CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY

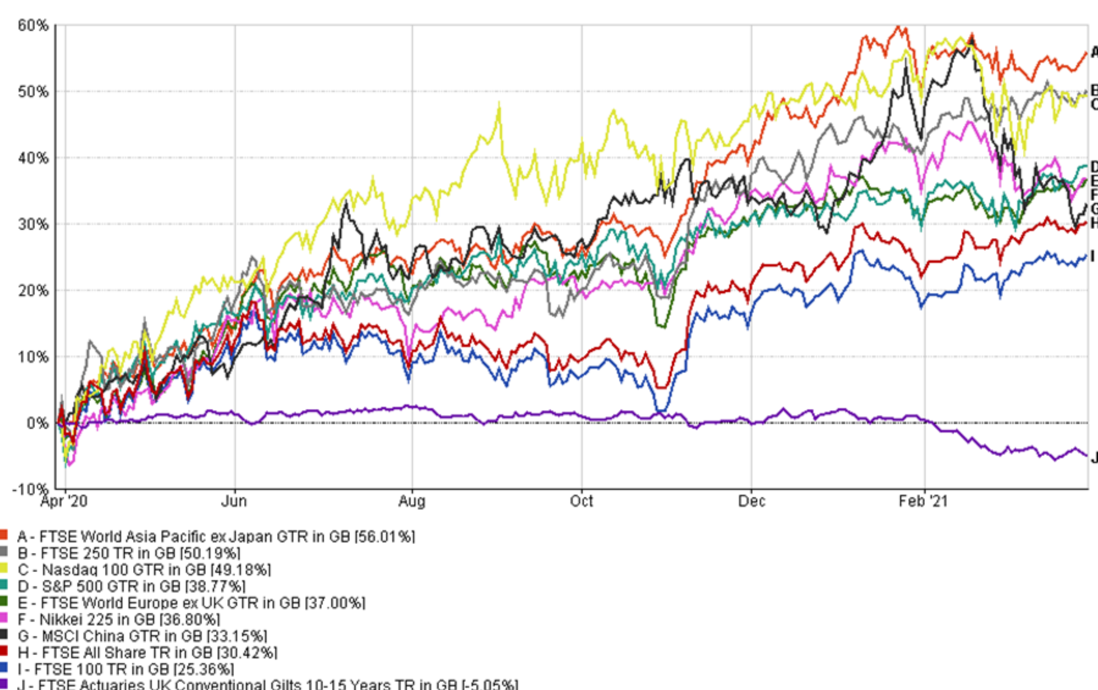
31 MARCH 2021

OVERVIEW

This time last year, we were facing the awful consequences of the potentially apocalyptic 'Covid 19' pandemic. In anticipation of 'worst case scenario' equity markets duly plummeted, whilst governments and central banks stepped in to support individuals and businesses - as the world plunged into global recession. Pessimism dominated with safe haven assets such as bonds, the US dollar and Japanese Yen all performing well. Most investors wished they had been holding more of them.

Over the first quarter of 2021, international confidence in Sterling has significantly improved, bond prices have fallen materially and investors are astonished by the strength of their 12 month equity returns. Having fought the case for equities last Summer – we are by this stage having to do the same for bonds. It is difficult because whilst some equities were undoubtedly over-sold, quantitative easing is all that is supporting bond prices - bonds remaining over-valued. We could have said just the same 12 months ago – but were glad to be holders then and on that basis, rest our case presently.

INVESTMENT MARKETS TOTAL RETURNS OVER ONE YEAR



30/03/2020 - 30/03/2021 Data from FE fundinfo2021

Balanced portfolios must always be positioned to face the 'unexpected' or the 'downside' which **will** eventually include the long overdue rout in the bond markets but not just yet. The money markets want lower bond prices and higher bond yields (and interest rates) because without them the 'risk premium' is insufficient. The central banks want the opposite and given their capacity to flood the markets with limitless credit, they will win for as long as they need to i.e. until growing economies and larger government revenues can support higher interest rates on sovereign debt.

In our commentary of 27 March 2020, we pointed to the fact that "the steep falls in asset prices do present opportunities" and it turned out to be so. Who would have thought that the FTSE 250 TR Index would be up 50% and the Asia Pacific ex Japan TR Index up 56% in Sterling terms? As we stated in the same bulletin, we need "to invest for the longer term looking through shorter term volatility". Equities proved to be the best place to be over the last year. Asian and Japanese equities made attractive returns as the regions coped with the pandemic relatively well. Whilst the US equity market was the stand-out performer over the early part of 2020 - especially its technology companies - the UK market finished the year strongly, as the approval and roll-out of vaccines almost coinciding with a UK/EU trade deal saw the market finally find favour. With the news of successful vaccines in November 2020, cyclical areas of the equity market i.e. those linked to improving economic conditions such as banks, oil companies and retailers performed well on the prospect of economies reopening as vaccination programmes gathered speed. The UK and European equity markets provide high exposure to companies of this type.

Economies will be 'jump-started' over 2021 as the pandemic recedes due to the approval, production, adaption and roll-out of more vaccines, coupled with greater testing. The prospect of stronger economic growth leads to fears that inflation will take off. Economic activity indicators for March point to manufacturing and service sectors continuing to improve in the main developed economies. Having seen his recent $1.9 trn stimulus package approved and actioned, President Biden is now proposing a US infrastructure plan totalling around $2.25 trn - albeit spread over the longer term – both programmes have the propensity to make the US economy run "hot". Pent up demand will be released (retail sales in the UK are already ticking up) and supply may be insufficient to meet it, so stoking retail price inflation. Normally the central banks would take action to suppress inflation by raising interest rates.

Based on current central bank rhetoric, it seems interest rates will continue to remain low, with the central banks prepared to accept a short period of above target inflation as economies recover - although last week's UK inflation figures remain below target. Investors worry that the central banks will be behind the inflation curve and be too slow in taking action. Unemployment has risen as companies laid off staff due to pandemic-induced financial stresses, despite government support. Whilst unemployment rates remain elevated, there will be less pressure for pay rises - which are usually key in pushing inflation higher. In a period of rising inflation, the returns from fixed interest securities are eroded and it is likely that 'growth' companies will not perform as well as 'value'/'cyclical' ones, as their future earnings will be less valuable if interest rates rise. The earnings of cyclical companies should benefit from a strong recovery in the global economy.

The Chinese economy was the only leading economy to grow in 2020, as the draconian measures implemented earlier to control the Covid-19 virus allowed the economy to reopen. The Chinese equity market performed well over 2020. However, performance has been weak in 2021, particularly in the tech sector. It would seem that President Biden is adopting a tougher stance than anticipated. Chinese companies face losing their US listings unless they can prove a foreign government does not own them and they follow US audit standards, which most seem unlikely to want to do. At home, the Chinese authorities are also cracking down on the biggest technology groups including 'Alibaba' and 'Tencent'. Investors are concerned that monetary stimulus will start to be withdrawn. Geo-political tensions have also intensified over violations of human rights against Uighur Muslims in Xinjiang and the continued erosion of human/legal/democratic rights in Hong Kong. The Western love affair with China is over presently. The West now has the unenviable task of containing China geo-politically, whilst continuing to exploit it as a market, turning a 'blind eye' to human rights abuses, beyond fairly token protest. Democratic values and geo-political risks rarely prevail against immediate economic expediency. We do not have specific Chinese exposure in our portfolios tending to prefer funds investing across the Asia Pacific region.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

Financial markets lumber on for extended periods – rarely uneventful – but sometimes without definite trends. In any domestic market, focus on immediate 'local' concerns will often distract attention from the global picture. Following such periods, events often move at lightening pace with the underlying picture fundamentally changed.

We have been talking about 'toxic' UK assets for years and the state of a FTSE 100 'with no definite prospects'. Yet between 30 March 2020 and 30 March 2021, the FTSE 100 has provided a 25.36% return to investors and the FTSE 250 more than 50%. Not such dullards if one invested only 12 months ago, but are they now over-valued? Can the same not be said of other equity markets which have largely delivered even more over the same period?

Presently, we consider the outlook for global equities remains positive. Corporate earnings can only improve as lockdowns ease and normal socio/economic activity resumes. As we said last month the global economy is in the process of recalibrating and that means businesses. There will be definite 'winners' and 'losers' amongst existing businesses and exciting new ones will emerge too. The demise of some creates fresh opportunities for others.

Does the closure of Debenhams and other well known high street stores presage the emergence of Amazon and similar as physical retailers? Britain is not a nation of shop-keepers – it is a nation of shoppers – and they need somewhere to go. Does anybody really believe Amazon is not alert to that? Ironically, the famed online retailer is likely to become the greatest advocate of the overall shopping experience. What is Netflix yet to do that will transform the world of cinema? Although highly valued already, such companies are capable of far greater future development.

Disrupters reform business sectors and at base level they destroy. Locomotive manufacturers which stuck doggedly to steam vanished, whilst those which developed diesel and electric alternatives flourished. Microsoft crushed an outdated Wang, whilst Apple developed a sophisticated alternative. Environmentally friendly technologies are critical to the world, to governments and to businesses. New fortunes will be earned for investors in these fields and in some instances at the expense of old ones.

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As always if you have any concerns please contact your usual Cartlidge Morland Partner/Director/Consultant.

OUR VIEW....continued

Due to the factors discussed earlier, only geo-political turmoil caused by unexpected events will lead to a surge in bond prices and reasonable profits in that sector. Bank deposits will not offer much until governments' prospective debt servicing costs are far lower as a ratio of GDP than they are presently.

In the publicly quoted investment arena, only equities are likely to provide strong returns presently with corporate earnings improving as countries and economies reopen through 2021. There may be more attractive debt (bond) opportunities in areas such as infrastructure and 'green' industries too.

We are mindful of the extent to which valuations have changed over the past 12 months but also that equities fell a long way last Spring, before their strong gains – and that in some markets (including the UK) valuations were far from demanding. US federal policy is vitally important; the huge stimulus the Biden administration is providing to the economy will be of significant global benefit. UK, Europe, Japan and Asia Pacific all export massively to the US. The greatest benefit of all will be to US industry and domestic consumers which means sentiment should remain highly favourable.

Currently, we encourage greater equity exposure than typical within our balanced portfolios. In more cautiously positioned portfolios, we shall be taking great care to encourage it too because without it there is significant danger that underlying investment objectives will not be achieved/achievable presently.

Overall risks must still be controlled and we therefore emphasise the value (the importance!) of maintaining an appropriate level of lower risk assets in portfolios as hedges are always needed in defence against the unexpected.

The partners and staff of Cartlidge Morland

wish you a very Happy Easter.

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