CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

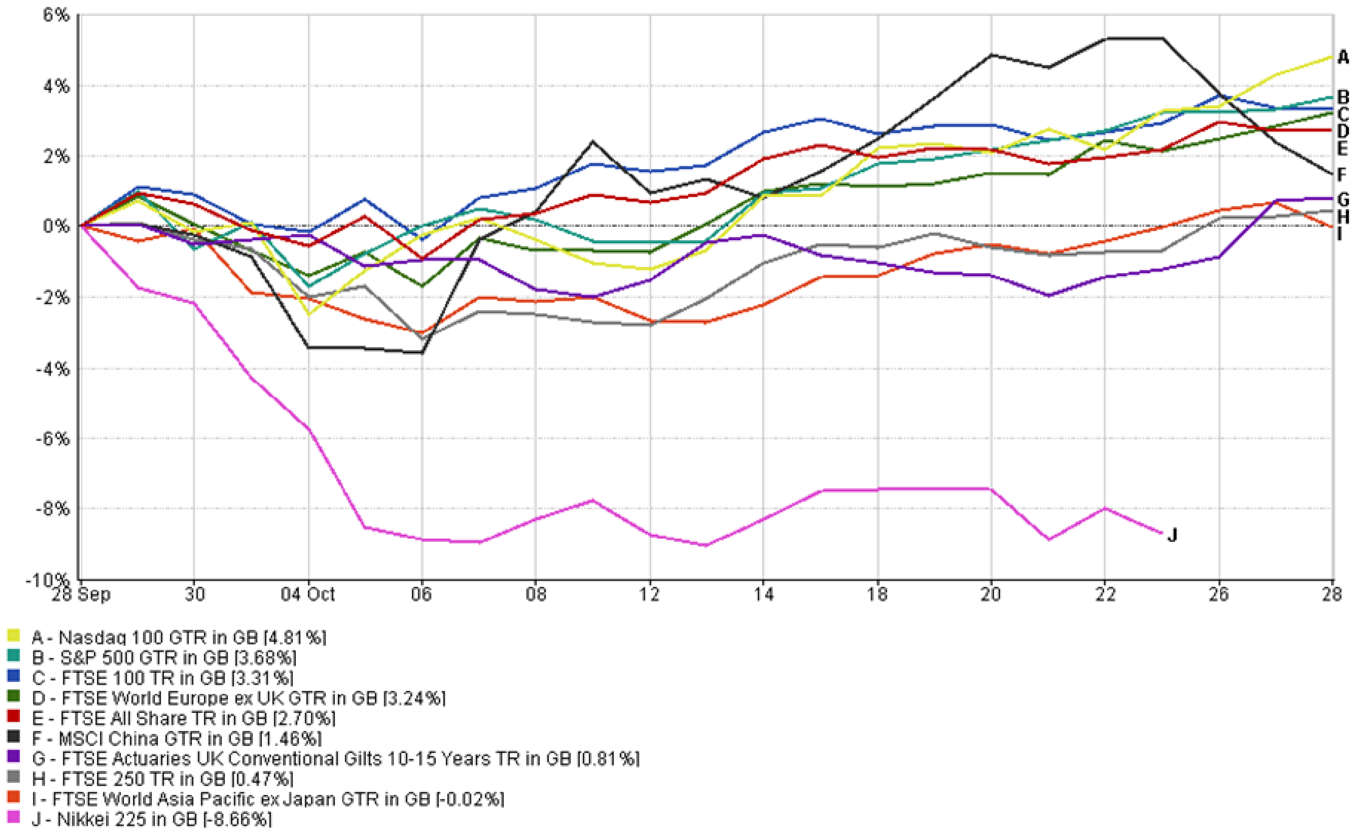
INVESTMENT COMMENTARY

29 OCTOBER 2021

OVERVIEW

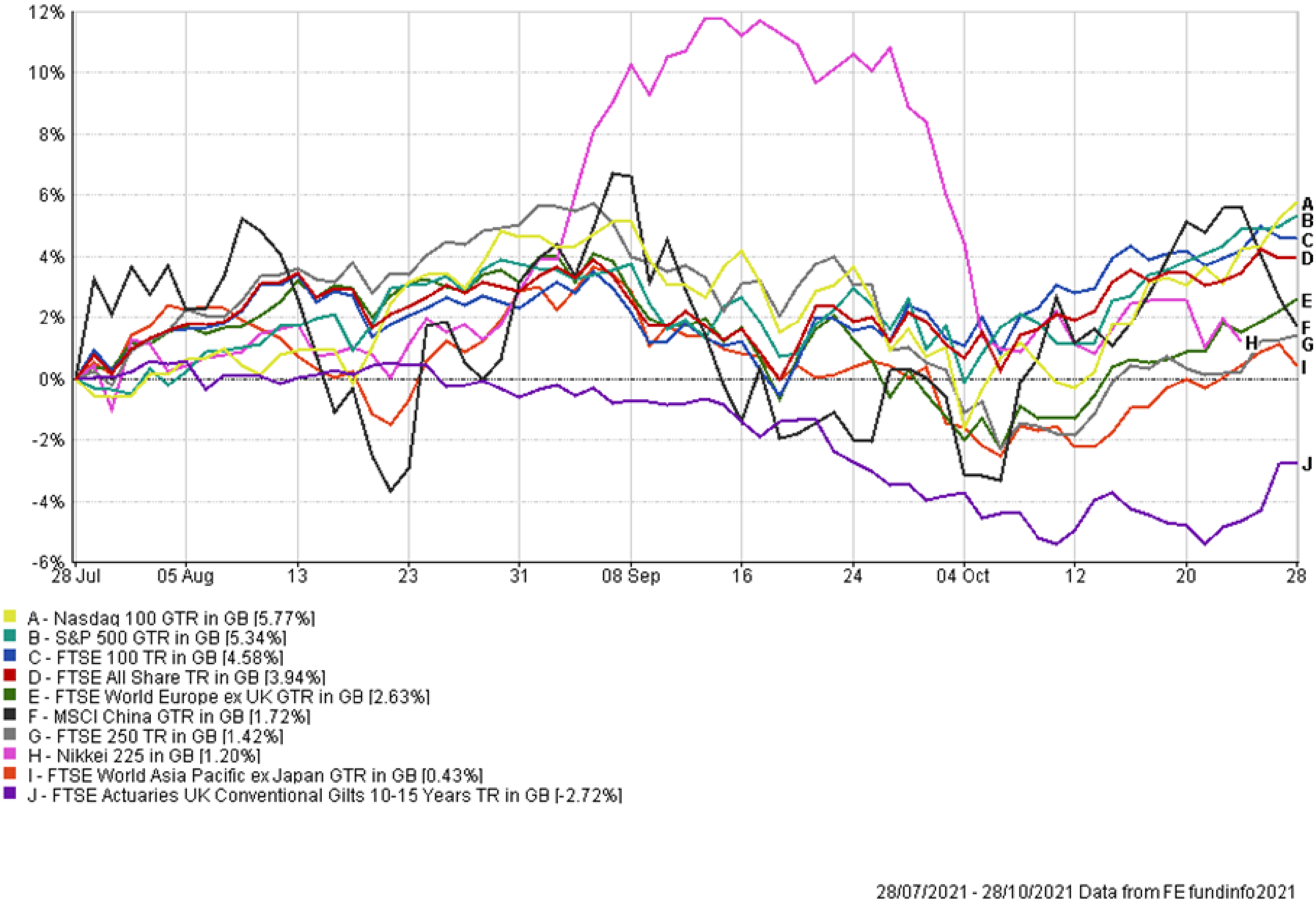
Over the past month, equity markets have made some strong returns with the US equity market reaching a new high and the Chinese equity market recovering to some extent from its summer lows. There have been some strong earnings reports in the latest quarter as economies continue their post-pandemic recovery, although the latest results from some of the big tech companies disappointed impacting on shorter term market movements. Inflation expectations remain elevated as soaring energy prices, manufacturing bottlenecks and a shortage of labour all add to price pressures and weigh on economic growth. The major central banks are poised to increase interest rates to quell inflationary pressures as the fear is the high level of inflation will persist longer than expected. Uncertainty over the timing of these rises continues - although the rise in UK interest rates could come as early as this week.

ONE MONTH INVESTMENT MARKET STERLING RETURNS



28/09/2021 - 28/10/2021 Data from FE fundinfo2021

THREE MONTHS INVESTMENT MARKET STERLING RETURNS



Economic data indicate that the US, eurozone and the UK continue to expand but at a slower rate as supply chain issues impact on economic activity. As a result, the US economy grew by 2% pa in the third quarter of 2021 (down from 6.7% pa in the second quarter) which was lower than expected but was also impacted by a rise in Covid-19 cases and slower consumer spending, as the government stimulus cheques were spent in March/April 2021. Economic growth in the eurozone is predicted to be about 2.2% pa in the third quarter with France and Italy outpacing Germany. The UK's GDP growth has been supported of late by strong activity in the services sector, in particular over the summer holiday period. China has also seen its economic growth slow with GDP growing at 4.9% pa in the third quarter down from 7.9% pa in the second quarter. The slowdown in the property market coupled with energy shortages and Covid-19 outbreaks are proving problematic for policymakers.

Above target levels of inflation are evident across the world with the levels in the US and Europe at their highest since 2008. Rising energy costs have had a significant impact as have labour shortages and manufacturing constraints as economies adjust after pandemic-related restrictions are gradually lifted. The consensus of the main central banks had been that the spike in inflation would be transitory. However, there is now concern that global supply chains may take longer to be re-established and that inflation will be more persistent. The major central banks are now expected to tighten monetary policy sooner, whilst the central banks of Australia, Canada and Brazil have already started this process. All eyes will be on the outcomes of US Federal Reserve and the Bank of England's (BoE) November meetings. The European Central Bank (ECB) seems to be working on a slightly different timeframe. At its most recent meeting, it kept its deposit rates on hold and postponed decisions on its level of bond buying until its December meeting. Christine Lagarde, the ECB President, commented that she sees inflation falling in 2022 and expected interest rates not to rise before the end of 2022. Persistently high inflation and the consequent interest rates rises are detrimental for bond values and weakness in bond markets reflects these expectations. The UK gilt market has proved an exception following the recent Budget as gilt prices experienced their biggest rise since March 2020. The UK government announced fewer planned debt sales, reducing supply by about £60bn – a much larger cut than expected. The strong rebound of the UK economy has increased tax receipts and the necessity for borrowing levels assumed by Treasury forecasters earlier in the year. Globally, investors have sought longer-dated government debt due to concerns that central banks may overreact to the inflation surge with higher than necessary interest rate rises. Economic recovery could then be derailed.

Developed equity markets performed well over October against the backdrop of a reasonable Q3 earnings season. The US equity market reached a new high but markets fell back on disappointing quarterly results from Apple and Amazon, as supply and labour constraints hindered growth. Tesla shares advanced further into the stratosphere as profitability, greater market penetration and a hundred-thousand car order from Hertz all materialised. Tesla remains a motor manufacturing minnow, yet its market valuation eclipses that of the major vehicle manufacturers combined. With the oil and gas prices rising as global demand outstripped supply, the value of oil and other energy and commodity companies increased as economies around the world rebounded from pandemic-related restrictions.

After a period of sustained weakness following a crackdown by the Chinese authorities on various sectors and slower economic growth, the Chinese equity market has recovered to some extent. Sentiment towards the badly affected technology sector has improved, as there is some thought that the worst of the regulatory clampdown may be over. Recent fines have been less than expected and Jack Ma, the founder of Alibaba - who criticised the Chinese financial regulators - has been travelling in Europe after not being seen for many months. However, Chinese regulation of the overall economy is still likely to be a consideration when investing in the region. Japanese equities had performed well in September after the Prime Minister Suga resigned and the prospective new Prime Minister, Fumio Kishida, pledged to provide a massive stimulus package. However, upon his appointment, he immediately sent the market into decline with his comments that capital gains tax may be increased. This is seen as a possible reversal of the more reform-driven Japanese economy of the last eight years.

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

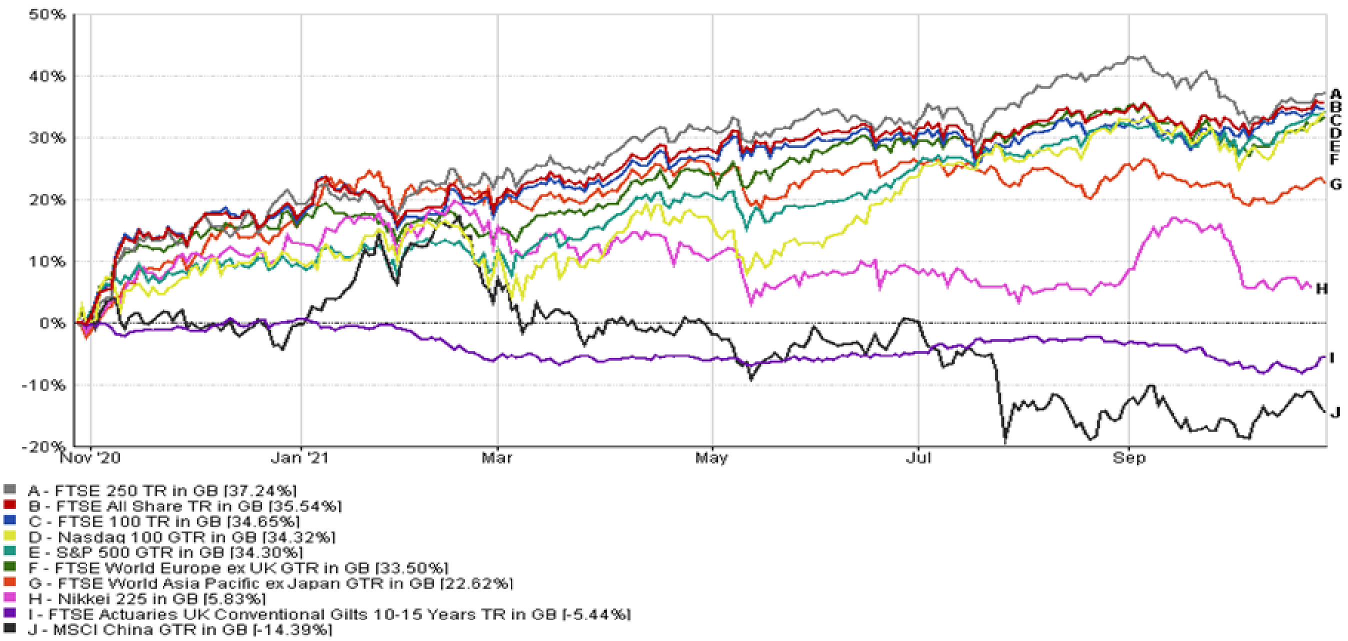
Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

It is almost a year since the news of a successful Covid-19 vaccine was announced and consequently there was a recovery in the equity markets. The chart below tracks the major markets over the last year and highlights the necessity of being invested in a diversified portfolio reflecting appropriate risk levels.

It is impossible to time equity markets – who would have thought that the UK mid cap index would out-perform the US equity market in sterling terms, with the UK equity market proving so unpopular after the EU Referendum in 2016? We invest for the longer term, taking into account income and cash requirements as well as risk tolerance. Portfolios are reviewed on a regular basis to ensure that the asset allocation and fund selection remain appropriate. We need to take note of inflation in portfolios - so index linked bonds, commercial property and equity funds may all be included. Within those equity funds, companies which have pricing power and strong cash flows should perform well. However, portfolios will continue to hold other fixed interest assets and cash as these provide protection in the event of equity market volatility.

ONE YEAR INVESTMENT MARKET STERLING RETURNS



28/10/2020 - 28/10/2021 Data from FE fundinfo2021

If you have any queries please do not hesitate to contact us via your Cartlidge Morland consultant.

OUR VIEW continued

Global economic growth for 2022 still appears promising as any increases in interest rates should be modest, supply problems will eventually ease – and it is forecast that elevated rates of inflation will moderate too over time. Covid-19 still has the potential to surprise on the downside and inflation may prove to be more deeply embedded than supposed – especially in the UK. Continuing concerns linger over the valuations of what have become the S&P 500 critical, mega tech stocks and whether they are 'riding for a fall'. Their importance to index tracking returns and to vast swathes of invested capital is often under-estimated, due to the S&P 500 being a supposedly broadly based index. It now represents an increasing concentration of risk which cannot be ignored.

Through fund selection, we increased US index tracking and tech/social media exposure during the worst of the pandemic and portfolios benefitted from it. Having acquired these additional exposures, we must take a long term view but it is likely we shall seek to divert profits into funds investing in more traditional US stocks which offer growth potential in the current environment of increasing US stimulus and likely elevated consumer demand.

Consolidating profits as markets advance further beyond pre-Covid levels is likely to be an increasingly important theme across most equity markets, especially in the case of portfolios from which income is being drawn. There is no shame in prudently consolidating gains even if markets do continue to advance afterwards. Core exposures will mean our clients should continue to gain from these – but no investor will thank us for profits which only ever exist on paper and which could abruptly disappear. Profits that are taken are available for withdrawal as income/gains or they can either be applied to areas seen as offering greater value/better medium term potential or embedded in lower risk sectors, as part of a recalibration of portfolio risk.

OUR VIEW continued

Whilst profit-taking is likely to become an increasingly important theme for the reasons described, it is important to emphasise that we still regard the global economy as being at the early stages of an expansionary phase and that against this background, companies, earnings and share prices should fare well. Neither higher rates of inflation nor interest rates are a welcome development for bond markets which remain distorted by central bank buying and their resultant holdings. Bonds will continue to provide insulation against the unexpected in global equity markets and the abrupt withdrawal of central bank support has long been virtually a fiscal impossibility. The major central banks intervened in concert in the bond markets and any lessening of support will need to be coordinated and gradual if their withdrawal is to be orderly. Importantly, the US Federal Reserve appears relatively relaxed about the currently high rate of US inflation and the Bundesbank appears resigned to ECB Chairman Christine Lagarde's very dove-like stance. Elevated supply side and political problems in Germany itself contributing to a decline in business confidence are probably the reasons for this. The Bank of Japan has long been addicted to highly accommodative monetary policy. Presently, the Bank of England is likely to be first to 'break ranks' in terms of interest rate rises and has already reduced its quantitative easing programme. It cannot go very far on its own, meaning the bank's scope to raise interest rates in 2022 is limited. Reduced gilts issuance (lower borrowing in consequence of greater economic expansion than anticipated) acts as support to gilts prices as BoE buying reduces.

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OCTOBER 2021 UK Budget — Our View

Chancellor Rishi Sunak's Budget stole the Opposition's clothes as he appeared to adopt exceptionally high-spending/higher taxation policies to maintain and improve public services, especially the NHS. The most significant factor in the UK's long-term legacy of 'poor productivity' is the outcome not of under-investment in capital equipment/skills training (as politicians of all hues prefer to discuss) but their own poor management of outcomes from the public sector, where productivity levels are very mixed. The danger is that the proceeds from higher taxes are not prudently allocated and spent, resulting in little improvement in outcomes.

The emphasis on a 'high wage/high skilled' economy was welcome. Making 'work pay' by providing 'living wages' without state support is vital for the economy and national finances. However, the more gradual withdrawal of Universal Credit as wages increase could lead to **employers** continuing to rely on taxpayer subsidy for under-rewarded workers. Increases in the minimum wage are a vital remedy for this situation and a series of real increases are promised. Definitely, unemployment is running at lower levels presently than predicted and in some sectors there are now labour shortages which could see salary levels increase to encourage applicants.

Over the extraordinary 'lockdown' period, the Chancellor has proved himself a conjuror in apparently being able to summon hundreds of billions of pounds of funding from nowhere. As tax revenues are higher than expected he can 'conjure' less money from nowhere and still spend more because the extent to which government expenditures exceed its revenues is less than he feared. Mr Sunak is of the view that as the results of tax increases flow into the system, he will achieve a budget surplus and begin to pay down debt by 2024/2025. That will be in time to allow some tax reductions in time for the next General Election. The threat to this scenario is that higher inflation followed by higher interest rates (increases of over 1% pa) could be sufficient to derail Mr Sunak's plans due to the effect on debt servicing costs.

The Chancellor cannot afford higher interest rates. His increased expenditure will be a stimulant countered to some extent by his tax increases so his Budget may not be inflationary. Certainly it is to be hoped this is the case because the BoE's scope to raise interest rates is limited both by the influence of other central banks and the government's debt servicing burden. The BoE says the latter 'fiscal' considerations will not influence its 'monetary' policy but that seems implausible.

The Budget is on balance supportive to the national economy but if the ability to control structural inflation has become too seriously impaired, there will be problems, if despite supply side problems subsiding, higher wages and demand for goods/services results in rising inflation and lower growth in due course. The Chancellor believes the latter outcome can be avoided, although it is by no means inevitable, financial markets hope that he is right.