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Portfolio Review *March 2021*

The month and the end of the first quarter of 2021 has brought mainly good news for UK-based investors with exposure to global stock markets. Equity markets have generally resumed an upward trajectory, while traditionally lower risk assets, particularly long maturity bonds, have sustained some losses. These fluctuating investment dynamics are reflected in the returns of portfolios of differing styles. The income portfolio, having an investment make up of a higher percentage of value stocks, has now outperformed growth portfolios over two consecutive quarters and whilst the growth portfolios are all in positive territory, the lower risk portfolios have been affected by the fixed interest headwinds.

It is easy to forget the start of quarter turmoil when the US Capitol was stormed and five people died. Donald Trump is no longer the dominant force within US politics, and successor Joe Biden's reputation as an effective and seasoned political operator has brought a welcome return to some sort of normality. It is traditional for 'the first 100 days' to be the most active period in every US presidency and so far, Joe Biden and his administration seem determined to make every day count. By 11 March, the $1.9 trillion American Rescue Act was passed. Its major component of direct payments to most adults of $1,400, along with $3,000 per child for lower income households, is almost complete. On the last day of the quarter, Biden's administration proposed $2.25 trillion of government-directed infrastructure spending spread over eight years, signposted as the first half of a ten-year $4 trillion investment programme. Much akin to start-up investments in new corporate ventures, the ultimate aim is to create a bigger economy, one with the capacity to generate a higher return on the investment than the cost of finance. If well executed, the administration's ambitious infrastructure plan has the potential to boost long-term economic growth and though higher taxes are likely to be a modest negative for stocks in the near term, they will be quickly priced in by the market, as the stimulus spending will be spread out over several years.

On the back of this, the S&P 500 rose above 4,000 for the first time as investors decided that a rapid roll-out of vaccinations, the consequent re-opening of the economy and unprecedented fiscal and monetary stimulus will deliver strong growth and rising profits. The US economy is forecast to be 8% bigger in the last three months of this year than it was in the final quarter of 2020. Companies most exposed to a strong cyclical upturn have fared best of all. Commodities, too, have built on last year's strong gains, with copper costing almost twice as much as it did last April. Conversely, long-term government bonds have delivered their worst quarterly fall since 1980. Fixed income investors are worried about precisely the same things that are pushing the stock and commodity markets to new heights, namely recovery, growth and inflation, leading in due course to higher interest rates.

In the UK, equities performed well. Lowly-valued, economically sensitive areas of the market extended the recovery seen since November. This was reflected in a very strong performance from materials, energy and financials. Banks performed particularly well amid better-than-expected results and a sharp increase in bond yields as the global economic outlook improved. A number of domestically focused areas of the market also outperformed as the forward-looking data for the UK economy improved. The composite PMI rose in March to 56.6 signifying increasing confidence and the fastest rate of economic expansion for seven months ahead of the easing lockdown measures towards the period end. Whilst the vaccination programme has started to slow, both as expected and also in part due to the early Easter

break, 31.6 million people have now received a first vaccine while 5.4 million have had two jabs. The Government lockdown exit plan therefore remains on track with non-essential retail to re-open on 12th April and confidence in the economy continuing to build.

European equities also advanced and hopes of global economic recovery supported sectors that fared poorly in 2020, such as energy and financials. Consumer discretionary stocks also performed well, whilst underperformers were defensive areas that are less tied into the economic recovery, such as utilities and real estate. However, the pace of vaccine rollout has hit the timing of economic recovery putting Europe possibly up to six months behind the UK and US. The vaccine spat with the EU continues as France imposes new lockdown measures. A senior EU policymaker said zero jabs would be shipped across the Channel to the UK if Astra Zeneca failed to meet its commitment to the EU. However, Pfizer criticised the EU for unnecessary administrative burden in rolling out vaccines and urged the EU to back down on threats to block vaccine exports as an essential ingredient for its vaccine is made in Yorkshire. So whilst the Eurozone PMI economic activity indicator readings for March were ahead of expectations with the manufacturing outlook positive, the outlook for the services sector has been particularly overshadowed by the risk of a third wave of Covid-19 infections and delays in vaccine rollout.

Japanese equities continued to rally as visibility on the corporate profit recovery improved after a strong set of quarterly results. Sentiment was also helped by the consistent weakness of the yen against the US dollar. The market was led by cyclical sectors and lower quality value style stocks, partly in response to early indications of changes in global interest rates and inflation expectations.

Asia recorded a positive return amid continued investor optimism for a return to economic normality. However, sentiment weakened towards the end of the quarter as slower vaccination rollouts led to the reintroduction of lockdown restrictions in some countries.

Portfolio Commentary

Global equity markets ended the month largely in positive territory, led by gains in the US, where greater than expected stimulus measures and vaccine progress resulting in new record highs for both the Dow Jones Industrial Average and S&P 500, up 9.6% and 5.7% respectively. In contrast, the tech-centric Nasdaq Composite ended the month with a modest gain of 1.8% as growth stocks continued to underperform value.

In the UK, the commodities heavy FTSE 100 was up 4.2%, slightly outperforming the broader FTSE All Share return of 4.0%, whilst smaller companies fared better still returning 4.3%. The weakest performances came from Japan, Asia and Emerging Markets as new lockdown measures in Europe dented hopes of a broad-based global economic recovery and a sell-off in Chinese technology stocks weighed on investor sentiment.

March saw a continuation of the themes that have dominated financial markets over the course of the first quarter, namely rising bond yields and a rotation from growth to value stocks. Whilst stocks have encountered some volatility, they have largely powered ahead over the quarter with cyclical stocks –

those sensitive to economic momentum – continuing to lead, building on the outperformance that began with the positive vaccine news last November.

The rise in bond yields has been closely correlated with the significant outperformance of financials and value stocks. Value stocks are up 9.8% year-to-date compared to just 0.3% for growth stocks, whilst small-caps continue to outperform large-caps.

In fixed interest markets, after weeks of declines in government bond prices, yields retreated from the 14-month peak hit earlier in the month after the Federal Reserve made clear its intent to stay well 'behind the curve' on inflation, keeping short-term rates low for longer and adopting a wait and see approach for inflation to materialise. The extent of moves in government bond markets since the start of the year have made it the worst quarter for the asset class in more than 30 years.

At portfolio level, pleasingly all models delivered positive returns for the month and quarter as a whole. The Income portfolios once again outperformed their Growth counterparts thanks to their exposure to income-generating value-based strategies. In terms of the Growth portfolios, those with the highest exposure to equity markets performed better than those with greater fixed interest allocation, reflecting broader market moves.

Unsurprisingly those funds with an income or value bias were the best performers over the course of the month, with JOHCM UK Equity Income once again coming out top delivering a return of 6.6%, whilst strong performances from the global equity income funds also contributed to overall portfolio returns. The Growth portfolios benefitted from the strength of the US markets via the Vanguard US Equity Index fund which returned 4.8%.

At the other end of the scale the weakest performing funds in the portfolios were unsurprisingly those in Asia, Emerging Markets and Japan, largely reflecting market movements over the course of the month.

Whilst fixed interest remains under pressure, pleasingly the funds held in this area delivered modestly positive returns over the month with the Vanguard UK Inflation-Linked Gilt fund up 1.9% on the month, although this remains in negative territory for the year-to-date.