

Alpha Beta

PARTNERS



Investment Update

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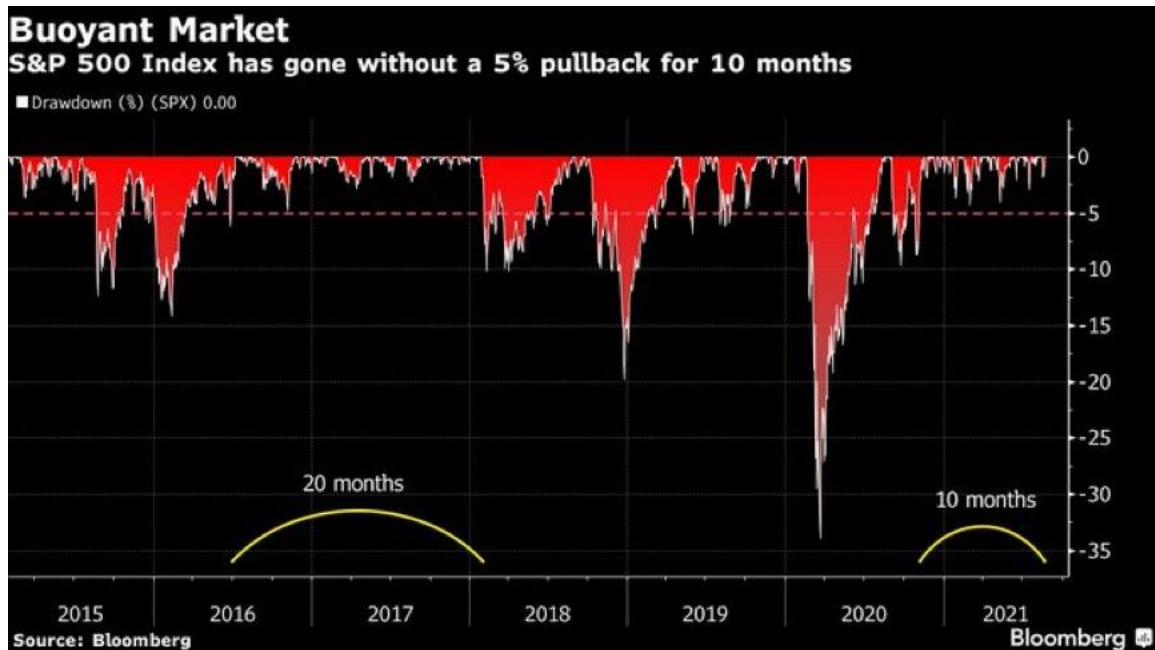
Equity investors have never had it so good! Global equities are now worth \$118.6 trillion, the highest value ever. The equity V shaped recovery we wrote about back in the dark days of 2020 has certainly played out. Equity investors have been brave but have been very well rewarded as the full extent of monetary and fiscal policies have stimulated a recovery like no other. Markets have uncannily looked through shorter term issues and only relatively small market wobbles have impacted progress along our journey.

We have now arrived on the other side of the economic gorge carved out by the pandemic consequences. The recovery is not complete but tremendous progress has been made and positive momentum will lead to a full rebound. Life on this side of the pandemic will certainly be more digital, more expensive, and more complex than what went before – the “new normal” commentators wrote about a year or so back is now taking full shape.

Last week saw the global central banker’s symposium at Jackson Hole. Central banks have become super-important over the past few years and so huge attention was fixed on this event. Jerome Powell, the Federal Reserve Chair spoke on Friday morning with what proved to be a well-judged crowd-pleasing address. He successfully delivered forward guidance of tapering back the \$120 billion per month liquidity programme, when the US economy is strong enough to bear it – perhaps later this year at the earliest. We expect a Tapering Committee to be created by the Federal Reserve sometime soon. Chairman Powell made it clear that liquidity tapering and a rise in interest rates are not necessarily linked events, as markets had feared. Equities celebrated with fresh all-time highs in the United States. Key spokespeople at the Federal Reserve and other central banks, insist inflationary pressure is transitory whilst maintaining an accommodative and dovish stance focusing on the twin mandates of 2% average inflation and maximum employment whilst interest rates are to remain at inflation-adjusted negative levels, for now. However, it is worth noting that some members of the Federal Reserve are more concerned about inflationary pressures than its Chair and have made comments about possible “financial instability”. Unemployment remains higher than is optimal with 6 million more out of work in the US than pre-pandemic, for example.

As with any passing storm, there are squalls that follow-on. We have consistently stated that inflation is likely to remain higher for longer as bottlenecks and supply squeezes trigger pricing pressure and steadily relaxing lockdowns provoke demand spikes. In US inflation has been running at 5.4%, the highest in over a decade. Some prices, notably lumber, clothes and used cars have begun to normalise but other items with knock-on impacts remain elevated. Shipping costs have quadrupled from \$3,800 to \$16,400 for a container to be transported from China to California. Logistical distribution hubs remain clogged and so moving the goods around the country once they arrive is far from easy. In the UK we have issues finding enough HGV drivers – wage pressures are now a reality. Higher demand for digital services has placed a demand surge on microchip manufacturers. Building new factories to satisfy demand is quite possible but on average takes 2-years for a supply impact to be noticeable. Companies will be forced to pass-on cost increases after absorbing as much pressure as possible from profit margins. If inflation does remain stubbornly above the 2% average, then interest rates will rise.

We are now passed the point of maximum economic growth as the speed of recovery naturally slows. The important quarter 3 earnings reports will be fascinating as so-called base effects will be much reduced and some earnings are bound to be smaller than before, particularly for some firms who have absorbed input cost inflation into profit margins. This could trigger a market correction from current levels which are undoubtedly very expensive, which would likely be viewed as healthy although potentially painful. At a technical level forward market momentum is less strong whilst leadership has narrowed. The chart depicts the S&P 500 which has not suffered a drawdown of 5% or more for 10 months – which is not the longest period without such a decline!



Source: Bloomberg
As at 31.09.2021

Chinese authorities sought to control excessive wealth and profits particularly from its own successful technology sector by imposing new checks and balances on firms. Chinese equities and those of emerging nations have suffered consequently and performance year-to-date now lags developed nations. Roll-out of Covid vaccinations across economically poorer nations has been slow and sporadic which has also held-back a recovery and kept prices lower. At portfolio level progress has been maintained although we took the decision to trim-back some equity exposure to China and certain other so-called higher beta markets raising cash, in a move of sensible housekeeping and prudence. Simultaneously we have allowed ongoing exposure to equities which are sucked higher by the improving pandemic economic environment expressed through strong earnings momentum, accelerating share buy-backs and ongoing central bank stimuli.

We have seen decent progress this year with momentum maintained throughout the summer. We remain vigilant to the potential for a short market pull-back and have raised cash levels to balance portfolios appropriately whilst allowing for growth should it persist for longer. The recovery from the Covid-19 pandemic will leave those well positioned companies and markets

in an enviable position. Alpha Beta portfolios are well placed to benefit. As ever we would like to thank you for your ongoing support. If you have questions or feedback, please do get in touch.

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