

- Markets appear to be experiencing increasingly marked cognitive dissonance.
- The Strait of Hormuz has been shut for eight weeks. The last ships went through on the 28th February and are arriving at their destination now, implying that we have effectively reached the point where pre-closure supply is exhausted.
- Commodity markets and government bond markets have repriced to reflect this.
 - Oil and gas price curves continue to show tightness of supply in the spot and the next few months' futures markets.
 - Government bond markets have priced in an inflation shock. In the UK, nominal interest rates have risen by around 50bp across the curve since pre-war levels.
 - OIS markets, which began the year pricing in 2-3 cuts to Bank Rate, now price in 1-2 Bank Rate rises, a reflection of stickier inflation expectations.
 - At the same time, short-term UK real interest rates have fallen, a function of increasing market expectations of inflation and lower growth over the coming years.
- The impacts are also showing up in the real economy. Petrol and diesel prices are higher; industry bodies are warning of potential double-digit food inflation; the number of payrolled employees has fallen; demand destruction is beginning, with mass flight cancellations being one of the most visible examples.
- By contrast, equity markets have continued their optimistic run:
 - After a steep drawdown in the middle of March, the MSCI World Index is currently around 5% higher than it began the year – even after accounting for GBP appreciation over the period.
 - The CAPE ratio for the S&P 500 is now in the 99th percentile of its historical range, with the CAPE yield on the index, 2.5%, now below the 20Y TIPS yield, 2.6%.
 - Equity markets have continued to be optimistic for both the upcoming earnings season and the outlook for AI – despite the fact that the combination of higher energy prices and weaker economic growth are negative developments for AI (notably, data centers are known to be hugely energy intensive) and broader equity markets.
- We are skeptical of the underlying companies' ability to deliver on the expectations priced in, and continue to position defensively, with a focus on inflation protection.
- In our multi-asset funds, our largest allocation is to inflation-linked government bonds (TIPS and UK index-linked, 5-year duration, 45% of the portfolio). We remain underweight risk assets (24% of the portfolio) and continue to hold elevated levels of managed liquidity reserve as a buffer against continued volatility (31% of the portfolio).

Emma Moriarty, Portfolio Manager