Quarterly Review

June 2021

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	Q2 2021	Return	Level
Equity	MSCI AW Index	7.39%	720
	S&P 500 Index	8.55%	4298
	MSCI EM Index	5.05%	1375
	MSCI CH Index	2.03%	109
	FTSE 100 Index	5.66%	7038
Debt	BBARC GA Index	1.31%	541
	US G2Y Index*	-0.07%	0.25%
	US G10Y Index*	0.53%	1.45%
	US G30Y Index*	2.89%	2.06%
Infrastructure	S&P GI Index	2.33%	2638

* TR on TSY futures
(Source: Morningstar 30/06/2021)

The good news for developed markets has been a powerful near V-shaped recovery from the pandemic. Equities have enjoyed a buoyant period of growth seemingly ignoring short term woes a few months back and breaking new all-time highs several times during June and pushing further still into expensive territory. Economic data has broadly supported the melt-up with GDP and Purchasing Managers Indices rebounding from low points and providing sparkling headline figures courtesy of barely concealed so-called base effects. The data suggests a "goldilocks economy", in other words sustained economic growth with monetary conditions not too hot or too cold. The Federal Reserve's mixed messaging saw some temporary blips in Treasury yields but the overall flattening of the yield curve remains on track, much as we expected.

We anticipated the post-Covid period to be a difficult one for investment strategists where the chances are that equities could melt-up on the back of re-opening optimism or could correct anticipating a tighter monetary policy move. For now, the re-opening story is in full swing with equity market performance expressing optimism.

Central banks have simultaneously chorused the same message – inflationary pressure is transitory and will abate as the Covid-19 economic recovery matures. Our forecast late last year of a rebound in inflationary pressure has certainly proven correct with CPI figures in most major economies spiking upwards as bottlenecks in supply meet rapidly expanding demand from unlocking populations.

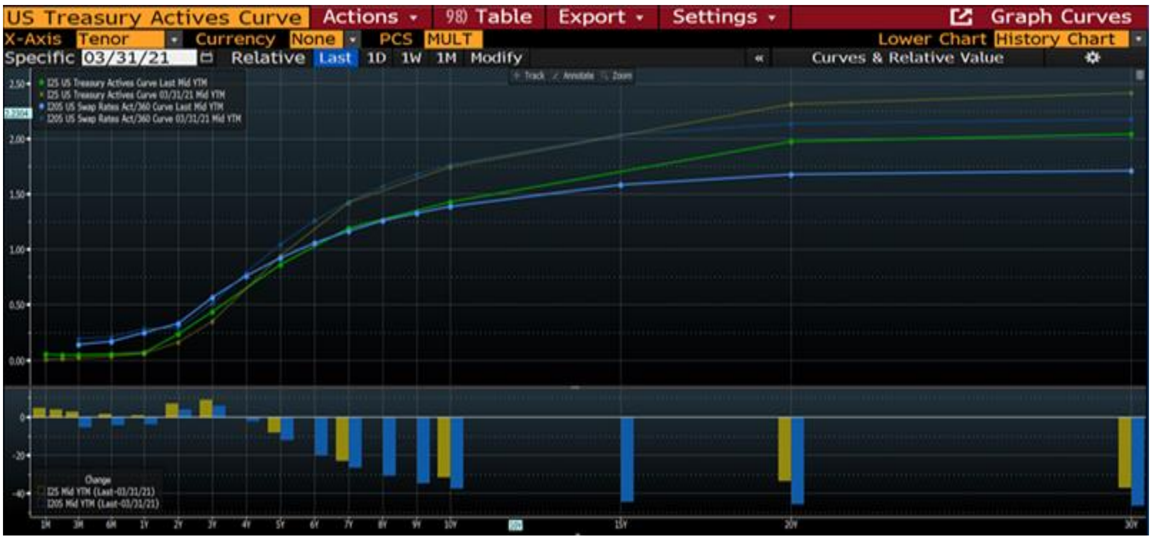
Inflationary data remains firm and the fabled Federal Reserve "dot plot" for June pointed clearly to two rate rises towards the end of 2023 and tighter monetary policy further out. The economist William Phillips described the inverse relationship between rates of unemployment and corresponding rises in wages. As stated last month, we keep a firm eye on wage pressure as economies accelerate out of the pandemic doldrums and unemployment falls back.

The underlying price components for many goods such as freight charges (Baltic Dry Index shown below), commodity and oil prices, and Purchasing Price Indices have risen sharply. These cost components are either going to result in a handed down price inflation or margin shrinkage for the manufacturers. Cost components such as wages and raw material prices may remain elevated well beyond central banks transitory horizon, which begs the question: why are bond yields not backing upwards already?

(Source: Bloomberg)

The Federal Reserve's £120 billion per month bond buying programme and loose monetary policy has kept credit spreads below pre-pandemic levels, which is good news. Treasuries are posting negative real yields if one deducts breakeven inflation levels. This phenomenon cannot carry on indefinitely. However, for now markets back the central banks expressed opinion that inflation will remain transitory.

The below chart shows the Treasury curve and swap rate curve as at the end of quarter two 2021. The long end of the yield curve saw a significant compression during the quarter and the short end continues to experience some increase, in line with the "transitory" thesis. The benchmark 10-year treasury yield fell from 1.7% to a little over 1.4%.



(Source: Bloomberg)

For now, loose monetary policy and fiscal support continues to fuel prices. US equities remain divorced from their fundamental valuations, P/E ratios factor in higher constant growth assumptions which, if not met, could mean a sharp reverse in markets. If central bank forecasts for inflation prove overly optimistic a sudden rate rise could result which would unseat equity markets.

In UK, notoriously blighted by poor productivity, we have seen data pointing to an improvement which is good news indeed. Europe, led predictably by Germany, is enjoying a strong recovery and Mrs Lagarde and colleagues at the ECB seem intent to support with ever more liquidity and the provision of Eurozone bonds designed to provide robust economic support to nations in the bloc recovering at different rates. In Asia, Japan's recovery remains underway with ongoing lower inflation and China's economic engine slowed a little in June but remains impressive.

In the equity arena, we anticipate a strong quarter two earnings season as companies continue enjoying a recovery buoyed by burgeoning demand and firm prices with headline data likely to be flattered by base effects still present in the system. Quarter three results could be an altogether more interesting affair.

Technically, especially in US equity indices, we see some overbought sentiment. Although we remain bullish in the medium-and longer-term time horizon, we do see some risks building up in the short term. The European, UK and Emerging market indices exhibit a better risk/reward ratio, but these higher beta markets are tethered to US indices.

Geopolitically, we maintain a close watch on tensions in the South China Sea between Taiwan and China, which brings the potential for an ongoing cold war in the region. The repositioning of the US following its withdrawal from Afghanistan will provide further insights.

At portfolio level, we held firm during June avoiding the temptation to take some profits and thus enjoyed the further melt-up in prices – we remain cautiously risk-on. All portfolios are positioned firmly within their allocated risk framework with no breaches. Our proprietary AB Momentum Indicator points to the potential for further equity expansion although this is more finely balanced as technical measures underscore the relatively expensive status of equities. All operational and dealing costs are kept at very low levels reducing performance drag for investors. Our decision to increase UK equity weightings paid off and overall performance remains firmly on track for the half year 2021 to-date.

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	2.40	2.53	1.00
Alpha Beta AB2 Core	3.69	3.23	1.29
Alpha Beta AB3 Core	5.24	4.02	1.47
Alpha Beta AB4 Core	7.17	4.84	2.07
Alpha Beta AB5 Core	7.67	5.46	1.82
Alpha Beta AB6 Core	8.27	5.85	1.78

AB Core Plus Performance %			
AB Core Plus Cautious	2.93	2.85	1.28
AB Core Plus Cautious Balanced	4.12	3.42	1.39
AB Core Plus Balanced	6.15	4.56	2.01
AB Core Plus Balanced Growth	7.77	5.31	2.51
AB Core Plus Growth	7.31	5.25	1.98
AB Core Plus Adventurous	7.72	5.56	2.04

SRI & Ethical Portfolios Performance %			
AB SRI Defensive	1.04	1.81	0.78
AB SRI Balanced Income	5.59	3.77	0.50
AB SRI Balanced Growth	8.16	6.10	1.18
AB SRI Adventurous	8.44	5.84	2.44
AB Ethical Balanced Income	5.46	3.73	0.79
AB Ethical Balanced Growth	9.16	5.95	1.76

(Source: ABP and Morningstar, Date: 30/06/2021)

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.
Cannon Place, 78 Cannon Street, London EC4N 6HL
info@alphabetapartners.co.uk I 020 8059 0250

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www.alphabetapartners.co.uk