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Portfolio Review *September 2021*

With a definite autumnal feel in the air, we approach the anniversary of the announcement of the first Covid-19 vaccine in November last year. Since then, 47% of the population around the globe have received at least one dose of the vaccine and the economic recovery, not to mention stock market performance, since then have been nothing short of remarkable. However, the events of the last 18 months have demonstrated the fragility of the delicate supply and demand balance in our very global economy.

Labour shortages and supply issues in food distribution and fuel have dominated headlines in recent weeks, but non-food retailers are encountering similar setbacks as they gear up for their busiest period of the year. Commodity price inflation, huge increases in shipping costs, container scarcity and congested ports are among the issues facing many retailers. Problems over the summer at some major Chinese ports and the blockage of the Suez Canal earlier in the year have compounded bottlenecks. Christmas cheer it seems is set to be rationed this year as logistical challenges both at home and overseas look set to narrow product ranges and result in less discounting during the festive season.

Supply chain disruptions, as well as ongoing impacts from the Delta variant have seen economic growth numbers start to moderate in recent months, while simultaneously creating inflationary pressures on everything from agricultural produce to electronics and medical supplies. And whilst panic hasn't been enough to dent stock market returns yet, forecasters such as the Centre for Economic and Business Research (CEBR) predict supply chain disruption could see economic growth fall by one percent. Added to the inflation already in the pipeline, all this translates into stagflationary winds for the global economy that will be unfamiliar to those that did not live through the 1970s.

It is no surprise therefore that inflation has once again been the dominant focus for investors as data continues to exceed expectations. In the UK, CPI increased 3.2% year-on-year in August, the biggest monthly gain for over 20 years, while in the US the figure rose at an annual 5.3%. Whilst central banks continue to stress the temporary nature of these increases, there was a noticeable shift in rhetoric from policymakers last month that contributed to a rise in government bond yields.

At its September meeting the Federal Reserve (Fed) indicated that it will soon begin tapering the pace of asset purchases, or quantitative easing, and expects to stop all purchases by mid-2022. In addition, the Fed released its projections for interest rates over the next few years, with the expectation now that interest rates will start to rise in the first half of 2022 and reach 1.75% by the end of 2024. This pace of increase is faster than the Fed had indicated just a few months ago and led to a rise in bond yields (a fall in prices) at the end of the month. This hawkish tone was mirrored by the Bank of England, with a suggestion that a rate rise by the end of the year may be warranted.

The negative news from China has seemed relentless in recent months, first in respect to regulation in private tutoring companies followed by technology companies. Last month investors had to contend with fears around the potential default of one of China's largest property developers, Evergrande, and markets held their breath to see whether this would become China's Lehman Brothers moment with potential spill over effects into the wider economy. As it was, a restructuring deal of the company's debt

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was agreed and the company will sell off some assets in order to meet their debt obligations. All of this uncertainty has weighed on Chinese equity markets at a time when growth in the economy is beginning to slow.

On the pandemic front news in relation to Covid-19 has improved in recent weeks as global virus cases declined in September, largely driven by a fall in cases in Asia after a sharp rise in July and August. Clearly the onset of winter brings with it some uncertainty in relation to the potential impact on health systems, however even if hospitalisations were to rise again it is likely the economic recovery will be delayed rather than derailed at this point thanks to the healthy savings balances consumers have accumulated. These elevated savings, along with solid wage growth, should also help consumers to absorb price increases in goods and services that is currently underway.

Following strong gains in August, global equity markets fell heavily in September as a growing list of concerns emerged. The MSCI World index posted its first negative return since January, down 2.2%. Worries over high inflation, weakening growth and the prospect of rising rates were compounded by falling commodity prices and wider concerns in China following the Evergrande debt situation. Although markets ended the third quarter in positive territory, the headline figure masks the damage done in September which erased some of the strong gains from earlier in the quarter.

Beneath the surface there were some material differences in sector performance. The energy sector bucked the trend to deliver positive returns, continuing its market leadership of the year so far as energy prices continue to climb. The price of Brent crude rose 10.3% during the month to reach over $80 a barrel for the first time in three years and is 30% higher compared to six months ago. Rising gas prices due to shortages in Europe, along with higher coal prices due to shortages in China, also helped boost the price of oil. Elsewhere the financial sector, particularly UK domestic banks and insurers, also did well benefitting from the rise in bond yields towards the end of the month.

In contrast to the energy sector, falling industrial commodity prices such as iron ore (down 25%) and copper (down 10%) resulted in materials stocks being among the worst performers in the month. Interest rate sensitive stocks, including utilities and real estate, also suffered as bond yields rose. Style wise we saw a rotation back towards value stocks while growth and quality stocks underperformed. The US mega-cap technology names, the so-called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) were particularly hard hit, reversing the trend of the last six months.

At a regional level, UK indices fared better than their developed market counterparts with the FTSE All Share index down 0.96%. A higher weighting towards oil and financials in the index prevented much larger falls seen elsewhere, whilst a weaker pound also helped boost multinational stocks. In the US, the S&P 500 ended 2.7% lower, breaking its seven-month winning streak and giving its worst monthly return since March 2020. In addition to investor worries already discussed, fears of political gridlock leading to a potential US debt ceiling default compounded investor woes. European stocks also fell sharply amid fears that the eurozone economy might be sliding into a period of low growth and high inflation (stagflation) and the euro depreciated against the dollar.

The best market returns came from Japan. Although Japanese equities had been rangebound in July and August as Covid cases rose, markets rallied 4.8% in September. Emerging Market equities underperformed amid the sell-off in China. Fixed Income markets also underperformed as bond yields moved higher. High yield bonds were the best performing area of the fixed income sector.

Portfolios

The Beckford James Portfolios mirrored moves in equity and bond markets to deliver negative returns for the month. The best performing model was Growth 4 which returned -0.71%, whilst Growth 10 returned -1.15%. These performances were marginally behind their benchmark returns, although in all cases by less than 10 basis points and all portfolios remained in positive territory for the third quarter and comfortably ahead for the year to date.

In terms of underlying fund performance, the best performance came from the Japanese holdings with the Vanguard Japan Stock Index fund up 4.9% and Baillie Gifford Japanese Smaller Companies fund up 1.31%. Property funds also proved resilient in volatile markets with L&G Property returning 1.6% and Threadneedle UK Property up 1.2%. At the other end of the spectrum, the ongoing issues in China resulted in poor performance for the Baillie Gifford Emerging Market fund which fell 3.6%. Elsewhere the Goldman Sachs Global Millennials fund declined 3.5%, being exposed to US growth names, which underperformed as outlined above.

The Income portfolio fell 1.10%, however despite the negative return did not fall by as much as its benchmark, thanks largely to outperformance from some of the equity income funds held, notably the Schroder Global Equity Income and JO Hambro UK Equity Income up 2.3% and 1.6% respectively. The Income portfolio has returned 11.84% year to date, making it the best performing Beckford James portfolio.

Lastly, in a reversal of previous months' trends, the Ethical portfolio was the weakest performing model for the month, delivering a return of -2.47%. Whilst this was behind its benchmark for the month, it was the best performing portfolio in the third quarter (up 3.25%) and has also delivered very strong returns for the year so far as a whole.