ASTUTE INVESTMENT MANAGEMENT

VT Astute Funds

Quarterly Commentary

Q1 2022

ASTUTE
INVESTMENT MANAGEMENT LTD

Introduction

Thank you for taking the time to read our Q1 commentary. The awful events in Ukraine overshadowed markets in the first quarter of the year, and it is always challenging to have to discuss markets in the context of such human tragedy. Events like these create a myriad of ripple effects across the globe, and where they intersect with our daily lives we tackle them as best we can. For the team at Astute, that means navigating these turbulent market conditions. As always, we endeavour to protect and grow our investors wealth, and to provide the financial security you need to plan for your future.

While we have written some ad hoc communications on the war in Ukraine, our CIO letter this quarter summarises what we know at this point, and what impact it could have on the world in the near future.

In our **Astute Overview** section, we look at why central banks are pushing on with interest rate rises in the face of a destabilising war in Ukraine, and why this may have more significant implications for "lower risk" investors, who traditionally depend on fixed income assets.

Our regular **Astute Perspective** shows our current conviction views, while **Astute Positioning** covers how those views translate into the portfolios, and what changes we have made in the past three months.

Finally, **Astute Observations** highlights some of the more interesting research, data, or charts we have encountered recently with a few short and, hopefully, enlightening comments.

As always, we take a long-term approach to investing our clients' assets, but success is a journey, not a destination, and the short-term views expressed herein are aimed at managing risk and making your investment journey as smooth as possible. By taking a risk-adjusted approach to your investments, we aim to deliver reliable growth in line with our stated risk profiles and provide you, and your financial planner, the consistency and security to plan for your long-term financial future.
Thank you for your continued support. If you have any further questions or require any additional information, please do not hesitate to contact your usual financial planner.

Fund Management Team

Scott Osborne
Chief Investment Officer

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The Signal and the Noise

In financial markets we often write about the importance of filtering out the noise and focusing on the key information that actually improves decision making and ultimately allows us to achieve our long-term objectives. Investment banks produce reams of research that promises to do just that, purify the signal and provide "actionable insights" to help manage portfolios (of course this means trading and thus generating attractive dealing commissions for them too!). Any indicators which have even a modestly reliable track record are regarded as sacred, the so called "inverted yield curve" (see Astute observations) is one such example, supposedly foretelling an imminent recession.

However, what do we do when the "noise" seems so significant? Today, we find ourselves in a world dominated by a vicious war, more visible than ever in our connected society. In the grip of a painful period of inflation, straining the consumer's ability to spend and pressuring central banks into aggressive monetary tightening. Inflation driven by a persistent imbalance in supply and demand, exacerbated by the Ukraine conflict, and overshadowed by fresh lockdown restrictions in Chinese manufacturing hubs. All of this while still weary and frustrated from a global pandemic that, even with some sense of normality returning, still presents the potential for unwelcome and unfortunate twists in the road ahead.

The fact is, none of these issues can be completely explained, nor swiftly resolved. None of them can reasonably be classified as "noise". Each in its own way creates uncertainty, volatility, anguish and, in combination, a constellation of potential outcomes. Acknowledging the hopelessness of prediction in such circumstances is, in my opinion, the best course of action. So while I will briefly discuss below what we *think* might happen in the near future, we are by no means nailing our colours to the mast. We remain nimble and reactive, constantly reassessing our positioning for risks and opportunities, but conscious that often the biggest risk to long term objectives is being shaken out of the market by short term volatility. So what of market developments?

The war in Ukraine remains front and centre, but the rally back in markets from mid-March has eliminated most, if not all, of the risk-off sentiment surrounding further escalation. The "strategic withdrawal" (I think we can say defeat) of the Russian attempt to take Kyiv likely moves the conflict into a second phase. Consensus is that Putin focuses on consolidating the gains made in the east and south and aims to retain the land corridor to Crimea as part of any peace deal. Economic sanctions incentivise Russia to find some resolution but it remains unclear what, if any, sanctions would be rescinded in the event of a ceasefire and also if Ukrainians would willingly swap land for peace. This means that one form of "resolution" is a drawn-out standoff, akin to the state of affairs before the invasion but with a much longer front, and higher tensions. The key question remains, what results in a rollback of Russian sanctions and thus easing pressure in energy and commodity markets? We have no special insight here but would suggest that while some of the commitments to reducing energy dependence are permanent in nature, incentives towards a resolution are becoming sufficiently aligned on all sides. This does present the risk of last ditch offensives and land grabs to maximise the negotiating position in the short term, particularly as further escalation does not seem to be priced in by markets currently.

More globally the impact is being felt through inflation and the central bank response. We discuss this in more detail below (see Astute Observations) but in brief we believe there is a firm commitment to cool economic growth and reduce demand side inflation, even if the bulk of the inflation pressure is supply led. However there is a recognition that the Ukraine conflict may achieve some of this goal through diminished sentiment and rising energy prices. Thus giving central bankers an "off-ramp" from their current aggressive path if required.

We have resisted significant changes to the portfolios through this volatile period but have growing conviction on a number of ideas which will likely result in some modest re-positioning in the quarter ahead. As always we remain focused on our long term objectives and carefully balancing the risk-taking required to achieve them.

Scott Osborne PhD CFA
Chief Investment Officer

Astute Overview

"HIKE ONE!"– INTEREST RATES

Just 6 months ago, in October 2021, the consensus market expectation for the number of US interest rate hikes in 2022 stood at one. Implying markets expected the US Federal Reserve (the Fed) to raise interest rates once, from 0.25% to 0.5%, at some point this year, and then stop. By the end of December, that expectation had risen to three, and by the end of January, it was seven. Implying 2% interest rates before the end of the year. Which is approximately where we sit today. This extraordinary shift in monetary policy expectations was in response to higher, and more persistent levels of inflation than the Fed anticipated, as well as rapidly tightening labour markets. Even between their December meeting and their March meeting, Fed members almost doubled their estimates for inflation in 2022, albeit partly in response to the Russian invasion of Ukraine.

Did the Fed misread the economy so badly that they were forced into this sudden pivot? There is certainly an element of that, although it is perhaps unfair to call their forestalling of policy tightening an error at this stage. Our house view was that the Fed would take a more cautious path, and to a certain degree will still believe this to be the case. However, given the positioning of the portfolios going into the January correction, and the relative underperformance we suffered, we have to accept we were wrong in our outlook for the Fed. In hindsight, the speed of the pivot was more a function of waning credibility than economic data. Just as the market started to doubt the Fed's commitment to its remit, Jay Powell pivots spectacularly, and without even touching policy, the market priced in seven rate hikes and a total unwind of quantitative easing. Since a slower pace of tightening is unlikely to put anybody's nose out, it's unsurprising the Fed signalled as aggressive a path as they think they can achieve without destabilising the market, when announcing their first hike last month.

Of course what really matters is the economy, not the market, and this is where we have our doubts about the Fed's commitment to hiking rates. Clearly, they are committed to tackling inflation. With the situation in Ukraine, it now seems like inflation will peak at a higher level and last for longer than anybody expected, and if the inflationary mindset becomes entrenched in consumer behaviour, the spiral of rising wages and rising prices may not be far away. Particularly given how tight labour markets are. This is what central bankers everywhere are trying to prevent. So why do we doubt the necessity to increase rates? Simply because we don't think the Fed or any other central banks have the right tools for the job. Withdrawing QE has little bearing on everyday life. Rising interest rates should dampen demand, but even this effect pales in comparison to the inflationary pressure itself. The increase in my energy bill is significantly more than the increase on my mortgage for example. If the cost pressures do a better job of slowing demand, growth, and eventually inflation, then interest rates on top may be a mistake. In the meantime they talk the talk, and, if the economy allows, they will walk the walk.

This is the line we believe central banks are walking. If there are signs of slowing growth or receding inflation they have room to back off. The same is true of the Bank of England, which was explicitly more cautious about the impact of the war in Ukraine when raising rates to 0.75% in March. They will almost certainly increase rates again in May, as will the Fed. The challenge is if growth does slow but inflation does not…

Astute Response:

The market moves in January are already discounting significant monetary tightening this year so there is potential value in some of the names that sold off hardest. However, the commitment to tackling inflation, perhaps even at the cost of economic growth, leads us to focus more on quality in both cyclical value areas and secular growers. Areas relying on lower rates, or strong economic growth, could be exposed to tail risks.

THE INVERTED ROLLERCOASTER – BOND MARKETS

Imagine a hypothetical investor who, two years ago, at the outbreak of the Covid pandemic, moved their entire portfolio to "risk-free" UK government bonds. Traditional portfolio theory suggests that this is an excellent place to hide during risk-off events. Assuming that the portfolio remained unchanged, those risk-free assets are now likely to have fallen in value by around 10% in nominal terms, and by over 15% in real terms, after inflation. That two-year period is the worst in the history of the FTSE index that tracks UK conventional gilts, dating back to 1996. Extending the period to three years also incurs a loss, albeit a more modest -1.5%, but in the context of a 35-year bull market, that loss stands out like a sore thumb.

Should we be worried about this? After all, equities have offered excellent returns to offset these losses. The issue arises when you consider that almost all of the negative returns for gilts have come within the last four months, hardly a strong period for equities. This fundamentally highlights the lack of diversification bonds can offer when interest rates are so low. There is limited room for yields to fall further, which is what bonds need to rise in value. Conversely, there is infinite room for yields to rise (which means bond prices fall) and it is this rising yield dynamic that is also putting equity valuations under pressure. However, equities, unlike bonds are not fixed-income assets and as long as they can grow their earnings enough to offset the downward valuation pressure of rising interest rates, they can still appreciate in value.

It is this relationship that underpins the classic 60/40 portfolio. If rates are rising (bond prices likely falling), the economy is buoyant and equities can grow. If rates are falling (bond prices are rising) the economy is slowing and equities will struggle. If only it were so simple! The environment we find ourselves in today is one where bond markets are suggesting long-term growth could be slowing and yet in the short term rates are still going up, that's bad for bonds (rates up) and bad for equities (growth slowing). This is the infamous "inverted yield curve".
As market jargon goes, it is really up there, but the principle is straightforward. Because lending to major governments is considered a safe bet, the cost to borrow is mostly influenced by investors' views of the prospects for economic growth and inflation, and how those in turn will affect central bank interest rates. The yield curve is usually upward sloping, which means a higher fixed rate of return is earned from lending money for longer periods. Shorter-term yields move in response to market expectations for central bank policy in the near term (currently rising quite quickly). Longer-dated bonds are more linked to investors' views on growth, and thus interest rates, over the medium to long term. So, when long-term views are negative but short-term rates are still rising, the curve flattens and eventually "inverts" becoming downward sloping. This has been a reliable harbinger of recessions in the past and usually spooks markets considerably.

This brings us back to the portfolio diversification dilemma, whereby the two principal asset classes may synchronously fall together. However, as bonds get cheaper there will come a point where they offer good value again, and, as yields get higher, diversification benefits too. We think we are approaching that day.

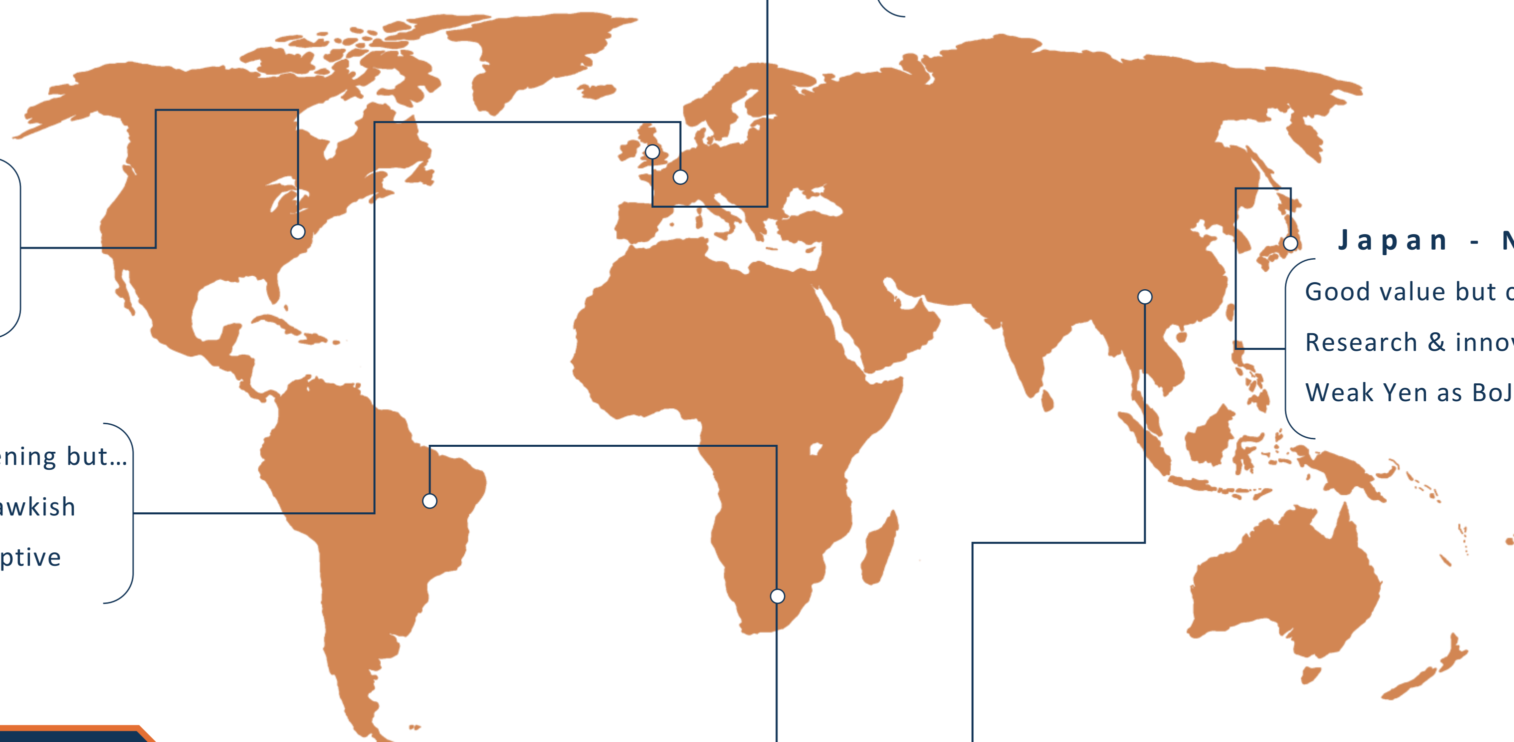
Astute Response:

We tentatively look to build our conventional bond position as yields rise, but acknowledge there remains a risk of calling the bottom of the market too early. We remain overweight alternatives that have demonstrated strong return and diversification benefits to date but turn our research efforts towards identifying potential areas of value in traditional fixed income markets.

Sources: The Financial Times, Refinitiv Lipper

Astute Perspective

ASTUTE INVESTMENT MANAGEMENT LTD



UK – Neutral

- Larger companies remain structurally challenged
- Prefer smaller companies with growth opportunities
- Labour/goods shortages likely exacerbated by Brexit

N. America - Neutral

- Expect strong recovery led by record stimulus
- Rising rates putting pressure on growth names
- Hawkish Fed pivot, committed to tackling inflation

Europe - Neutral

- Fiscal and political co-operation strengthening but…
- …inflation rising and ECB growing more hawkish
- Focus on energy security potentially disruptive

Japan - Neutral/Overweight

- Good value but corporate nationalism persists
- Research & innovation remains strong suit
- Weak Yen as BoJ committed to low interest rates

Asia & Emerging - Overweight

- Long-term growth from demographics & development
- China tightening policy will slow growth versus peers
- Company valuations attractive vs western equivalents

Conviction Views

A key part of our process is building conviction ideas which are then expressed across each of the portfolios. While asset class and regional views are an important input into this process, the opinions outlined below will be the driving force behind any potential future returns.

1. Pivot to Cyclical ➡ **Focus on Quality**
    - Economic rebound will broaden growth opportunities, benefiting cyclical sectors most
    - **Risks arising from inflation and geopolitics necessitates a refocus on quality, in both expensive secular growers and cyclical value rebounders.**

2. Overweight Technology
    - Technological revolution will continue, lean into disruptive areas, the strong get stronger
    - Look beyond current global leaders and use specialists to stay ahead of the curve

3. Invest Sustainably
    - ESG will become the default option, and the market will shift accordingly
    - If sustainable investing is the future, invest with those who have ESG way into their past

Asset Class Views

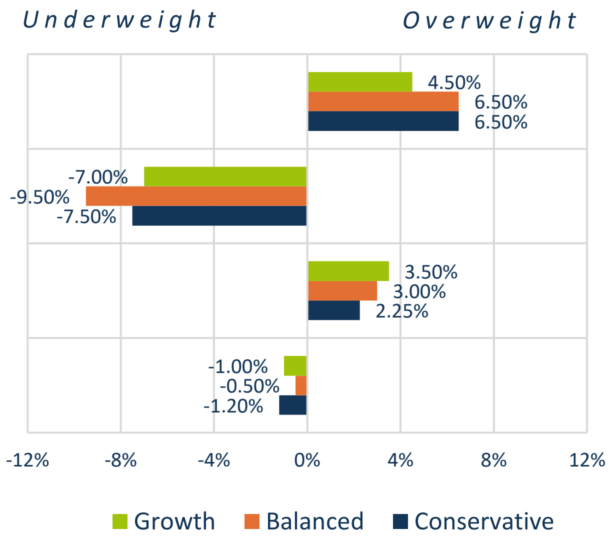
Fixed Income	Negative						Positive
Sovereign Bonds							
Corporate Bonds							
High-yield bonds							
EM Debt							

Alternatives	Negative						Positive

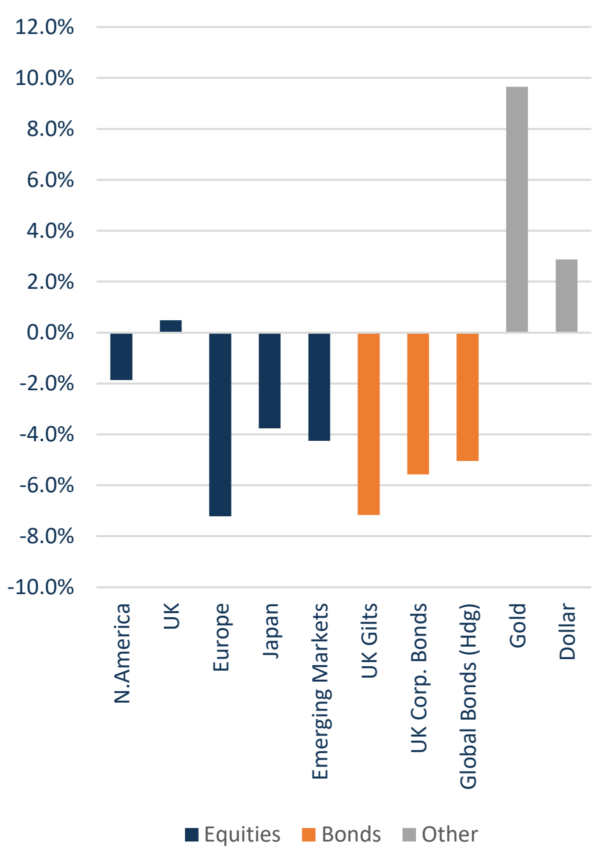
Equities	Negative						Positive
UK							
Europe							
Asia & Emerging							
Japan							
US							

Astute Positioning

Tactical Asset Allocation[1]



Asset Class Returns[2]



Fund Activity

New Purchase	iShares China Bond	Bal
	LXI REIT Ord	Gro
	Aberdeen Standard European Logistics	Gro
	Chrysalis Investments Limited Ord	Gro
	HarbourVest Global Private Equity	Bal & Gro
Top Up	Aberdeen Standard European Logistics	Con & Bal
	Gresham House Energy Storage	Con & Bal
	iShares China Bond	Bal
	LXI REIT Ord	Con & Bal
	Royal London Diversified ABS Fund	Con
	Tritax EuroBox Euro Ord	Con & Bal
Trim	Baillie Gifford British Smaller Comps	Bal & Gro
	Granahan US SMID Select	Bal & Gro
	Invesco Physical Gold	Gro
	iShares $ TIPS ETF	Con
Sold	iShares $ TIPS ETF	Bal
	Polar Capital Global Tech	Con, Bal, Gro

The high degree of volatility seen over the course of the quarter limited our activity to opportunistic purchases where we believe we saw irrational selling. We also saw some of our preferred alternative trusts raising equity at attractive discounts which we took advantage of. In terms of asset allocation, this shifted a portion of our exposure from equities into alternatives, moving international equity underweight for the first time since launch. However, the alternatives purchased were predominantly private equity and so the change was only a very modest reduction in total risk.

The quarter was clearly a difficult one for markets with almost all asset classes falling in value. The period began with the re-pricing of interest rate risk and a substantial sell-off in growth equities, like technology, where valuations were stretched. This quickly shifted into the Ukraine crisis with broader risk-off sentiment dominating and traditional safe havens like gold and the dollar outperforming. While March saw a modest recovery in equity markets, the only real winners over the period were energy and commodity stocks. Fixed income indices had one of the worst quarters in recent history. Despite the market shock from the war in Ukraine, investors spurned the traditional haven of government bonds, and yields continued to rise, pushing bond prices lower.

Fund performance over the period was negative in absolute terms for all funds, but with much better relative returns for the lower risk fund. The re-pricing of US interest rate expectations in January was a significant drag and had much more of an impact on our Balanced and Growth funds where we maintain a more significant bias toward growth strategies. We expected some downward pressure on growth valuations, but we underestimated the market reaction and the extent of the Fed policy shift. The longer time horizons on our higher-risk strategies facilitate longer-term thinking and while we are disappointed with performance we do think some of these areas, particularly in mid- and small-cap, now look very attractively valued for patient investors. The Conservative fund has lower exposure to these themes and fared relatively better despite still falling in value. The same is true for the fixed income exposure where the fund has been persistently underweight helping to avoid most, if not all, of the losses seen in fixed income markets. Alternatives again demonstrated their diversification benefits and proved to be one of the few areas that did not fall in value through the course of the quarter.

All trades made occurred either in the January correction, where we saw some attractive relative value opportunities appear or in response to equity raises from our favoured alternatives managers. While we saw some of our key holdings fall sharply in January we also saw very large discounts open in less liquid markets, particularly in private equity. While we retain conviction in the long-term growth theme, we saw this as an opportunity to continue to further reduce our equity market sensitivity and increase company-specific risk. We sold the remaining holdings in our global tech fund and trimmed our US mid-cap growth manager and purchased HarbourVest Global Private equity. This is a very broadly diversified private equity product where the drivers of return are much more linked to company performance. We also trimmed our UK smaller companies position in favour of another private equity fund, Chrysalis. This fund is more concentrated and thus higher risk but also has a stronger bias to technology and growth themes.

Elsewhere we took advantage of capital raising to increase exposure to our UK long lease portfolio and European logistics assets, both of which benefit from inflation-linked rents. We also continued our recent progress towards introducing Chinese government bonds. These are not exposed to monetary tightening in the west and that value was quickly demonstrated as Chinese bonds ended the quarter flat versus the painful losses seen on US and UK government bonds.

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 31/03/2022. Past Performance is not a reliable indicator of future results.
[1] Relative positioning is expressed versus Astute's long-term strategic weights. [2] Total returns in GBP. Broad market indices are used to represent the performance of different regions over the period 31/12/2021 to 31/03/2022

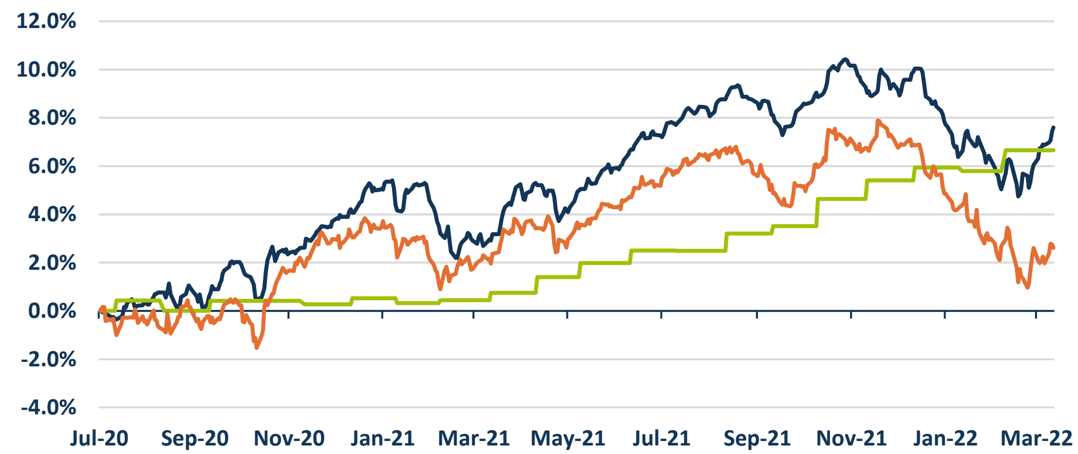
VT Astute Conservative

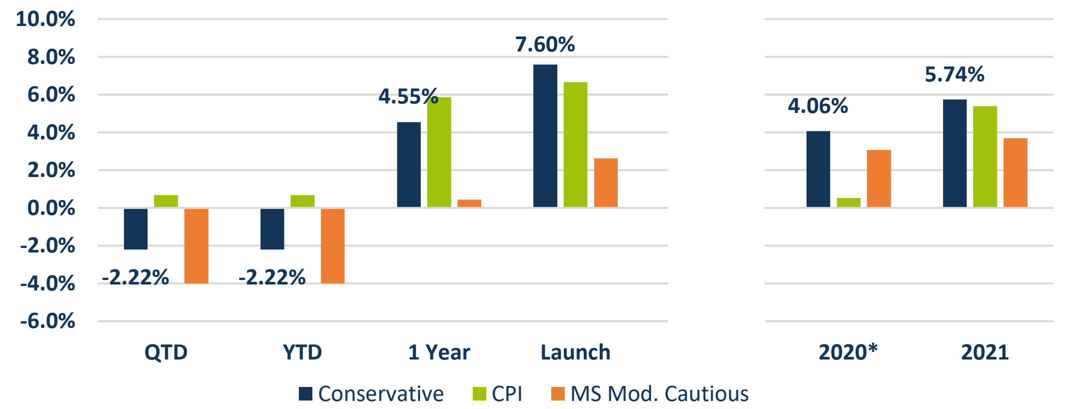
The Conservative fund fell in value despite outperforming the market comparator. The underweight to fixed income significantly reduced the fund's sensitivity to rising interest rate expectations and thus helped minimise losses seen more broadly across lower-risk funds.

The only positive contributor to performance over the period was the alternatives component. This is our key diversifier and principally how the fund aims to defend against losses when bond markets and equity markets are falling at the same time. All equity components were negative in line with the market. The overweight to the UK relatively helped while the underweight to the US relatively hurt as these were the best-performing markets.

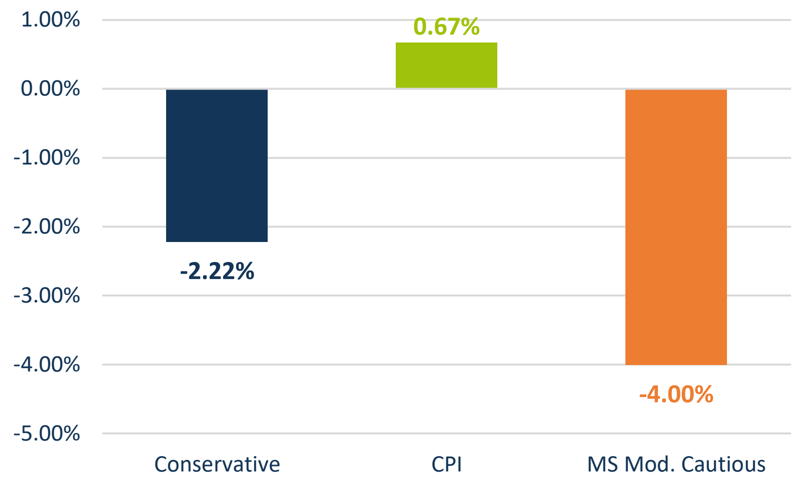
The top contributing funds over the quarter are all alternative holdings. Some of which, Gravis Clean Energy and Gresham House Energy Storage were beneficiaries of the increased focus on the energy transition and broadly higher energy prices. However, there were also solid contributions from more traditional risk hedges such as gold and our absolute return managers.

Performance[1]





Q1 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	17.00%	-0.65%	-0.11%
Government	9.39%	-2.24%	-0.21%
Credit	14.21%	-3.26%	-0.46%
UK	6.61%	-2.45%	-0.18%
N. America	10.41%	-3.75%	-0.39%
Europe	3.47%	-8.68%	-0.30%
Japan	1.88%	-8.95%	-0.17%
Asia & Emerging	4.38%	-8.18%	-0.36%
Alternatives	32.64%	0.59%	0.19%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
VT Gravis Clean Energy Income	3.71%	5.80%	0.22%
Gresham House Energy Storage Ord	1.31%	8.31%	0.11%
Invesco Physical Gold	1.62%	6.67%	0.11%
Protea ECO Advs ESG Abs Ret	4.13%	1.65%	0.07%
VT RM Alternative Income	3.14%	1.79%	0.06%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 31/03/2022. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] Data for the period 20/07/2020 to the 31/03/2022. [2] Data for the period 31/12/2021 to the 31/03/2022. * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding and averaging.

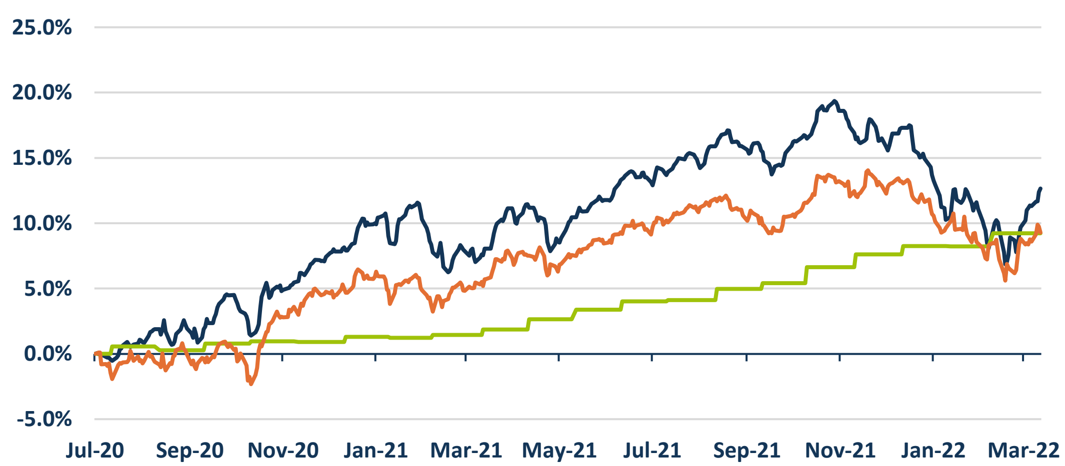
VT Astute
Balanced

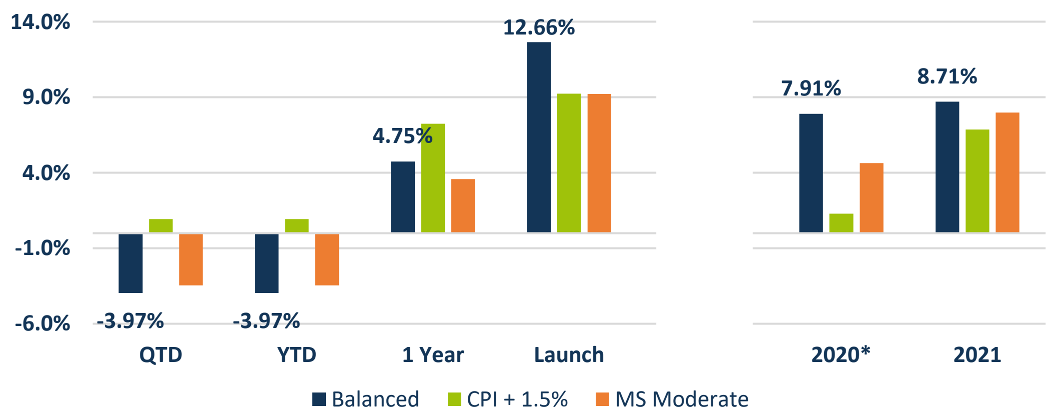
The Balanced fund fell in value and marginally underperformed the market comparator. The underweight to fixed income helped reduces losses however the overweight to equity markets and the growth bias within those positions was the main detractor.

While the UK generally outperformed other markets this was not captured within fund performance due to the higher proportion of mid and small caps companies held. The biggest beneficiaries of the energy and commodity price move were large-cap FTSE 100 stocks. The same bias also saw the European and US components underperform but to a lesser extent. Fixed income was generally positive as lower sensitivity to interest rates helped to minimise the losses seen more broadly in bond markets.

The top contributing funds over the quarter are all alternative holdings. Some of which, Gravis Clean Energy and Gresham House Energy Storage were beneficiaries of the increased focus on the energy transition and broadly higher energy prices. The strong performance of the UK large-cap can also be seen in the performance of the JPMorgan UK equity core fund.

Performance[1]





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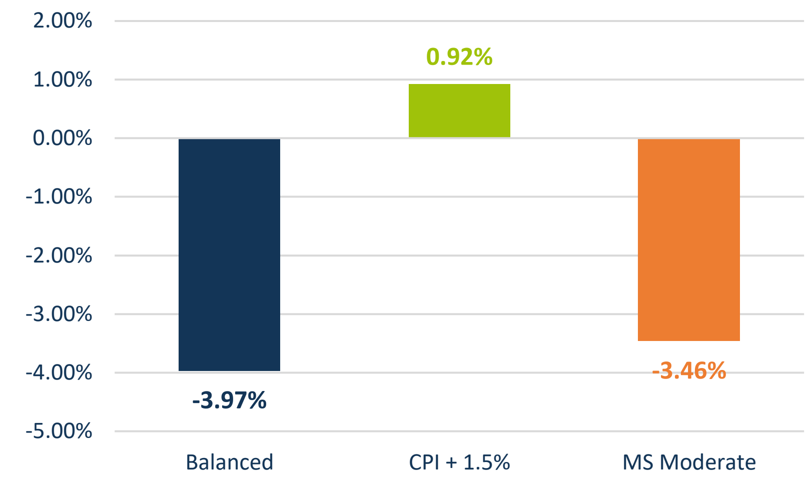


Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	6.29%	-1.30%	-0.08%
Government	3.48%	-3.55%	-0.12%
Credit	8.30%	-4.25%	-0.35%
UK	11.14%	-5.00%	-0.56%
N. America	22.59%	-4.43%	-1.00%
Europe	7.60%	-10.18%	-0.77%
Japan	4.43%	-7.02%	-0.31%
Asia & Emerging	9.15%	-7.85%	-0.72%
Alternatives	27.01%	-0.41%	-0.11%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
VT Gravis Clean Energy Income	3.66%	5.80%	0.21%
Invesco Physical Gold	1.63%	6.67%	0.11%
Gresham House Energy Storage Ord	1.30%	8.31%	0.11%
JPM UK Equity Core	5.90%	1.24%	0.07%
Protea ECO Advs ESG Abs Ret	4.28%	1.65%	0.07%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 31/03/2022. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] Data for the period 20/07/2020 to the 31/03/2022. [2] Data for the period 31/12/2021 to the 31/03/2022. * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding and averaging.

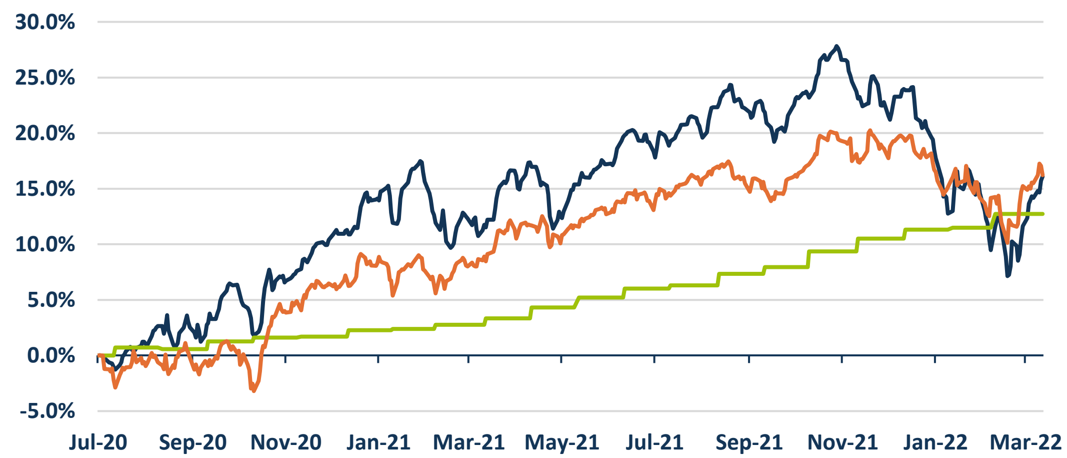
VT Astute
Growth

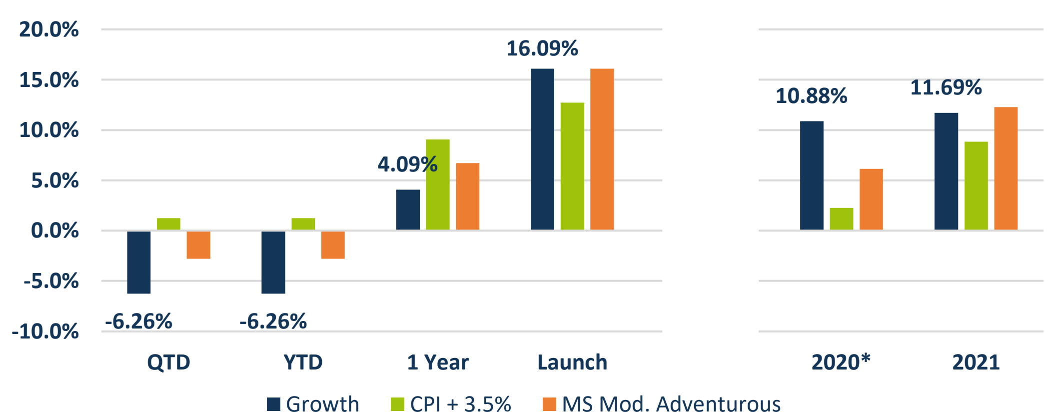
The Growth fund fell in value and underperformed the market comparator. While we expect a drawdown of this nature on our higher-risk fund we did not expect to underperform the market comparator to such an extent. The principal driver of this relative underperformance is our overweight to equity and our growth bias.

Across most of our equity components, we retain a growth bias and small and mid-cap bias. Both these factors relatively underperformed the market in the January correction and fell in line with the market during the invasion of Ukraine. We did however see a stronger rebound than the market through the latter half of March. The alternatives within the growth fund now contain a reasonable degree of private equity which will offer less downside protection in acute risk-off events but should over time provide more uncorrelated growth opportunities.

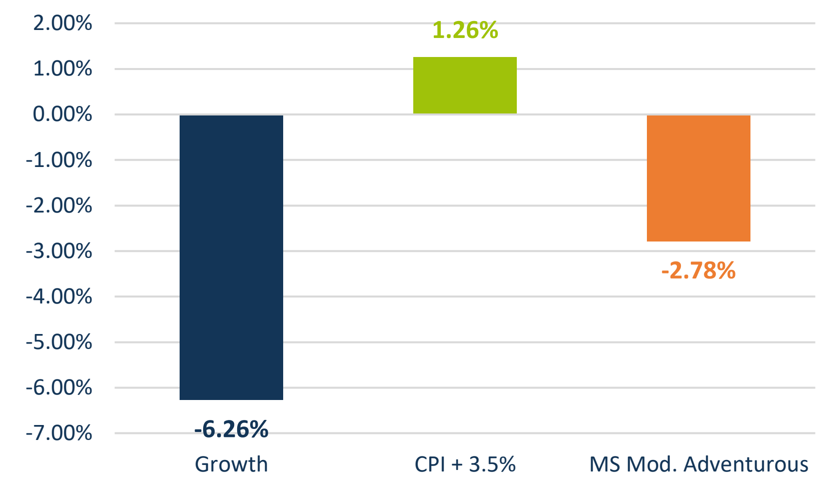
Such was the extent of the market falls that only three underlying holdings finished the quarter in the green. The strong performance of UK large-cap can also be seen in the performance of the JPMorgan UK equity core fund while gold proved its worth as a traditional risk hedge. Both LXI and Abrdn Europen logistics were purchased at a difficult time, just before the Ukraine invasion, but held up relatively well. The latter fared slightly worse due to the European focus and thus slightly closer proximity to the war.

Performance[1]





Q1 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	0%	0%	0%
Government	0%	0%	0%
Credit	0%	0%	0%
UK	16.22%	-6.17%	-1.00%
N. America	35.91%	-4.97%	-1.78%
Europe	12.17%	-9.69%	-1.18%
Japan	7.18%	-7.27%	-0.52%
Asia & Emerging	14.30%	-7.85%	-1.12%
Alternatives	14.21%	-7.27%	-1.03%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
Invesco Physical Gold	2.63%	6.67%	0.18%
JPM UK Equity Core	7.36%	1.24%	0.09%
LXI REIT Ord	0.59%	3.14%	0.02%
abrdn European Logistics Income PLC	0.65%	-4.84%	-0.03%
SPDR® MSCI USA Small Cap Val Wtd ETF	3.07%	-1.46%	-0.04%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 31/03/2022. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] Data for the period 20/07/2020 to the 31/03/2022. [2] Data for the period 31/12/2021 to the 31/03/2022. * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding and averaging.

Astute Observations

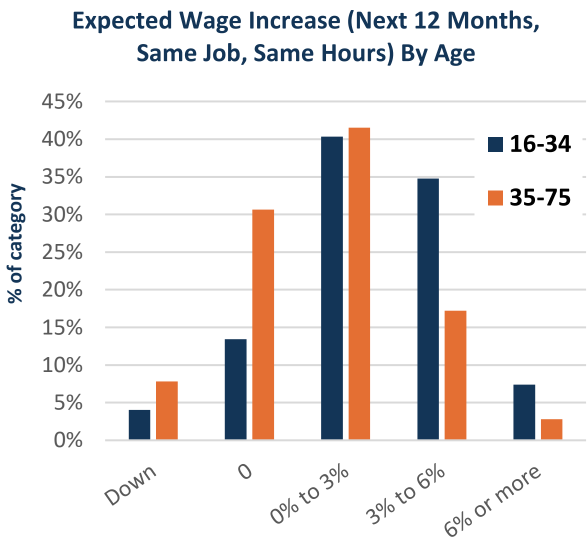
ASTUTE INVESTMENT MANAGEMENT LTD

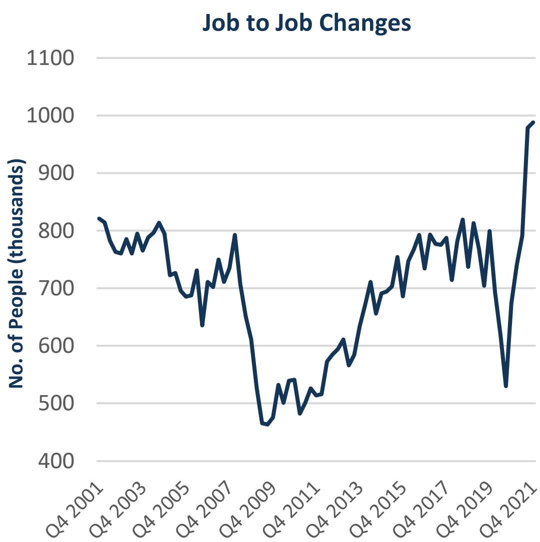
LABOUR MARKETS- THIS IS GOING TO HURT

One of the major concerns underpinning rising inflation is the idea of a "wage price spiral", where rising prices lead to higher wage demands, which in turn leads to higher prices and so on, until inflation accelerates exponentially, or action is taken to break the cycle. Key to this process is the ability of labour to demand higher wages i.e. a tight labour market. This is why the US Federal Reserve targets a so-called "non-accelerating inflation rate of unemployment" rather than 0% unemployment.

In the UK, labour markets also appear tight, but inflation has mostly outstripped wages. This means real disposable incomes are down and, in theory, should lead to higher wage demands. Hidden away in the annex of the Bank of England's February inflation attitudes survey was the question shown in the first chart to the right. "By how much do you expect your earnings, before taxes and deductions, to change over the next 12 months, assuming that you stay in the same job and work the same number of hours?". While only representing a very small sample size, the data suggests wage expectations remain relatively modest when compared to inflation, with younger people generally expecting larger increases.

The caveat is this does not account for quitting your current job for a better paid one. The second chart shows that the number of people leaving one form of full-time employment for another is at multi-decade highs. One possible explanation for this is a structural upskilling of the labour market, as those who left the workforce during the pandemic are replaced by junior hires from elsewhere. However, it could also represent a labour market so tight that where workers believe they can get higher wages they don't wait around for their current employer's annual pay review. A much more worrying outcome for inflation.





Source: ONS & Bank of England