Alpha Beta
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Investment Update

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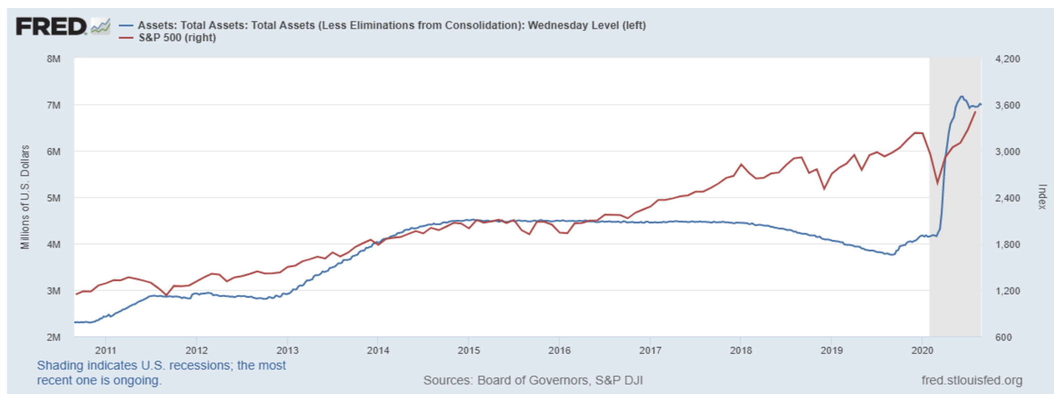
For the first time in history, the annual Jackson Hole economic meeting was a virtual affair this year thanks to Coronavirus. Jerome Powell, Federal Reserve Chairman took this opportunity to set out an important but low-key shift in Fed policy. The new policy framework heralds a clear departure from central bank thinking of the past several years. We discuss the implications of this change and our views in this update.

Since our last update, the S&P500 has successfully pushed onto a new high above 3500 as anticipated. On the other hand, US Treasury yields have moved upwards at the medium to longer end, with the 10 year now yielding a shade over 0.70%, a little sooner than we expected.

The unprecedented monetary and fiscal policy response to Covid-19 has prevented a banking crisis. These extraordinary measures have also fuelled a meteoric rise in equity indices, divorced from the economic fundamentals. Technology has been a major beneficiary. Investor portfolios have largely recovered although the economics must rapidly play catch up to avoid a relapse. The following chart visualises the magnitude and support central banks have provided to risk assets so far.



Alpha Beta's strategy to date makes a strong positive case for risk assets, of course, led by equities over the medium to longer-term, taking advantage of central bank policy.

For the best part of the last 2 quarters, central banks and governments alike have focused on keeping their economies on ventilators (this ventilator is estimated to cost over $10tr once the Covid-19 episode is over). Inevitably, the result is excess liquidity, higher asset prices and has encouraged leveraging with an implicit "Fed guarantee" applied to mainstream asset prices. Overarching central bank policy has also impeded the ability of efficient capital markets to allocate capital to deserving business models, by rescuing the worthy and the unworthy alike.

At the Jackson Hole meeting last week, the Fed Chairman updated the "Longer-Term Goals on Monetary Policy" and signalled the Fed will change its method of inflation targeting and, in the future, will target *average* inflation of 2%. Previously, the Fed had simply targeted core inflation of 2%. One of the reasons for this change in policy can be traced to the magnitude of money injected into the economy via quantitative easing. This excess liquidity is and will further fuel asset prices and inflation above 2% over the longer term, hence the use of an "averaging mechanism".

As we have previously stated, the fall in the value of the US dollar is another direct consequence, albeit a reaction positive to a broader economic recovery amongst dollar dependent economies.

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We included gold in client portfolios as a result and valuations have benefitted accordingly. The likely resurgence of inflation could impact the price stability of Treasuries and by extension, all debt, except if the Fed keeps Treasury demand high by direct market action. This in turn will expand the Fed's balance sheet beyond current levels and further extend Modern Monetary Theory.

Recent data is starting to indicate the possibility of increased short-term pressure on equity prices. Valuations remain extremely high by long term standards, recent market highs have been fuelled, surprisingly perhaps, by faltering momentum. As we had anticipated, a 3600 level in the S&P 500 index is achievable, but a confluence of events and indicators signal a

possible pullback in the short-term in the absence of a positive surprise or even more central bank activity. Volatility is expected to increase before the US elections set for November as shown by the chart above.

Over the medium to longer-term risk assets remain well supported by a recovering global economy, historically low-interest rates, and central government spending. We expect inflation to push risk asset prices further in the medium term. We also expect some investor capital to switch from fixed income to risk assets once vaccine delivery news becomes tangible. As the S&P 500 pushes further into the virgin territory of new highs we are pleased to see our portfolios performing well and in line with expectation.

We remain focused upon the changing landscape and ready to implement changes swiftly should they become necessary. Our portfolios have benefited from a higher allocation to the US equity market and a timely increase in these positions during March. We continue to manage our portfolios adopting the "Risk-First" approach that has served investors well to date.

If you have questions or feedback please get in touch, it would be good to hear from you.

Written by the Alpha Beta Investment Team.

Contact: Andrew Thompson. Tel: 07968 934127

Email: at@alphabetapartners.co.uk

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Alpha Beta Partners Ltd.
4 Lombard Street, London EC3V 9AA
info@alphabetapartners.co.uk I 020 8059 0250

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