Beckford · James

chartered financial planners

Portfolio Review — *October 2021*

This November sees the UK play host to COP26 – the 26th Conference of Parties – where global leaders from almost 200 nations will come together and discuss climate objectives and, more importantly, revisit the commitments as made as part of the 2015 Paris Agreement. The parties are likely to agree that efforts will need to be meaningfully increased to ensure that achieving net zero by 2050 is within reach. But what will this mean for investors? There's no doubt that in the coming years companies can expect a raft of policy changes, with governments increasingly targeting public spending on infrastructure. Companies are likely to face higher costs as a result of the broader adoption of carbon reducing initiatives, however they may find markets reward them for focusing investment spending on climate-related issues. Companies that can get ahead of impending changes and work with governments to achieve their goals are likely to be rewarded in the longer-term.

Climate change issues only added to the list of worries that caused investors to pull back from equities in September and set the tone for the start of the fourth quarter. These headwinds included slowing global growth, rising inflation, surging energy prices, supply chain bottlenecks and China's property market woes to name but a few. However, after a weak start to October stocks regained the momentum that they have enjoyed for the majority of this year and many equity indices reversed September's losses and reached new highs during the course of the month.

There were two broad reasons why investors turned positive during October. Firstly, outside of the UK, Covid-19 cases have been steadily declining, particularly in the US, which has led to improving consumer expenditure patterns and providing a boost to the global economic growth picture. Secondly, third quarter earnings results season is in full swing and has so far followed in the footsteps of the previous two quarters to deliver record beating results fuelling investor appetite for risk. Earnings are one of the most important drivers of share price returns over the longer term, so it is unsurprising that investors chose to focus on these ahead of inflation and interest rate factors.

In the US over half the companies in the S&P 500 have reported results with around 65% beating analysts' earnings estimates, driving strong gains for US stocks. For now, it appears profit margins are holding up as companies have been able to offset higher input costs through price increases which consumers are seemingly willing to accept due to higher savings rates and health discretionary spending capacity. As in previous quarters, financials, energy and technology were the key gainers although there were some high-profile disappointments from the likes of Apple, Amazon and Starbucks. In the case of Apple supply shortages for component parts – in particular semiconductors – means they are unable to meet very strong demand which is negatively impacting underlying growth. The key question for these companies is what will happen to this demand going forward? Will it just defer sales or will demand destruction occur if supply chain challenges persist for longer than expected.

At a more macro level, the second budget of the year provided an upbeat view of the UK's pandemic economic recovery, with growth forecasts being revised up. The Office for Budgetary Responsibility (OBR) revised its GDP forecast from 4% in March up to 6.5%, but also revised down its 2022 forecast from 7.3% to 6% - though this is largely a function of a faster recovery from the pandemic recession. The revised growth outlook was also accompanied by a rise in inflation forecasts with the OBR now predicting inflation will average 4% in 2022, before falling back to 2.6% in 2023. Assuming the economic recovery continues as planned, the chancellor is on track to lower borrowing and debt levels just in time for the next pre-election fiscal spree.

With investors focusing on better prospects for economic growth and solid corporate earnings, markets rose strongly during October with the MSCI World Index returning 3.9%. US equities delivered the best returns with the benchmark S&P 500 up 5.2%, its strongest month since November 2020. In addition to strong market data, political concerns dissipated somewhat as issues around the debt ceiling were inevitably resolved and as progress was made towards further fiscal stimulus packages.

UK equities also rose in October, helped by a strong start to the domestic Q3 reporting season. Internationally focused sectors led the market higher, with banks in particular, performing very well amid growing expectations central banks will react decisively to rising inflationary pressures. Large-caps outperformed small-caps with the FTSE 100 Index rising 2.2%, while the broader FTSE All Share Index rose 1.8%. It was a similar picture in Europe, where strong earnings releases helped to reverse some of September's losses with the FTSE Europe ex UK index rising 3.0%.

Japan was the weakest performing equity market in October, with the TOPIX falling 5.1%, as investors digested the prospects for the new prime minister Fumio Kishida. Despite the Liberal Democratic Party (LDP) winning with a stronger than expected majority in the general election that took place on 31 October, Kishida's economic policies have so far not been well received by investors. Whilst Kishida has said he will aim for growth through a similar model to his predecessors, he has also vowed to create a more equal distribution of wealth, however he has yet to announce any specific details which is unsettling investors. A suggestion he would increase tax on capital gains and dividends resulted in an 8-day losing streak for Japanese indies – the longest since July 2009 – and has been dubbed by some as the "Kishida Shock" on social media.

In fixed income markets, government bond yields rose (meaning prices fell) as central banks indicated they were prepared to withdraw monetary policy accommodation in light of the rising inflationary pressures. In the UK, 10-year gilt yields stood at 1.03% at the end of the month, with the Bank of England widely expected to be among the first central banks to raise interest rates, if not in November, then very shortly afterwards.

Commodity indices again reached new highs driven by higher energy prices as the global economic recovery gathers pace. Energy was unsurprisingly the best preforming component as oil hit a 7-year high of $85 a barrel. The price of natural gas fell back towards the end of the month following robust gains in September after Russian President Vladimir Putin announced his intention to increase gas supplies to Europe. Industrial metals also performed strongly amid supply chain problems while gold edged high by 1.6%. Finally, Bitcoin rallied nearly 40% to hit a record high of $66,975 after the Securities and Exchange Commission (SEC) in the US approved the first-ever Bitcoin futures exchange traded fund. The green light is a milestone for the crypto industry, where companies have been trying for several years for approval of a crypto-linked ETF.

Looking ahead, although investors are feeling more optimistic about stocks than they were a month ago, this doesn't mean the many reasons for caution have gone away and these are likely to form a key part of investment strategies as we look towards 2022. But for now, at least, we expect investors to focus on the remaining corporate earnings releases and the upcoming holiday shopping season, which should provide a tailwind to boost asset prices into year-end.

Portfolios

Against this market backdrop, the Beckford James portfolios all delivered positive total returns for the month. The best performing portfolio was once again the Ethical portfolio, returning 0.73%, with some strong performance from some of the global funds, most notably the ESG Developed World Index and Liontrust Sustainable Future Global Growth, which returned 3.83% and 3.42% respectively.

The Growth portfolios were led by Risk Profile 5 which returned 0.65% with the other lower risk profiles delivering similar returns and were all ahead of their benchmark returns. The higher risk profiles delivered the lowest returns, although these were still modestly positive, with Growth 10 returning 0.25%. Despite a higher degree of equity exposure and some strong gains from the likes of the US and Europe, this was offset by weakness in Japan with both the Vanguard Japan Stock Index and Baillie Gifford Smaller Companies funds down nearly 5%. Unsurprisingly the Vanguard US Equity Index was the best performing fund, taking its lead from strong gains from the S&P 500, and rose 4.95% on the month.

Finally, the Income portfolio returned 0.34% and remains the best performing portfolio year to date. There were some strong performances from the Vanguard UK Equity Income Index and BlackRock Continental European Income fund, which strengthened thanks to strong earnings results and continued dividend progress.