policy, we remain acutely aware that we must retain a healthy valuation discipline while recognising the scarcity context.

To obtain further information please speak to your normal EdenTree representative, visit **www.edentreeim.com or call** our support team on **0800 011 3821**