Investment Update

November 2021

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There are not many investment managers operating today with genuine portfolio management experience during periods of inflation. The fact Alpha Beta Partners has a deeply experienced team has paid dividends for clients on several occasions in recent years, but most certainly now. We forecast and positioned portfolios appropriately for the resurgence of inflation with our "higher for longer" forecast when many of the peer group were firmly of the opinion that inflation would be unlikely to result from central bank policies. So far so good, but in asset management and particularly at Alpha Beta Partners whilst learning from the past, we look forwards.

Federal Reserve Chairman Jerome Powell surprised markets by suggesting that liquidity tapering could be completed earlier than originally planned and stating that inflation may be more persistent and less transitory than originally thought. Wage settlements will be a key determinant of how embedded inflation is to become and how long the spectre stalks economies and markets. 2021 has been a year of extraordinary demand spikes and supply bottlenecks with some eye-popping price increases for us all to manage. The US economy is very strong with unemployment levels falling and adding further impetus to liquidity tapering and potential rate increases further out. From here we expect 2022 to see a calming of demand and we believe this transition has already begun.

The US Beige Book report pointed to a steadier demand profile, whilst other leading indicators have begun a long journey towards normalisation. Apple reported steady but not excessive demand for its latest iPhone, a product which would have been snapped up by consumers spending stimulus cheques until very recently. Some commodities and particularly industrial metals have seen prices begin to cool off. The Baltic Dry Index which tracks the cost of bulk shipping around the world has seen a steep decline and the number of container ships anchored outside key ports awaiting a docking time slot has also reduced. To balance this emerging and helpful trend is the double-edged sword of building "green infrastructure" which in its infancy is likely to keep prices higher and maintains high demand levels for certain commodities such as lithium and copper.

Chart as of 30th November 2021
Source: Bloomberg

The chart shows US Treasury yields after most recent Federal Reserve Commentary on inflation. At a technical level we have been surprised but somewhat comforted by the downward trajectory of long-term bond yields where the 10-year US Treasury offers a 1.45% yield. Of course, this suggests fewer inflationary concerns further out albeit with the likelihood of a slowing economy. High yield spreads have expanded in more recent times offering a more sensible risk premium for lower quality credits and reflecting market risk. The ECB balance sheet continues expanding and simultaneously Eurozone inflation nears 5%, the highest level on record.

In Germany inflation has breached 5% - putting things into perspective, the last time German inflation stood at these levels the Bundesbank had raised rates to >8%, whereas today the ECB has rates pegged at or close to zero. In China where the real estate sector makes up around 25% of domestic GDP the Evergrande debacle continues to bring idiosyncratic risk to the region and many emerging markets in general.

We remain underweight as the implications become manifest and keep the situation under close review. The UK stock market offers attraction at a valuation level, and we remain cautiously optimistic particularly for smaller and medium sized firms. The FTSE 100 index is of course unreflective of much of the innovation and growth from smaller firms, being skewed to miners, banks, and oil companies.

Late in November the emergence of the Omicron Covid-19 variant rocked markets and cooled sentiment bringing down share prices around the world. Traders and managers were left wondering whether they had discounted the impacts of the pandemic too soon. The variant appears to be mild at the point of writing but with insufficient data to robustly refute alarmist claims markets will remain volatile until more facts are known.

The VIX volatility index, a good leading indicator, is not pointing to notable disruption currently. Markets usually overreact with the pendulum swinging to extreme points – underlying economies remain strong and as we have seen already central banks will move to provide support should it be required. At this stage and without hard data for the latest Covid variant we cannot help feeling the comments of Jerome Powell, set out earlier, are the significant development of the month. Of course, we remain vigilant and with cash levels increased over the past few months we feel portfolios are in good shape.

All data as of 30th November 2021 and sourced from Bloomberg.

If you have any questions or feedback, please do not hesitate to get in touch.

Written by the Alpha Beta Partners investment team.

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

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

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www.alphabetapartners.co.uk

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