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Portfolio Review *August 2021*

So as summer gives way to meteorological autumn, the temperature begins to cool. The same could be said of markets as, having enjoyed the summer, which is normally a quiet period for markets, a number of issues bubbling under the surface are beginning to focus the attention of investors.

Ongoing global recovery concerns continued to overhang markets and there was some profit-taking in risk assets following the release of the latest minutes of the meeting of the US Federal Reserve (Fed)- more on which shortly. However, slowing global economic growth, Fed tapering, and increased Chinese regulation has hit commodities particularly hard with copper at a four-month low and iron ore down by 18% so far this year.

The question of inflation continues to be whether it is transitory or insistent and with us long term. The early spikes have been skewed by post COVID supply issues both in materials and supply chain as well as labour disruption in certain sectors. In the UK and Europe this has been compounded by "local" issues such as Brexit. In terms of central banks' inflation targets only Japan and China are currently below their inflation targets but after a long period of subdued inflation, there is a feeling that some inflation is good and that the current spikes should be short term. Longer term central banks are predicting that inflation will return to within their expected target levels and therefore are not concerned to make adjustments too quickly. Whilst there is some evidence of wage inflation picking up, this needs to be coupled with an increase in profitability otherwise profit margins may well falter.

As a counterpoint to inflation, the rise of the Delta variant is providing some deflationary impetus. Although vaccines are continuing to reduce hospitalisations and deaths significantly, some doubt has been cast over the lasting efficacy of Covid-19 vaccines after an increase in infections amongst the fully vaccinated. An Oxford University study indicates that infected people carry the same viral load even if they have been fully vaccinated. Meanwhile, the Delta variant has continued to spread globally. Investors remain concerned that additional lockdown measures could disrupt global supply chains even further and hence economic recovery. At the same time, some of the longer-term systemic deflationary pressures such as an ageing population, the levels of debt and the disruptive nature of technology development, also continue to keep some downward pressure on prices.

With long-term central bank support since the recession of 2008, the key question continues to be to what extent the tapering of these quantitative easing measures will have on yield curves, and therefore capital markets, and how and when this will appear. There is an increasing belief that the loose money policy is no longer needed and central banks are looking at some tapering. A recent speech by Chairman Jerome Powell at the Jackson Hole symposium reflected the Fed's desire to "keep options open". Three key messages from his speech were that inflation and growth have demonstrated sufficient progress to justify starting tapering in 2021; that the spike in inflation was transitory, but wage inflation could become more persistent and finally that any interest rate lift off was disconnected from tapering. Central banks are keen not to choke off any recovery and will look for a slow and steady tapering for markets to remain orderly and, in the US, complete any tapering cycle before increasing interest rates.

With regards to the economic cycle, there is evidence that we are past the peak point and so the question is where are we? Is this a pause for breath on a continued expansion cycle or are we moving to slow down? We've seen a sharp recession with the advent of COVID followed by an equally dramatic recovery and

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so what will continue to drive the current expansion? In this area there are some grounds for confidence as in both the UK and US there is evidence of rising capital expenditure and business investment plans indicating companies' confidence for the future. It also appears this confidence is returning quicker than in previous recessions, not least due to the financial support that has been put in place through recent economic difficulties.

Looking at equity markets, valuations across most major asset classes continue to be a concern with many markets above their 25-year average, however opportunities do remain. UK valuations on the whole remain under-stretched. Emerging markets are currently out of favour but are actually at a 20-year low in terms of valuations versus developed markets. There is a concern of the rising regulatory risk in China but some commentators welcome this intervention as a way of curtailing monopoly in a large market. The re-distribution of wealth or rather 'common prosperity' are the latest thoughts to emerge from President Xi Jinping. This is in addition to the passing into law of a new set of rules for the Chinese technology sector.

Finally, corporate earnings continued to recover strongly in the second quarter but there is some concern on the ability to sustain earnings growth as output prices struggle to keep up with input costs. As we said earlier, there are opportunities and the key here will be to look at companies that have the ability to retain their profit margins despite increased costs.

Portfolios

Global equities gained in August, delivering total returns of 2.5%, supported by the well-regarded speech from Jerome Powell at Jackson Hole outlined above. US equities were once again among the top gainers, reaching new highs yet again. European equities also gained supported by a positive Q2 earnings season and ongoing economic recovery from the pandemic, while small and mid-cap UK equities also rose thanks to continued M&A activity. However, the wider UK market lagged other developed regions as global asset allocators remained indifferent towards UK equities. Elsewhere there were also gains for Japanese equities, despite a continued rise in Covid infection rates, and in Asia and Emerging Markets where investor sentiment was boosted by the continuing global economic recovery.

In bond markets, global bond yields rose modestly in August meaning prices declined with inflation and the withdrawal of monetary policy support being the main focus for markets. There were small negative returns for government and investment grade corporate bonds, although high yield bonds produced positive returns. Commodity markets were weaker, largely driven by a sharp decline in the energy component as a spike in the Delta variant threatens to slow the recovery in the demand for oil. Precious metals also declined thanks to a strong fall in the price for silver, although the price of gold rose slightly during the month.

The Beckford James portfolios once again enjoyed positive performance across the board and are comfortably ahead for the year as a whole. In a similar pattern to previous months, the Ethical portfolio was the strongest performing portfolio, delivering a return of 4.05% and was also ahead of its benchmark return. This was followed by Growth 10, returning 2.77%, through to Growth 3 delivering 1.19%. Whilst these positive returns are pleasing, they slightly lagged their benchmark returns, although over such a short time period and by only a few basis points is not a cause for concern. The Income and Balanced Income and Growth portfolios returned 2.42% and 2.15% respectively and were ahead of their benchmarks.

There were some strong performances from many of the funds in the Ethical portfolio, most notably the Baillie Gifford Positive Change and Stewart Asia Pacific Sustainability, both returning in excess of 7%. In the Growth and Income portfolios, funds in Japan and Emerging Markets topped the leaders board, with Baillie Gifford Japan up 5.69% and JP Morgan Emerging Markets Income up 5.32%. Other notable performers included the Goldman Sachs Global Millennials fund, up 4.31%, and the Amati UK Smaller Companies fund, up 3.95% reflecting the outperformance.