

Investment Panel 27 May 2022 – Follow up answers from Brunel

1. What were the knock-on risks and impact on poorer countries of commodity shortages resulting from the Russian/Ukraine conflict and how do your managers assess this when constructing their portfolios?

Food prices are at their highest level since 1990. Ukraine and Russia, being major agriculture and fertilizer producers, the war in Ukraine further compounded the upward price spiral which began in mid-2020. For poorer countries surging food and fuel price inflation are a worrying prospect. Food represents a larger percentage of headline CPI baskets in EM (50% of India's CPI basket, 30% of Philippines and China vs 8% in the US) While high food and fuel inflation impacts all countries – lower income countries are hit harder as families spend more of discretionary income on basic goods and services. This has prompted export restrictions from governments with Indonesia and India banning palm oil and wheat exports recently. Continuation of the conflict is putting the planting season for wheat, barley, maize, rapeseed, sunflower at risk. It is unclear at this stage if food will be weaponised or will food exports from the region flow through. Some of the poorest countries in the developing world like, Sri Lanka and Ethiopia for example, have seen food inflation running at 25-40%. This crisis will no doubt set back the UN SDG to end world hunger by 2030, and worsen malnutrition in many low-income countries.

From a portfolio construction perspective - large agricultural and energy exporters like Brazil, and the middle east benefit from these elevated prices while large importers like Sri Lanka, Egypt and Vietnam have been adversely impacted. Using the Emerging Markets Equity portfolio as an example, some managers have approached this from a bottom-up perspective to identify company specific risks around food/agricultural input costs and revenue streams which could create a margin squeeze. For example, in consumer staples, one of our EM managers focused on which companies have the brand and pricing power to pass on price increases and where demand is relatively inelastic.

2. What analysis was taking place about the lessons learnt from the Covid pandemic in relation to the investment risk and within wider markets?

The main lesson learnt was the true value of diversification by investment style and also by sectors, themes and countries. Covid was first a short-lived demand shock as the world shut down but was then followed by a longer lasting supply shock. In the demand shock phase - the level of stimulus (low rates and anomalous QE that central banks unleashed) led to outperformance of a narrow group of growth stocks – led by digital companies that benefitted from pandemic lockdowns. However, in phase 2 - when demand recovered, it was clear that years of underinvestment in commodities meant the world cannot produce enough of these commodities at scale and the global economy saw persistent supply chain bottlenecks. This was the catalyst for the comeback of value as an outperforming style, led by sectors that were unloved and had underperformed for a decade. Rather than time style rotations, many managers learnt that an effective way to manage risk around these transitions is to prudently balance style exposures and monitor the earnings inflection these companies were going through.

COVID created one of the fastest stockmarket sell offs in history and a massive bull run in a year when economies saw the biggest contraction since WW2. Taking advantage of these dislocations and subsequent regime changes from QE to QT, disinflation to record inflation needed an adaptive process. It was important for managers to discriminate between intrinsically expensive companies and optically expensive companies - for example in the strongly performing technology – hardware,

software, semicon/internet sectors. As value rotation took hold, again the analysis focused on sifting value traps from sound business models that offered discounts to intrinsic value.

Finally, several managers cited the need to maintain a strong liquidity profile of their portfolios to manage risks at this time of multiple transitions.