Investment Update

July 2021

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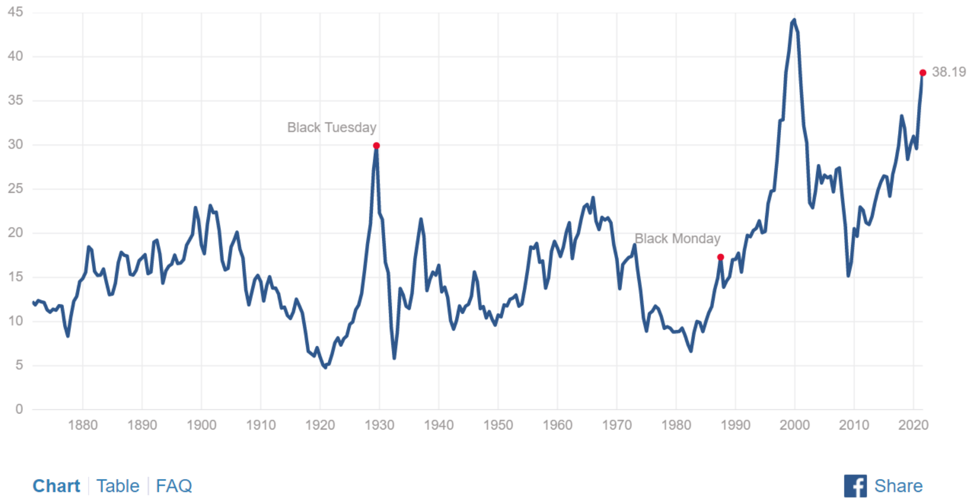
It has been something of a "stop-go" summer so far. Short spells of very hot weather punctuated by longer periods of rain and grey skies. Other parts of the world have suffered greater severity of course, with El Nino or climate change pushing things along. In some ways markets have portrayed similar attributes. All-time highs punctuated by mini market corrections delivered at high speed and accentuated by all powerful central bank liquidity whilst equity market momentum has typically been falling.

We have been monitoring inflationary drivers as set out previously. Pressure continues to build with supply-side squeezes now accentuated by Covid factors and by disruptive weather. Commodity prices overall, and notably oil prices have risen sharply too. President Biden's $3.5 trillion stimulus package is hiking demand for goods from the public at a time when delivery is difficult. Wage pressure is the next and obvious corollary and is happening in some sectors already. Central banks persist with their statements defending the inflationary spike as what they term as "transitory". The Congressional Budget Office last week pointed to a reduced output gap which supports an inflationary thesis. In Europe, if there is one piece of evidence that the Bundesbank's legacy has passed into history it must be this - the last time inflation stood at 3.8% the key interest rate was 6%. Today the key interest rate remains pegged at 0%. Thinking back to the Great Financial Crisis of 2008, Ben Bernanke the Federal Reserve Chairman of the day cut rates and poured liquidity into markets in the form of quantitative easing, but President Obama did not intervene with very significant fiscal support to supplement the Federal Reserve. Inflation remained extremely low, but unemployment remained higher for longer and a full recovery took almost a decade. The Covid-19 crisis has been different with massive fiscal and monetary support combined to inject powerful adrenalin into economies and the resultant recovery has been speedier. We do anticipate inflation being more stubborn to shift based upon a multitude of factors, we also anticipate the headline rate of inflation to persist at a level higher than central banks will be entirely comfortable with, despite the narrative.

The Federal Reserve continues to pour $120 billion each month into the US economy. Jerome Powell the Fed' Chairman has commented that tapering-back this huge commitment is likely to begin in the not-too-distant future. We anticipate a build-up in forward guidance and the Jackson Hole central bank conference next month offers an ideal platform. Equity markets may well react unfavourably to news of a gradual withdrawal of economic adrenalin.

Corporate earnings announcements from larger firms have continued to boost already expensive equity valuations. Financial results from the likes of Apple and Facebook to name just two have powered ahead at almost unmatched velocity. Facebook simultaneously advised investors not to expect an ongoing repeat of such growth. We are increasingly of the opinion that peak growth for this cycle has perhaps been achieved. As stated last month, we would expect quarter 3 earnings growth rate to come in at a lower level than preceding quarters as the impact of so-called base effects will be much reduced.

The chart shows how US equity markets have become expensive.



Source: Shiller PE Ratio
As at 02.08.2021

Fixed income markets witnessed falling yields during the month with the headline 10-year treasury yield falling to 1.2% driven lower by technical factors and a lack of supply. The fall in yields is counter intuitive when set against the backdrop of rising inflation and may have masked inflationary concerns for some investors. The Chinese authorities announced restrictions impacting growth and dominance of its own technology companies and these moves proved a serious detractor to Asian stocks and particularly Chinese and Hong Kong markets.

At portfolio level we remain pleased with performance in robust shape year-to-date.* We are mindful of our mandate to protect hard earned capital and not to be overly greedy with our quest for wealth generation. We are minded to reduce equity exposure marginally and raise cash when the time is right. We anticipate a softening in short term growth potential and the possibility of a market correction after prices and valuations have come so far so quickly. We are cognisant of the potential for a short-term pullback later this year based around the confluence of events set out above, liquidity tapering and the possibility for a sedentary interest rate rise further downstream. Once markets have adapted to these likely changes, we believe further equity price expansion will result. The backdrop for economic growth and an exciting modern global economy remains entirely compelling.

As ever we would like to thank you for your ongoing support. If you have questions or feedback, please do get in touch.

*Reference by fact sheet performance data available until 30.6.21 at www.alphabetapartners.co.uk

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