# Quarterly Review

September 2021

www.alphabetapartners.co.uk

| | Q3 2021 | Return | Level |
|---|---|---|---|
| Equity | MSCI AW Index | -1.71% | 709.51 |
| | S&P 500 Index | -0.29% | 4307 |
| | MSCI EM Index | -8.41% | 1253 |
| | MSCI CH Index | -18.31% | 90 |
| | FTSE 100 Index | -0.54% | 7086 |
| Debt | BBARC GA Index | -0.88% | 536.03 |
| | US G2Y Index* | -0.05% | 0.28% |
| | US G10Y Index* | -0.67% | 1.49% |
| | US G30Y Index* | -0.95% | 2.05% |
| Infrastructure | S&P GI Index | 0.10% | 2654 |

(Source: Bloomberg. Data as at 30 September 2021)

Buoyed by further signs of economic recovery and accommodative monetary and fiscal policy, a number of developed equity markets, led by the US, continued to make new high as we entered the third quarter, only to be held in check somewhat in September as the focus shifted to potential moderating from central banks, rising stagflation fears and the Evergrande corporate bond situation. The story for developing markets, however, was more challenging, as further signs of a steady slowdown in China's growth rate coupled with regulatory clampdowns, clipped a number of Asian equity market wings. A steady slowdown in China, product and labour shortages, further commodity price rises and the rate of spread of Delta variant contributed to a modest cooling in both productivity and business sentiment in some parts of the developed markets too. Despite this, the PMI readings remained expansionary, and reopening remains on track.

The global economy has now entered a more challenging phase of its recovery, with monetary policy at the centre stage. The annual Jackson Hole symposium and recent policy debates give an insight into the central bank's direction of travel. A broadly held and stated position by the developed world's central banks is that the current inflationary pressures are transitory and are a result of the bottlenecks in supply chains. Whilst that may eventually prove to be a correct prognosis, "transitory" is a vague term and we have consistently argued that inflation is likely to overshoot the central banks expectations and stick around for a little longer than expected. Output shortages, cargo constraints combined with a strong demand are creating price pressures across the board.

The two-day Federal Open Market Committee concluded in late September. In the FOMC statement, Chair Powell noted that tapering "may soon be warranted" without giving any specifics of time and quantum, although suggestions point to around November. As for the interest rate increases, FOMC voting (Dot Plot) suggests that the momentum is building for the first move start at some stage in 2022. On tapering, we believe the economic recovery is broadly on track and scaling back bond purchases may not have a similar affect as it did in 2013. The current Reverse Repo facility at the Fed hold more than $1.5tr in deposits that may provide replacement demand for the treasury market.

In his post-FOMC statement, Chair Powell noted that "substantial further progress" tests for both the inflation and full employment must be met before interest rate increase. In our view, this is creative ambiguity that provides the Fed ample time before interest rates can be revisited. The unemployment figure now reads 5.2%, well above the pre-Covid February 2020 figure of

3.5%. We believe that the current rate of inflation (CPI 3.6% annualised, 08/2021) is well above the Fed's or the Market's breakeven levels but on an average over the pre-pandemic years, it still falls below the 2% threshold.

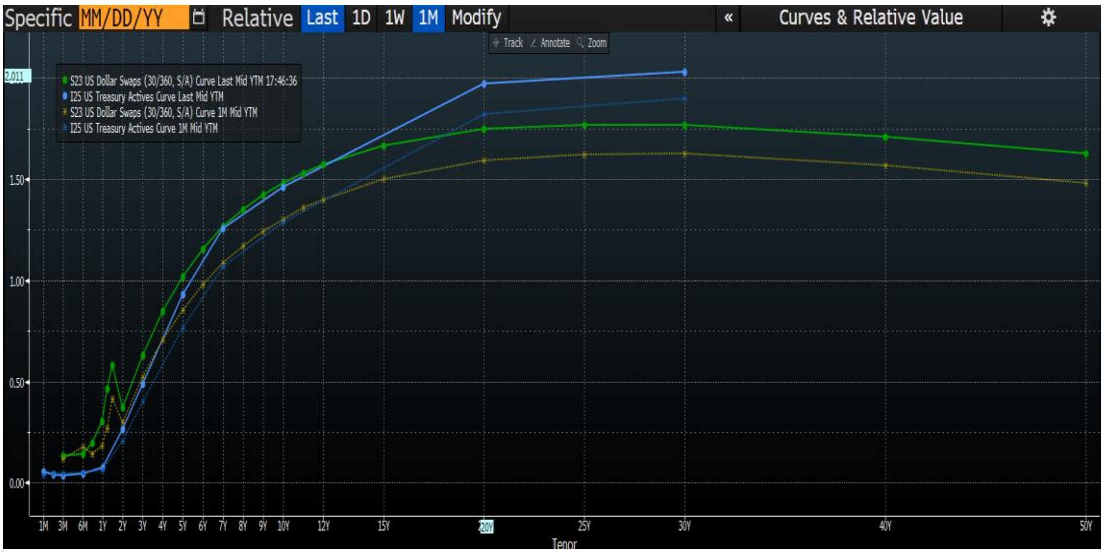
The market implied inflation rates for the UK and the US are

| Largest Breakevens | |
|---|---|
| 1) UK Breakeven 5 Year | 3.88 |
| 2) UK Breakeven 10 Year | 3.81 |
| 3) UK Breakeven 15 Year | 3.75 |
| 4) UK Breakeven 20 Year | 3.74 |
| 5) UK Breakeven 30 Year | 3.54 |
| 6) UK Breakeven 50 Year | 3.41 |
| 7) Italy Breakeven 1 Year | 2.94 |
| 8) US Breakeven 6 Year | 2.60 |
| **Smallest Breakevens** | |
| 43) France Breakeven 2 Year | 1.46 |
| 44) France Breakeven 7 Year | 1.42 |
| 45) France Breakeven 4 Year | 1.30 |
| 46) Japan Breakeven 9 Year | 0.40 |
| 47) Japan Breakeven 6 Year | 0.36 |
| 48) Japan Breakeven 5 Year | 0.33 |
| 49) Japan Breakeven 10 Year | 0.30 |
| 50) Japan Breakeven 7 Year | 0.27 |

Source: Bloomberg. Data as at 4 October 2021)

The last few days of the quarter were littered with political risk emanating from the US. Political manoeuvring over the debt ceiling vote and on the Biden administration's $3.5tr spending package only added to market jitters. The debt ceiling increase has not yet passed through the US Senate. Once resolved, this should provide a relief to the markets.

The Bond markets reacted to Fed's statement on tapering as expected with the yield on the 10-year bond rising from 1.28% to 1.46% during the month (leaving it only marginally charged compared to the end of Q2). The swap rate market expects a marginal increase in short to medium term yields as shown in the graph that follows:



Source: Bloomberg. Data as at 4 October 2021)

Chinese equities had a disappointing quarter again. The Chinese government have taken measures to disrupt the hedonistic wealth being created within Chinese technology firms by placing restrictions on on-line gaming and other internet services capturing the imagination of impressionable minds. Chinese technology related share prices have fallen heavily. Likewise in the important Chinese property sector, Evergrande one of the largest property developers with an eye-watering $300 billion of debt has struggled to meet its interest payments and led to falls in the value of related securities. These local issues coupled with the port congestion, raw material shortages and energy crises, are proving to be a strong headwind for the Chinese economy this year. In our July Investment Committee, we reduced our Chinese GDP growth expectations to 3%. We do expect a combination of an accommodative monetary policy and an increase in export demand will help Chinese equities perform better in the medium to long run.

The latest Purchasing Manager's Index print points to an interesting mix. Whilst the developed world's readings remain in the expansionary territory, the change is marginally negative. The Chinese PMI readings, however, show a different picture for this quarter.

Both UK and European equity markets exhibited a mix of sentiment during the quarter. European markets, although correlated with the US, did not exhibit the same level of drawdowns. The UK is suffering from labour shortages, particularly in the distribution and the agricultural sectors, with some consequent wage pressures adding to the stagnation narrative. Labour shortages are expected to ease but not disappear where the loss of immigrant labour is problematic. This, however, is not expected at this stage to have a material impact on our UK GDP growth or equity return expectations.

Globally, the timing of debt ceiling drama, tapering talks and Chinese slow down created a confluence of events that resulted in a ~5% correction in equities during September. Our proprietary technical indicator points to a change in momentum after this recent drawdown.

In the absence of a shock or a material negative event, these readings usually signal a renewed upward momentum. Considering the current state of the market, the excess liquidity with the US and European banks, household savings and expected rotation from fixed income to equities, we expect equities to perform strongly in the last quarter of the year.

During the quarter we reduced our exposure to higher duration bonds and added an indexed linked bond exposure. We reduced our exposure to Emerging Market equities and reduced our EM growth expectations. We increased our cash exposure marginally and continue to hold our exposure to the US equities.

We remain risk-on as the world navigates through the reopening phase. The central bank's policies and their forward guidance will remain pivotal in keeping an orderly transition into a normal economy.

We would like to thank you for your ongoing support, and please do get in touch with any queries or questions – as ever, always good to hear from you.

# Our Portfolio Returns:

| AB Core Performance % | Year to Date | Quarter to Date | Month to Date |
|---|---|---|---|
| Alpha Beta AB1 Core | 2.81 | 0.40 | -1.07 |
| Alpha Beta AB2 Core | 4.47 | 0.75 | -1.17 |
| Alpha Beta AB3 Core | 6.39 | 1.10 | -1.22 |
| Alpha Beta AB4 Core | 9.06 | 1.77 | -1.12 |
| Alpha Beta AB5 Core | 9.05 | 1.28 | -1.44 |
| Alpha Beta AB6 Core | 8.43 | 0.15 | -1.95 |

| **AB Core Plus Performance %** | | | |
|---|---|---|---|
| AB Core Plus Cautious | 3.53 | 0.58 | -1.11 |
| AB Core Plus Cautious Balanced | 5.04 | 0.89 | -1.21 |
| AB Core Plus Balanced | 7.36 | 1.14 | -1.14 |
| AB Core Plus Balanced Growth | 9.66 | 1.75 | -1.23 |
| AB Core Plus Growth | 7.34 | 0.02 | -1.44 |
| AB Core Plus Adventurous | 6.55 | −1.09 | -1.93 |

| **SRI & Ethical Portfolios Performance%** | | | |
|---|---|---|---|
| AB SRI Defensive | 1.88 | 0.83 | -1.67 |
| AB SRI Balanced Income | 6.91 | 1.25 | -2.40 |
| AB SRI Balanced Growth | 12.31 | 3.74 | -2.28 |
| AB SRI Adventurous | 11.96 | 3.24 | -2.10 |
| AB Ethical Balanced Income | 6.98 | 1.38 | -1.79 |
| AB Ethical Balanced Growth | 13.05 | 3.53 | -2.29 |

| **AB Sustainable Portfolios Performance%** | | | |
|---|---|---|---|
| AB Sustainable Cautious | 2.48 | 0.21 | -1.47 |
| AB Sustainable Cautious Balanced | 3.96 | 0.61 | -1.74 |
| AB Sustainable Balanced | 6.09 | 1.20 | -1.85 |
| AB Sustainable Balanced Growth | 7.12 | 1.23 | -1.95 |
| AB Sustainable Growth | 8.76 | 1.45 | -1.86 |
| AB Sustainable Adventurous | 9.16 | 1.23 | -2.20 |

(Source: ABP and Morningstar. Data as at 30 September 2021)

Written by the Alpha Beta Investment Team.

Contact: **Andrew Thompson**
Tel: 07968 934127
Email: at@alphabetapartners.co.uk

Important Information:

This document has been prepared and issued by Alpha Beta Partners which is a trading name of AB Investment Solutions Limited who are authorised and regulated by Financial Conduct Authority (FCA). Retail clients should not rely on any of the information provided in this document and should seek assistance of the Financial Adviser for all investment guidance and advice.

The information and opinions contained in this document are subject to updating and verification and may be subject to amendment. The information and opinions do not purport to be full or complete. No representation, warranty or undertaking, express or limited, is given as to the accuracy or completeness of the information or opinions contained in this document by Alpha Beta partners and AB Investment Solutions Limited. No liability is accepted by such persons for the accuracy or completeness of any such information or opinions. As such, no reliance may be placed for any purpose in the information or opinions contained in this document.

Please remember that you should not base decisions on past performance and that the prices may fluctuate, and you may not get back your original investment. Past performance is not a reliable guide to future performance.

**Alpha Beta Partners Ltd.**
**Northgate House, Upper Borough Walls, Bath BA1 1RG**
**info@alphabetapartners.co.uk I 020 8059 0250**
www.alphabetapartners.co.uk