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Investment Update

November 2021

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The investment landscape is changing rapidly as the Covid-19 storm has largely passed over us. As with most storms there is turbulence and squalls which follow before things settle into a new rhythm. Metaphorically this is exactly what has happened within global markets. We now look forwards to ascertain what the conditions are likely to offer us all as the post-Covid environment emerges.

The first observation is that Covid-19 will not disappear altogether, rather populations and economies will learn to live with the virus in our midst at lower levels and increasingly controlled by vaccines. Consequences are clearly for a more digital and environmentally friendly tomorrow. Meantime we have a series of economic and political hurdles to navigate. Let's start with inflation - Our higher for longer narrative is playing out and the next few months will continue to see headline figures rise as the effects of the supply chain disruption continue to impact along with higher energy prices. We continue to keep a close eye on wage rates, which have been trending higher and are the key to whether inflation becomes more engrained longer term. For now, it looks like the headline figures after peaking in early 2022 should begin to subside during the second quarter as some of the year-on-year comparison effects drop out of the data.

Linked with economic robustness and inflation is monetary policy and so-called quantitative easing. Several central banks around the world have already responded to rising inflation and edged up rates. In the UK the pressures are certainly rising for the Bank of England to follow suit. Of course, interest rates cannot and should not remain at emergency levels forever, despite an economic recovery. In Europe the ECB have announced an end to its emergency liquidity programme called PEPP during the second quarter 2022. Likewise in the United States the Federal Reserve is now widely expected to begin tapering-back soon. These withdrawals of economic adrenalin will be gradual but will be delivered by larger central banks with some synchronicity as set out here in previous updates.

The US economy continued to offer positive surprises during the month. Whilst inflation remains a feature, the 5-year breakeven figure of 2.92%* is lower than others. Unemployment remains sticky at 4.8%, * a higher level than when the pandemic hit. This feature may possibly persuade the Federal Reserve to delay tapering a little while longer. The 3rd quarter earnings season is important as many of the inflationary base effects have dropped out. With some notable exceptions such as Facebook and Amazon the results have been robust and positive. Key market indices including the Dow, S&P500 and Nasdaq have posted new all-time highs. This market rebound from the correction of previous weeks has been a welcome development. The ongoing stimulus of corporate buybacks of issued stock remains a trend in US which helps to keep prices higher. In Congress President Biden seeks permission for the debt ceiling to be raised. This is an emotive political debate between Republicans and Democrats which as a rule is allowed to push a decision to the last moment. We see the same issues this time although relative party-political positioning is even more entrenched than before and there is a volatility risk to equity markets unless the debate can be controlled and passed.

One important development during the recent past has been the flattening of the yield curve towards the longer end. This points to a slower economic expansion than has been the case in the recent Covid recovery phase. This is entirely understandable and demonstrates markets

*Source: FRED Economic Data Date 29.10.2021

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anticipating some monetary tightening. US economic growth was reported materially lower last week and whilst US GDP is often revised upwards later the trend of slower growth in clear. In the world's second largest economy, China showed signs of further weakness in October as power shortages and surging commodity prices weighed on manufacturing, while strict Covid controls put a brake on spending. A slowing economy witnessing some strong inflationary pressure stimulates talk of "stagflation".

The Chinese authorities have sought to control levels of "hedonistic wealth" particularly in the technology sector by enforcing restrictions and access to online gaming and other fast growth sectors which are shaping attitudes and behaviours of the populous. In a quote close to that of Karl Marx, the Chinese authorities referred to online gaming as "spiritual opium" and "opium of the mind". Chinese technology stocks have lost significant value. The Chinese property sector makes up around 25% of GDP* and one of the larger developers, Evergrande is experiencing financial difficulties associated with its huge $330bn debts*. Defaults have impacted the Chinese high yield markets. We see the Evergrande issue impacting Chinese and to an extent Emerging Markets only, but higher risk investors will have felt some impact. We are monitoring the situation closely.

At portfolio level, we raised cash weightings higher across the range before markets corrected and we are pleased with the relatively defensive positioning during market volatility. We will review the cash positioning again once the forthcoming US debt ceiling debate has been resolved.

Looking out from here, valuations point to more room for the European equity markets (including UK, which is one of the cheapest relatively) to move ahead over the next 12-24 months. Expect US equities, likely to be driven mainly by earning growth to continue expansion. Pointers are still positive with 4th quarter 2021 earnings growth currently indicated by Factset to be around 20% year-on-year, * but clearly with little room for disappointment.

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

Written by the Alpha Beta Investment Team

*Source: FACTSET Data Date 29.10.2021

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