meridian

ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

Despite the unsettled geopolitical and economic background and unexpected banking developments towards the end of the quarter, markets have shown a resilient performance and both equity and bond investors have seen positive returns in the first quarter of 2023. In the currency markets, sterling has shown the strongest performance as some measure of confidence returns to the UK after the negative economic events of late 2022. Gold performed well as the volatile background played to its perceived strengths.

The tables below detail relevant movements in markets :

International Equities 30.12.22 - 31.03.23

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+3.3	-0.8	+2.0	+0.2
Finland	+0.4	-0.6	+2.2	+0.4
France	+12.6	+11.6	+14.7	+12.6
Germany	+12.8	+11.7	+14.8	+12.8
Hong Kong	-1.2	-4.5	-1.8	-3.5
Italy	+13.1	+12.0	+15.1	+13.1
Japan	+7.1	+3.3	+6.2	+4.3
Netherlands	+14.5	+13.4	+16.6	+14.5
Spain	+12.8	+11.8	+14.9	+12.8
Switzerland	+5.9	+4.3	+7.2	+5.4
UK	+3.7	+3.7	+6.6	+4.7
USA	+7.7	+4.8	+7.7	+5.8
All World Europe ex UK	+10.1	+8.6	+11.7	+9.7
All World Asia Pacific ex Japan	+4.1	+0.8	+3.6	+1.8
All World Asia Pacific	+5.0	+1.6	+1.5	+2.6
All World Latin America	-1.4	+1.3	+4.1	+2.2
All World All Emerging Markets	+2.5	+0.2	+3.0	+1.2
All World	+7.0	+4.4	+7.3	+5.4

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : +2.1%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	30.12.22	31.03.23
Sterling	3.66	3.48
US Dollar	3.88	3.47
Yen	0.41	0.32
Germany (Euro)	2.56	2.29

Sterling's performance during the quarter ending 31.03.23 (%)

Currency	Quarter Ending 31.03.23
US Dollar	+1.9
Canadian Dollar	+1.7
Yen	+3.2
Euro	+0.7
Swiss Franc	+0.9
Australian Dollar	+4.0

Other currency movements during the quarter ending 31.03.23 (%)

Currency	Quarter Ending 31.03.23
US Dollar / Canadian Dollar	-0.3
US Dollar / Yen	+1.3
US Dollar / Euro	-1.2
Swiss Franc / Euro	-0.2
Euro / Yen	+2.6

Significant Commodities (US dollar terms) 30.12.22 - 31.03.23 (%)

Currency	Quarter Ending 31.03.23
Oil	+5.8
Gold	+8.3

MARKETS

Despite the upheavals towards the end of the quarter, it has been a solid quarter for international equity and bond markets.

Looking at international equity markets first, the FTSE All World Index showed a total return of +7.0% in local currency terms, in sterling terms +4.4%, in US dollar terms +7.3% and, in euro terms, +5.4%. Looking at individual markets in local currency terms, the stand out area was Europe ex UK, where the FTSE All World Europe ex UK index returned +10.1%. The FTSE USA Index showed a modest outperformance, returning +7.7%. On the negative side, the weakest performer was the FTSE All World Latin America Index which returned -1.4%. Moving on to sterling adjusted returns, the FTSE All World Europe ex UK Index remained the outstanding performer, with a return of +8.6%. The FTSE USA Index continued to show a slight outperformance, returning +4.8% against the return of +4.4% on the FTSE All World Index. The weakest performers in our table in sterling terms were the FTSE Australia Index which returned -0.8% and the FTSE All World Hong Kong Index which returned -1.2%. The FTSE All World Latin America Index moved into positive territory, returning +1.3%.

International bond markets performed a smart turnaround towards the end of the quarter as investors saw them as a safe haven, at least temporarily, in the light of the turmoil in the banking sector. Taking 10 year government bond yields as a yardstick, the gross redemption yield on the UK government bond fell by 18 basis points to 3.48%, on the US Treasury bond by 41 basis points to 3.47%, on the German Bund by 27 basis points to 2.29% and on the Japanese government bond by 9 basis points to 0.32%. The best performer in our table of international currency movements was sterling. Against the Australian dollar it rose by 4.0%, against the yen by 3.2%, against the US dollar by 1.9%, against the Canadian dollar by 1.7%, against the Swiss Franc by 0.9% and against the euro by 0.7%.

In the commodity markets, gold, although off its peak price in the quarter, rose by 8.3%, whilst oil, as measured by Brent crude, rose by 5.8%.

ECONOMICS

Just when one thought that the geopolitical and economic background was understood and discounted by investors, along comes a banking crisis, not like 2008, but, nevertheless, one with consequences. The collapse of Silicon Valley Bank, (SVB), the sixteenth largest in the USA, was due to special circumstances, but it was a large enough bank to cause significant concern and two other banks failed in the USA as well, again due to special circumstances. Then, over in Switzerland, a much bigger bank, Credit Suisse, a systemically important bank, came unstuck as a result of clients removing assets and deposits from the bank, necessitating a rescue operation involving the Swiss government and central bank and its acquisition by UBS.

First of all, what caused the specific problems with these banks? In the case of SVB, it was closely connected with the technology industry and private equity and had been receiving a flood of deposits, but, crucially, it did not manage its balance sheet correctly. In the search for higher yield and a better net interest margin, it invested short term liabilities, deposits, into longer term assets, bonds, offering a higher yield but without proper hedging arrangements in place. Its balance sheet was badly mismatched. Banks are always susceptible to a loss of confidence, so, when SVB faced a run on deposits, it sold long term assets, which had fallen in price at a loss. Banks in the USA are allowed to value bonds at their redemption value so don’t have to show the true market value unless they have to realise them.

This is what happened at SVB and the loss affected their capital cushion so a liquidity crisis caused by large deposit withdrawals became a solvency crisis. A failed capital raising issue was the final straw. In the end, the authorities ensured that all deposits were guaranteed, even though it had a high percentage of deposits over the US$250,000 per account guaranteed cut off. SVB appeared to be too reliant on types of clients where deposits were too flighty and the sudden removal of substantial amounts of deposits was too much for the bank. It seems the basic rules of balance sheet management of matching assets and liabilities in a way which could have avoided the problems were not followed and the borrowing short and invest long strategy without proper interest rate hedging ended in disaster.

Bank failures are not uncommon in the USA but they are mainly amongst small sized banks. According to the Federal Deposit Insurance Corporation (FDIC), there were 4,236 FDIC insured commercial banks in the USA in 2021. Since 2001, there have been 563 bank failures and, since the 1970s, over 90 banks in the USA with US$1 billion or more in assets have failed, so it is a not uncommon occurrence. However, SVB Financial Group, the parent company, had held assets of US$211 billion in 2021, an 83% rise over 2020, and therein lay part of the problem as the bank sought to invest its increased deposits profitably but, in doing so, took great risks, as we now know. Two other US banks failed, Signature Bank in New York and Silvergate Capital Corporation. Both had connections to the crypto industry and a high percentage of uninsured deposits, i.e. those over US$250,000. After the scandal at FTX, confidence weakened and the banks' heavy involvement in the crypto industry made them vulnerable to a loss of confidence. Silvergate was a much smaller bank than Signature Bank, with assets of about US$11 billion compared with US$114 billion for Signature Bank. Confidence is crucial to banking and a run on deposits as confidence ebbs away can sink a bank. The CEO of Citigroup, Jane Fraser, has made a relevant point. The development of mobile banking has meant that money can be moved instantly from a bank and social media stories make banks highly vulnerable to rumours.

A much larger and systemically important bank, Credit Suisse, had to be rescued by the Swiss National Bank and UBS, which purchased the equity, along with government support. Here, the story was rather different. It did not have a solvency problem and its ratios were satisfactory but its demise turned out to be the culmination of a series of scandals which ultimately ate away at confidence in Credit Suisse. It appeared to have weathered the storm with an earlier capital raising exercise and support from some large shareholders. Ironically, it was a statement from the Chairman of Saudi National Bank, at the time when the concerns about banks were unsettling investors and depositors, which may have been the tipping point for Credit Suisse. He said that Saudi National Bank would "absolutely not" be open to further investment in Credit Suisse if there was another call for liquidity. The remarks in a Bloomberg TV interview saw Credit Suisse's share price plunge further and credit spreads widen. As an aside, the Chairman of the Saudi National Bank has now resigned. Credit Suisse was probably a victim of its previous problems as, once confidence in a bank disappears, survival is difficult. But, as a result of previous banking crises, regulators and governments are more confident about the actions which they need to take and, so, over a hectic weekend, a deal was agreed whereby UBS, its arch rival, would buy Credit Suisse's equity, giving Credit Suisse's shareholders a small stake in its recovery prospects under the much stronger UBS. Not so fortunate were the holders of the lowest tier of Credit Suisse's bonds, called AT1 (sometimes called CoCo bonds). Normally, of course, equity holders would be on the lowest rung of the ladder when it comes to distributions from companies which were in trouble. In this case, equity holders in Credit Suisse will receive some payment in the form of UBS shares, but AT1 holders will be wiped out as the Swiss central bank says it is entitled to do. This will be the subject of litigation and carries risks in its own right, since it will make raising additional balance sheet buffers more expensive given that investors will perceive the risks from holding these types of bond to be greater after the Credit Suisse experience. Other regulators, however, fearful of contagion, have emphasised the understood order of repayment for banks in trouble, with shareholders ranking after everyone else.

As we write, the atmosphere has become less febrile. Regulators have tightened controls and the supervision of banks, especially those considered systemically important, which receive special monitoring and have additional balance sheet requirements. As we see things now, we do not consider a major banking crisis likely, but, even if our view is correct, what has happened in March is likely to have wider ramifications in the area of economic policy, especially on the monetary side where central banks may rein in their tightening policy. That is not a given but it is a possibility.

Whilst there has been some relief on energy prices which have weakened more quickly than expected, inflation remains a problem for central banks, hence the continual upward, though not as steep as previously, rise in interest rates. Looking at current inflation in the G7 countries, we see levels of 6.0% in the USA, 4.4% in Japan, 9.3% in Germany, 6.6% in France, 8.2% in Italy, 10.4% in the UK and 5.2% in Canada. For the eurozone as a whole, the rate is 8.7%. The figures for the UK and the eurozone countries represent the harmonised consumer price index. Inflation at these levels, therefore, remains well above target, hence the reluctance of central banks to rein back on their interest rate increases. However, there is a trade off, especially in relation to the concerns about the banking sector. Too sharp an increase could sap the ability of their clients to repay borrowings and lead to an increase in bad debts, thereby affecting the strength of their balance sheets and worrying depositors and investors further. Paradoxically, but not in a way that central banks would have wanted, the scare in the banking sector will have tightened economic conditions as banks become more cautious about their lending. The knock on effect from this is likely to be lower economic activity than would otherwise have been the case, resulting in lower inflation and reducing the need to tighten monetary policy at the rate which may previously have been envisaged. Movements in the bond markets were very interesting at the height of the crisis as investors fled to perceived safety. If we look at two year government bond yields, the yield on the two year US Treasury bond fell from a three month high of 5.070% to a three month low of 3.767%. In the UK figures, the respective levels were 3.968% and 3.138%, in Germany 3.314% and 2.328% and, in Japan, always rather a special case, 0.038% to -0.089%. For five year government bond yields, the three month high for US Treasury bonds was 4.349% and a low of 3.371%. For the UK, the relevant figures are 3.692% and 2.854%, for Germany 2.884% and 2.037% and for Japan 0.302% and 0.038%. In the ten year government bond market, the three month peak yield for the US Treasury bond was 4.056% and the low 3.370%, in the UK the respective figures were 3.875% and 3.00%, in Germany 2.741% and 2.010% and in Japan 0.498% and 0.160%. The moves in the thirty year bonds were not as dramatic. For the USA, the high was 3.993% and the low was 3.538%, for the UK 4.246% and 3.517%, for Germany 2.687% and 1.973% and for Japan 1.636% and 1.039%. If we exclude Japan from our comments, we can see that, in the USA and Germany, there is a downwards sloping yield curve in the sense that thirty year US Treasury bonds are yielding less than two year US Treasury bonds. The same is true in Germany but not in the UK. Even when there was more confidence in an economic recovery than there is now, the US and German yield curves were sloping downwards. A downwards sloping yield curve is often thought to presage a recession, the theory being that investors can accept lower long term interest rates than current higher short term interest rates on the basis that central banks will be cutting interest rates in the face of a recession. At the moment, as this is written, two year US Treasury bond yields at 3.981% are higher than ten year yields at 3.392% and thirty year yields of 3.606%. Similarly, in Germany, the two year Bund is yielding 2.634% against 2.241% for the ten year Bund and 2.328% for the thirty year Bund. So, in both those markets, investors are becoming increasingly confident, perhaps without much justification, that the Federal Reserve and ECB will cut interest rates later this year. In the UK, the yield curve is pretty flat in the two to ten year range and about 40 basis points higher at the thirty year end of the market, showing perhaps less confidence that the inflation outlook will allow the Bank of England to cut interest rates in the near future. At this stage, it is unlikely that these three central banks have finished raising interest rates if the narrative coming out of them is to be believed.

The problems which have recently been experienced in the banking sector still lead some investors to believe that central banks will automatically cut interest rates at the first sign of trouble in the sector. The sharp rise in inflation can be traced back further than the economic effects arising from the Russian invasion of Ukraine to central banks' misreading of inflation in 2021, labelling the rise as "transitory" due to supply chain shocks arising from the pandemic which would resolve themselves when things returned to normal. Central banks will be more resolute this time simply because the rise in inflation has been so shocking that it has to be brought under control. Also many lessons have been learned from previous banking crises and the way that the SVB, Signature Bank, Silvergate and Credit Suisse problems have been dealt with gives some confidence that central banks are on top of the situation. Of course, we do not want to speculate too soon, given the number of unexpected events which have occurred in the financial world, but it does look, even with a bank the size of Credit Suisse, as if the issues can be contained, given the particular causes of the problems at these four banks.

When the Global Financial Crisis struck in 2008, it was inevitable that central banks would use the tools at their disposal to steady the position in which the banking industry found itself. So, very loose monetary policy, including rock bottom interest rates, did steady the ship and, as intended, though not particularly stated at the time, paved the way for a recovery in asset prices. So, although at various times since then and before the current cycle of interest rate increases was enacted, it has proved impossible to return interest rate levels which would have been appropriate in the past. Money which was priced too cheaply caused asset price bubbles and the Covid-19 pandemic has made one asset class particularly vulnerable, namely commercial property. Changes in working patterns, particularly the number of people working from home, has changed the dynamics of the commercial property market, causing some valuations to fall, as well as well as certain REITS seen as bad bond proxies. This will have a detrimental effect on some banks' balance sheet asset quality. This will be an area to watch as banks report their results over the year.

At the end of the day, it is a trade off for central banks between the serious and enduring consequences of very high inflation and the need to avoid a recession, with potential problems in the banking sector falling into the mix. It appears that, on this occasion, central banks will put the fight against inflation at the top of their agenda and that those investors betting on a reduction in interest rates in the near future may be overoptimistic.

In so far as this affects the bond markets, the sharp drop in yields towards the end of the quarter was more a reflection of a perceived flight to quality and safety because of concerns about the banking sector but, as confidence in the banking system recovers, as we think likely, the short term attraction of bonds will fade again. It is true that the rate of inflation is likely to fall as the year on year effects of the economic consequences of the Russian invasion of Ukraine drop out of the comparisons but, as the figures from our earlier narrative show, real bond yields are still significantly negative. Furthermore, the technical situation for the fixed interest market does not look good. Most countries are still running significant budget deficits which have to be financed and markets will also have to absorb the extra supply of bonds arising from Quantitative Tightening (QT) as central banks try to run down the size of their balance sheets which had exploded in size during the period of Quantitative Easing (QE). The supply side of the bond equation will not be helpful to fixed interest prices and, for inflation and supply reasons, we retain our negative outlook on the fixed interest market. However, should there be a major banking crisis, which is not our central view, there would obviously be a short term shift into "safe" assets, namely government bonds and short term paper which would depress yields, as happened at the time of most uncertainty in March.

As we said earlier, the performance of international equities in the first quarter of 2023 has been resilient in the face of difficulties, such as the problems at SVB, and this hints at underlying strength. Whilst equities remain our preferred asset class, it will certainly not be plain sailing, so we have to expect the sort of volatility that we have seen in the first quarter of 2023. The world economy is expected to grow in 2023, albeit modestly. The latest OECD Outlook Interim Report has just been published and now predicts world economic growth at 2.6% in 2023 and 2.9% in 2024. Within that figure, G7 countries are forecast to grow by 1.1% in 2023 and 1.0% in 2024 and, within the G7, the USA is forecast to grow at 1.5% this year and 0.9% in 2024. Germany's figures are 0.3% and 1.7% respectively, France's are 0.7% and 1.3%, Italy's are 0.6% and 1.1%, Canada's are 1.1% and 1.4%, and Japan's are 1.4% and 1.1%. For the UK, the OECD is forecasting an economic contraction of 0.2% this year and growth of 0.9% next year, although some other forecasts are more optimistic. For China, the OECD sees growth this year at 5.3% and at 4.9% for next year, with the respective figures for India being 5.0% and 7.7%. Overall, these are clearly sub par figures but, against such a difficult background, company earnings are unlikely to fall sharply and dividends hold up reasonably well. It would not, therefore, be reasonable to expect large gains in equity prices which will always be susceptible to setbacks such as when SVB got into trouble. But price/earnings multiples do not look high. For the US market, the P/E on this year's earnings is around 19, for the UK around 11, for the Euro Stoxx 50 around 12.5 and for Japan around 16. As to which stocks will do well, the course of interest rates will be important. As interest rates rose last year, value stocks outperformed growth stocks which were affected by the reduction in the net present value of future earnings, these being more uncertain than for value stocks where earnings are more solid and predictable and often have a decent yield. Interestingly, relative to a modest but highly acceptable rise in the S & P 500 index, so far this year the technology heavy NASDAQ index has significantly outperformed. Heavyweights in the sector, like Apple, Microsoft, Alphabet and Meta, have all performed strongly. They are, of course, well established companies so there can be much more certainty about their future than for the more speculative end of the market where rises in interest rates particularly badly impact on share prices when interest rates rise. Nevertheless, the performance of the NASDAQ Index this year suggests that US equity investors believe that we are near the peak of the cycle and can anticipate a time when interest rates start to fall. Overall, in most markets, there is, we believe, more value in equities than in other competing classes, notably bonds.

During the pandemic, our reviews concentrated very much on its economic effects and how monetary and fiscal policy would affect securities' markets. In more normal times, however, we would also consider the political aspects, since politics can be as important as economics in formulating investment policy. Obviously, we are still not in a normal position but it is less abnormal than it was in 2020 when the pandemic came abruptly and forcefully to investors' attention.

One of the unfortunate consequences of the Global Financial Crisis in 2008 and the economic hardships resulting from the pandemic has been a resurgence of anti business sentiment, which has had negative consequences for investors. The more immediate threat is closer to home in the UK. The need to tackle the enormous amount of debt, taken on as a result of support for businesses and individuals in the pandemic, has meant measures like windfall taxes on the energy industry and a steep rise in Corporation Tax which would normally make the UK a less attractive country in which to invest. UK investors have been hit with some large tax increases either directly or indirectly, as in the case of the significant reduction in the tax free exemption allowance from Capital Gains Tax. Should there be a change of government at the next General Election, due by January 2025, there is a good chance that taxes will be raised further. Therefore, although the UK market looks cheaper than nearly any other, these tax increases for companies make the UK equity market a less attractive place and the political risk is increasing that there will be further measures which will adversely affect business.

In Europe, the EU is keen to introduce windfall taxes on the energy sector and it is, therefore, little surprise to see companies in those sectors standing on much lower multiples than their US counterparts. Going back to the UK, Shell has been under pressure from some investors to move its listing to New York to obtain a higher share rating. The UK is not the only European country to impose windfall taxes. Spain, for example, is imposing them, not only on energy companies but also banks. Windfall taxes, as far as governments imposing them are concerned, are a "heads I win, tails you lose" situation. When oil companies, for example, were losing vast amounts of money when the oil price collapsed during Covid, there was no offer of support for them but, as soon as the price rose sharply after Russia invaded Ukraine and profits took off, politicians wanted to introduce windfall taxes. It is not relevant that the oil companies were able to survive financially, it is the lack of symmetry in the approach of the relevant governments which defines investors' attitude to different markets and a reason why companies affected by capricious government policies are less highly valued than those which are not affected by these policies.

Another political event in Europe also has the potential to shape investors' attitudes to the region and/or particular markets and this is the turmoil in France arising from President Macron's decision to raise the pension age from 62 to 64 by decree. This is viewed by most objective observers to be a sensible move, given that the present situation is untenable from a financial aspect, with the demographics posing a threat to France's finances as fewer people will have to pay for more pensioners. 64 would still be a low retirement age by other countries' standards and raising the retirement age elsewhere has been generally accepted as a realistic reaction to the facts of demographics and life expectancy. But not so in France, where strikes and violence have become widespread as a result of the move to raise the pension age to 64. The problem has wider repercussions, especially for the eurozone. France's outstanding government debt to GDP is high, at around 113%, which is a concerning level because, as interest rates rise, higher debt servicing costs will worsen France's budgetary position. That this is a potential issue is shown by the fact that France has to pay more to borrow than the best credit in the eurozone, Germany. If we look at 10 year government bond yields, we see that France is having to pay over 50 basis points more for its money than Germany, reflecting investors' perception of increased risk. That is a much lower risk premium than for Italy, where outstanding government debt to GDP is around 150%. Italy has to pay around 180 basis points more than Germany for 10 year money. Nevertheless, the stakes are very high for France as a result of the present stand off between President Macron and the trade unions. The worst outcome would be for President Macron to back down on his proposals. Were that to happen, it would be a big blow to confidence in France and one would expect the risk premium of French debt to rise. Although the French economy is undoubtedly suffering from the present social unrest, were President Macron to prevail, investors would see this as some recognition of financial reality and price the risk premium of French debt accordingly. But, being part of a monetary union, this is not a French problem alone. The effect of contagion in the eurozone caused by concern about French finances could easily imperil the euro project later on . Problems in Greece were manageable, but that would not be the case for a large economy like that of France. For various reasons, eurozone economies have been diverging rather than converging since monetary union and outstanding public debt levels are a long way away from the target of 60% of GDP. Investors may, therefore, become more cautious of the eurozone for economic and political reasons. There are, of course, many excellent eurozone based companies, but the politics of the region are becoming more of an issue for investors.

For the moment, politics in the USA does not pose such an immediate problem for investors, but it comes with a significant caveat and that is the result of the next Presidential and Congressional elections in November 2024. At the moment, there is Congressional deadlock, with the Democrats controlling the Senate and the Republicans controlling the House of Representatives. This is a good position for investors since not much can get done and, therefore, the background is more stable and the outlook more visible. However, President Biden recently outlined his 2024 Budget proposals and these were quite disturbing for investors in the US stock market. For businesses, the proposal is to increase the rate of corporate income tax from 21% to 28%, effective from 2023. The stock buyback tax would be increased from 1% to 4%. Given the importance of stock buybacks in supporting the market, this is a particularly hostile measure. US corporations' foreign income would generally be subject to a 21% tax rate. For individuals, the top rate of income tax would rise from 37% to 39.6%. The top rate on long term capital gains would rise from 20% to 39.6%. The current net investment income surtax of 3.8% imposed on high income taxpayers would be likely to continue to apply, meaning that the new top rate of capital gains tax would rise from 23.8% to 43.4%. If these proposals were enacted, it will indicate a fairly hostile attitude to businesses and wealth. Whilst it could be argued that the personal tax measures only applied to the wealthy, it is the signalling that is important and this would be a negative one for investors.

As it stands, these measures will almost certainly not pass the House of Representatives, so should not be an immediate concern for investors, but they may become so next year, depending upon how the opinion polls look. Because of the checks and balances in the US Constitution, the results of the Congressional elections will be very important. If President Biden, or another Democrat, is elected to the White House and if the Democrats win both houses of Congress, then these type of measures have a strong chance of being enacted. For any other combination, the chances fall considerably and any negative political effects on the stock market lessen markedly.

Elsewhere, it is important to see how events in China will unfold because developments have been unpredictable there. The pandemic lockdown, which continued long past others, caused immense damage to the Chinese economy before it was suddenly lifted at the end of last year. As we see from the OECD economic forecasts made in March, that organisation is now forecasting 5.3% economic growth this year and 4.9% next year, higher against its November Economic Outlook forecasts by 0.7% and 0.8% respectively. The leadership has blown hot and cold on its attitude to big business. President Xi's common prosperity theme has resulted in seemingly capricious policy decisions which have damaged various sectors of the market, technology and private schools, for example, and have hit some of the very wealthy entrepreneurs hard, with the share prices of their companies often falling very heavily. Now, with his third term secured, the mood music seems to be changing again and there is evidence that, in order to improve the prospects for the Chinese economy, such entrepreneurs are being brought back into the fold. Problems in the property market, which the authorities had been trying to cool down, are severe, with knock on effects on the banking system. This is a big constraint on the Chinese economy. A continuing concern for investors is what, if anything, China will do about Taiwan. The words and actions of China have been becoming ever more bellicose and there is always the concern that China will attempt to take Taiwan by force, with unimaginable geopolitical consequences, far greater than those arising from Russia's invasion of Ukraine, bad enough though this has been.

While we talk about all these economic and geopolitical factors, Russia's war on Ukraine continues and nobody knows how this will end. At the moment, it has been baked into the investment scenario as a continuing event. It remains as shocking as ever, but how it does end is likely to be a market factor.

So, where does all this leave investors? Completely unexpected events have been a feature so far this century and there are bound to be more but, as we see matters at present, equities should be the preferred asset class. In a way, it is a process of elimination because, as we have tried to explain in this review, fixed interest securities, in our view, remain unattractive, notwithstanding the rise in nominal yields although there may be some options in the corporate bond market. Significant cash holdings, in the sense that they would represent a discrete part of a portfolio as opposed to liquidity held for working needs or for opportunistic purchases in an effectively fully invested portfolio, also remain unattractive to us. Notwithstanding improved deposit rates arising from central banks' interest rate increases, real interest rates remain negative, sometimes significantly so. For equities, investors can take some assurance from modest economic growth, profits to hold up reasonably well and, with them, dividends and ratings which are not excessive. There is, of course, more uncertainty around than usual and we have emphasised, more in this review than previous ones since the onset of Covid-19, certain political risks which may be needed to be considered in the context of geographical asset allocation. Against the uncertain background, perhaps more so the geopolitical one, investors must expect to experience short term volatility against the background of more settled economic times in future. However, we are long term investors and expect equities to be the best performing asset class so an internationally diversified equity portfolio remains our preferred investment option.