Portfolio Review — *February 2021*

Twelve months ago in February 2020, stock markets hit their pre-pandemic high. The following month the world began to comprehend and react to the increasing threat of Covid-19 and with that we saw some of the most extreme market movements in recent memory. Whilst none of us could have foreseen just how much the pandemic would disrupt our daily lives, our belief that globally diversified investment portfolios without specific style biases were likely to weather the storm, proved to be well founded. We commented that this would not be a classic recessionary period, but one that should prove more short-lived and that fortuitously appears to have been the case, with the remarkable and speedy response to the development of a vaccination programme.

Learnings from the global financial crisis of 2008/2009, and the impaired growth dynamics that followed, led to timely and decisive policy intervention by many governments in terms of fiscal support, and from central banks in terms of monetary policy. Without doubt there are sectors that have suffered severely and may take years to recover and most of us will have some personal encounter with the consequences of Covid, but there now does appear to be grounds for real optimism. Many commentators are anticipating a synchronised global economic recovery during 2021 helped not only by the lifting of lockdowns but also the dual tail winds of pent-up demand and structural restocking. Globally, the number of companies seeing earnings forecasts revised up in comparison to those seeing downward revisions, is high relative to history.

But with this good news could come a slight sting in the tail and particularly for bond markets, with respect of the "I" word – inflation.

Policymakers have to tread a fine line between allowing economic momentum to build whilst ensuring investors remain confident that inflation will remain under control in the medium term. This could become increasingly difficult as the year progresses, as year-on-year comparisons of inflation figures could come in significantly higher than expected due to base effects at a time of strong global economic growth. Developed economies are proving more resilient to lockdown restrictions in 2021 than they did in early 2020 and current forms of lockdown are also doing less damage than many observers feared. There are expectations that economies will emerge strongly from lockdown. With inventory levels at historic lows, elevated savings rates, and an abundance of liquidity due to central bank stimulus, we could see global growth and demand lead to a higher than expected output. The potential of strong post-COVID growth, along with higher inflationary pressures, could also see energy needs, and therefore prices, rise.

As a result, at the end of the month we saw a big rise in bond yields across global regions and maturity durations. A rise in yields is a reflection of a fall in capital values. And as markets begin to expect the recovery in demand will be strong enough to push up the price of goods and services, their fear is the risk that this turns into structural inflation and therefore to mitigate this risk, bond holders demand higher yields. The Federal Reserve (Fed) believes some of increase in bond yields is justified and indeed

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was welcomed as it expressed greater confidence in the Fed meeting its targets. Even an increase in real yields from historically low levels is not unwelcome if it reflects an improving medium-term outlook.

Investors should be re-assured that central banks want to play a role in smoothing out the rational increase in long-term bond yields. Indeed, Jerome Powell and his Fed Reserve officers conceded inflation would likely advance, but only temporarily as this wave was due to the low staring point. Stronger and sustained price pressures wouldn't come because the economy was still too weak to support such moves. Overall, the rapid and widespread dissemination of vaccines is setting the foundation for strong growth once economies start reopening. Vaccine rollouts have been particularly brisk across the U.S. and UK. Latest U.S. data indicate that if the current pace of dose administration persists, close to 75% of the U.S. population aged 16 and older could be fully vaccinated by early September. Further, experts now project that 16% of the global population could be vaccinated by the end of 2021. Critically, the projected rollout is likely to be broad-based across geographies. If it is, that would be a remarkable achievement against a deadly virus that only emerged about a year ago.

The U.S. Congress, working with the new Biden administration, is now preparing another round of fiscal stimulus that will likely be approved within the next month. Although it will fall short of the White House's original proposal, it seems set to top USD1 trillion, or more than 4% of GDP.

In the UK, all eyes are on this week's Budget where chancellor Rishi Sunak will be walking a fine line between supporting a fragile economic recovery and tackling a high and mounting debt level. He will have to decide whether to raise taxes to balance the deficit or further support consumers and jobs until the economy is on a steadier footing.

Portfolios

Against this backdrop of vaccine rollouts and improvements in the outlook for economic growth, global equity markets rose in the first part of the month before pulling back sharply in the last week as global bond yields rose. For the month as a whole most major indices ended broadly flat, with UK stocks being the best performers in sterling terms.

Sterling gained strength to reach its highest level against the dollar in nearly three years ($1.42) putting pressure on the majority of overseas earners that make up the FTSE 100, which returned 1.58% for the month. The more domestically focused FTSE 250 fared better and therefore, by extension, the FTSE All Share which delivered a slightly higher return than the Blue Chip index of 1.99%.

At the other end of the scale, markets in Asia and Japan were the weakest performers over the course of the month ending marginally down in sterling terms. In the US, the tech heavy Nasdaq Composite posted its worst month since October as the likes of Tesla and Amazon came under pressure.

At a sector level, energy stocks had a strong month as the oil price rose to $66 a barrel and we saw a rotation into cyclical stocks fuelled by optimism around the reopening of the global economy. This shift

led value stocks to outperform their growth counterparts, leaving them well ahead for the year to date, while small caps outperformed large caps.

However, as outlined above, the biggest moves during the month were in the fixed interest space where bond yields rose sharply (and correspondingly prices fell) to their highest levels in a year, causing government bonds to significantly underperform. This pain has not been confined to government bonds, with high quality corporate bonds also suffering.

In terms of our portfolios, these moves were exemplified in returns, with those portfolios that have a higher degree of exposure to fixed interest underperforming those with more equity content. In particular, the Vanguard UK Inflation-Linked Gilt Index fund, which fell 5.02%, weighed on portfolio returns. Another notable detractor was the Foresight Global Real Infrastructure fund, down 6.5%, which is also correlated to bond yields.

However there were some stand out performers, most notably the Amati UK Smaller Companies fund which returned 4.02%, benefiting from the strength in sterling and the Natixis H2O Multi Returns fund, which rose 6.78%.

The best performing portfolio was the Income portfolio, which returned 2.13% over the month. This benefited from a high degree of exposure to the UK and, in particular, to equity income funds which have more of a value bias. The best performing fund in the portfolios was the JOHCM UK Equity Income fund which delivered a very respectable 7.33%.