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Inflationary pressures

Global Matters Weekly

27 June 2022

– **Jackson Franks**

Having a Swedish partner meant that this weekend was spent eating a whole load of pickled herring and drinking unsweetened flavoured schnapps. For those who are unaware, this means it was Midsommar, an annual celebration in Sweden which celebrates the middle of summer. The festivity consists of a never-ending lunch party which involves flowers in your hair, dancing around a maypole, singing songs and enjoying the acquired tastes of the above-mentioned food and drink. This year we spent it in Hyde Park and were lucky enough to be close to The Rolling Stones Hyde Park concert. So, whilst Gimme Shelter was playing live in the background, we were dancing around the maypole singing Små Grodorna, which translates to The Little Frogs. You can make your own mind up, but I know where I would have rather been…

Surprisingly this year's maypole, which is traditionally made from birch, pine or ash and bound with leaves, flowers and ribbons, had its main structure built from steel. The organisers must have been thinking about longevity over price, as over the last 12-months structural steel prices have increased by 38.5%[1]. Steel is not the only commodity that has seen its price soar. Over the 12-months to June 2022, aluminium, timber and concrete were all up 41%, 30% and 28%, respectively[1]. With these being key materials used in developing an asset (which typically accounts for 25% to 30% of the total build cost) margins within the sector are being squeezed, and we are starting to see the impact.

Here in the UK, the construction industry is booming. What should translate to healthy profitability for building companies has in fact seen more than 3,400 smaller UK construction businesses enter administration in the year up to April 2022, the highest number since the global financial crisis. Soaring material and labour costs have caused construction prices in the UK to increase by 25% over the last 12-months[2]. The inflationary pressures are hitting the smaller construction companies harder than the larger companies. Where larger construction companies have access to cash to buy supplies in advance, visibility on demand, room to store materials, and the ability to pass the costs on to customers, smaller builders do not. However, larger developers may begin to feel a tighter squeeze in the months to come. Adding to the already soaring material prices, energy costs continue to rise, meaning plant equipment on building sites are becoming increasingly more expensive to use, and therefore margins will continue to tighten.

With the construction industry under pressure, current asset owners may be the beneficiaries.

Nevertheless, with the construction industry under significant pressure, current asset owners may be the beneficiaries. Due to the ever-rising costs in developing a new asset, the new supply coming to the market is minimal. Berkley Group, one of the UK's largest home builders, recently announced that the number of new homes being built in London could halve in the coming years because of these rising costs. With a lack of new supply entering the market, competition for existing space may intensify, enabling landlords to take advantage as supply and demand dynamics shift across sub-sectors.

At Momentum, we gain our property exposure by investing directly and indirectly in REITs and property companies. Our managers are highly skilled in the form of their asset management capabilities and capturing opportunities within their specified sub-sectors. Both these factors are key in providing a positive impact on shareholder returns over the long term.

Sources: [1] Energy & Petroleum Regulatory Authority (EPRA), Main Suppliers of Construction Material in Kenya, KNBS & MACE YMR. [2] Department for Business, Energy and Industrial Strategy

The **Marketplace**

- Global equities fell 2.0% last week
- The World Bank became the latest body to downgrade their global growth forecast and openly warned about the risk of stagflation, now projecting a 2.9% rise in GDP for 2022 compared to a 4.1% estimate in January
- Brent crude rose 2.8% to $123.1 a barrel
- Gold fell 0.1% to $1848.8 per ounce

Market **Focus**

US

- US equities fell 2.2% last week
- Consumer Price Inflation (CPI) gained 8.6% year-on-year in May, above expectations of 8.3%
- Weekly initial jobless claims for the week ending 4 June came in higher than expected at 229k vs 206k, the highest level since January as well as the largest weekly jump in claims since July 2021
- The Atlanta Fed wage growth tracker increased to 6.1% in May, its highest reading since the series began
- The University of Michigan long-term inflation expectations series hit 3.3% vs the prior reading of 3.0%, its highest reading since 2008.

Europe

- European equities fell 1.7% last week
- German factory orders for April saw a 2.7% contraction; much weaker than the 0.4% expansion expected, the third consecutive monthly decline
- German industrial production grew by a weaker-than-expected 0.7% in April vs 1.2% expected
- Euro Area growth in Q1 was revised up to show a 0.6% expansion vs 0.3% previously
- The European Central Bank (ECB) met last week, confirming the end of the net Asset Purchase Programme (APP) purchases this month, paving the way for rates lift-off in July. Beyond July, they opened the door for 50bps hikes if inflation persists.

UK

- UK equities fell 0.6% last week
- The final Purchasing Manager Index (PMI) for May was revised up relative to the flash readings, with the composite PMI at 53.1 (vs 51.8 flash)
- A confidence vote was held for Prime Minister Boris Johnson and the final result saw him win by just 211-148, meaning that 41% of his own party's MPs voted against him.

Asia/Rest of The World

- The benchmark Global Emerging Markets index returned +0.6% last week.
- Japanese equities returned 1.9% over the week.
- Chinese equities rose 5.9% last week
- The Reserve Bank of Australia hiked rates by a larger-than-expected 50bps. Their statement also indicated further tightening ahead
- The final estimate of Japan's Gross Domestic Product (GDP) for Q1 showed a contraction of -0.5% year-on-year
- China's May exports advanced 16.9% year-on-year, stronger than the estimates of 8.0% and the prior 3.9% increase in April
- China's trade surplus grew to $78.76bn in May, compared to a $51.12bn surplus in April.

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 June 2022	Month to date	YTD 2022	12 months
Developed Market Equities					
United States	USD	6.5%	-5.3%	-17.5%	-7.4%
United Kingdom	GBP	2.8%	-4.8%	2.1%	8.6%
Continental Europe	EUR	2.4%	-6.8%	-16.3%	-10.4%
Japan	JPY	1.7%	-2.4%	-5.1%	-1.8%
Asia Pacific (ex Japan)	USD	1.6%	-5.1%	-15.1%	-22.2%
Australia	AUD	1.6%	-8.8%	-9.9%	-5.8%
Global	USD	5.4%	-6.1%	-18.2%	-11.8%
Emerging markets equities					
Emerging Europe	USD	1.2%	-8.9%	-76.6%	-76.9%
Emerging Asia	USD	1.4%	-4.0%	-16.5%	-24.4%
Emerging Latin America	USD	-2.0%	-16.6%	-0.1%	-17.8%
BRICs	USD	3.3%	0.4%	-16.9%	-29.6%
China	USD	4.7%	6.8%	-11.1%	-30.6%
MENA countries	USD	-3.9%	-10.8%	-2.8%	4.7%
South Africa	USD	3.1%	-8.9%	-3.3%	-9.1%
India	USD	2.4%	-6.0%	-13.2%	-4.5%
Global emerging markets	USD	0.8%	-5.9%	-17.0%	-24.2%
Bonds					
US Treasuries	USD	0.5%	-1.6%	-9.5%	-9.1%
US Treasuries (inflation protected)	USD	0.5%	-2.0%	-8.4%	-3.9%
US Corporate (investment grade)	USD	0.3%	-3.0%	-14.6%	-14.0%
US High Yield	USD	0.6%	-5.0%	-12.6%	-10.9%
UK Gilts	GBP	1.6%	-1.8%	-14.4%	-13.8%
UK Corporate (investment grade)	GBP	1.1%	-2.7%	-13.6%	-13.9%
Euro Government Bonds	EUR	1.5%	-2.3%	-12.6%	-12.9%
Euro Corporate (investment grade)	EUR	1.1%	-3.2%	-11.6%	-12.0%
Euro High Yield	EUR	-0.4%	-5.0%	-12.7%	-12.4%
Japanese Government	JPY	-0.1%	-1.0%	-3.1%	-3.3%
Australian Government	AUD	2.7%	-1.8%	-10.6%	-11.3%
Global Government Bonds	USD	1.0%	-3.1%	-14.2%	-15.9%
Global Bonds	USD	1.2%	-3.3%	-14.5%	-16.2%
Global Convertible Bonds	USD	2.1%	-4.3%	-19.4%	-23.9%
Emerging Market Bonds	USD	0.5%	-5.5%	-25.6%	-26.6%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 June 2022	Month to date	YTD 2022	12 months
Property					
US Property Securities	USD	6.0%	-5.6%	-19.1%	-6.1%
Australian Property Securities	AUD	7.3%	-7.3%	-21.5%	-12.6%
Asia Property Securities	USD	2.9%	-3.1%	-6.0%	-16.3%
Global Property Securities	USD	4.3%	-6.6%	-18.0%	-12.7%
Currencies					
Euro	USD	0.8%	-1.7%	-7.4%	-11.6%
UK Pound Sterling	USD	0.7%	-2.8%	-9.4%	-11.8%
Japanese Yen	USD	0.0%	-4.9%	-14.9%	-18.0%
Australian Dollar	USD	0.3%	-3.3%	-4.5%	-8.3%
South African Rand	USD	1.5%	-1.3%	0.9%	-10.0%
Swiss Franc	USD	1.4%	0.0%	-4.9%	-4.1%
Chinese Yuan	USD	0.4%	-0.3%	-5.0%	-3.3%
Commodities & Alternatives					
Commodities	USD	-4.0%	-7.2%	26.2%	41.0%
Agricultural Commodities	USD	-7.1%	-8.8%	10.7%	28.5%
Oil	USD	0.0%	-7.9%	45.4%	49.7%
Gold	USD	-0.7%	-1.0%	-0.1%	2.8%
Hedge funds	USD	-0.5%	-1.7%	-5.0%	-5.0%

Source: Bloomberg. Past performance is not indicative of future returns

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