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Portfolio Review *December 2021*

We ended the year pretty much as it had begun with investors worrying about the implications of a new variant of Covid-19, rising inflationary pressures and scrutiny over the future of central bank monetary policy decisions. It is understandable then that global equity and bond markets continued to exhibit the volatility at the start of the month that had begun in November. However, this quickly abated as it became apparent that the Omicron variant was less severe in terms of hospitalisation rates and the prevailing positivity that we have seen for much of the year drove markets higher, with many major indices ending the year near record highs.

The last two weeks of the year saw equities rally as Omicron risk was repriced, led by the UK where the FTSE All Share Index returned 4.68%. The strong conclusion to the year sees UK indices, and many overseas benchmarks, now at higher levels than before the onset of the pandemic. There were similarly strong gains for European stocks with the FTSE Europe ex UK Index up 3.8% while in the US the S&P 500 benchmark returned 2.0%. However, there were some weak spots, notably Asia and Emerging Markets where the continued fallout from China's property sector and slowing growth weighed on indices. Fixed income was the main detractor for the month as central banks turned more hawkish prompting bond yields to rise and consequently bond prices to fall.

Whilst Omicron news dominated the headlines, it was monetary policy that provided the narrative for investor returns. After months of speculation, the Bank of England became one of the first central banks to raise interest rates in the face of mounting inflationary pressures. Data from the Office for National Statistics showed inflation rose to a 10-year high in November of 5.1%. This was accompanied by strong jobs data following the end of the furlough scheme with the unemployment rate falling and job vacancies continuing to climb, partly exacerbated by post-Brexit immigration rules. This is likely to create upward pressure on wages as employees demand wage increases in the coming months which could fuel further price rises. So, whilst the timing of the decision took some by surprise given the surging Covid cases, ultimately the Bank decided that the risks from higher inflation outweighed the risks of disruption from Omicron.

It was a similar picture on the other side of the Atlantic, where inflation hit a 39-year high of 6.8% prompting the Federal Reserve to announce a doubling to their quantitative easing tapering programme which will now end in March 2022 rather than the autumn. The actions of both central banks should allow them some breathing room to see if inflation figures start to trend down, particularly if some of the supply chain issues that have been a major factor in price rises start to ease.

The positive end to the year has capped off another strong twelve months for equity investors, with many major indices delivering double-digit returns, something which may have been unthinkable as we headed into the events of early 2020. The US has undoubtedly been the standout performer of the last 12 months with the S&P 500 climbing 29.3% and notching up 70 all-time closing highs during the year, which is only second to the 77 achieved in 1995 in the early days of the tech boom. The UK has also delivered a healthy return of 18.4% over 2021, however some commentators noted that returns from UK stocks have been somewhat disappointing given the cloud of uncertainty from Brexit was removed this time last year and the UK market looked relatively cheap compared to its international counterparts.

This hasn't turned out to be the catalyst for the UK to outperform, which is likely to be attributed to the makeup of our domestic market which is relatively light in terms of technology names compared to the US where the likes of Microsoft, Google, Apple, Nvidia and Tesla have collectively accounted for a significant proportion of the benchmark's return over the last year. However, the investment case for the UK remains intact and, if anything, looks even better value so could 2022 finally be the year the UK outperforms?

The key investment theme for 2021 turned out to be inflation and is unlikely to change anytime soon. It seems one of the enduring consequences of the pandemic has been how quickly and how far prices have risen as economies have reopened and the knock-on implications on supply chains and labour markets the pandemic has caused. While some price pressures were to be expected, the rise in energy prices and the impact of the semiconductor chip shortage on things like motor vehicle production in particular, has played a significant role in pushing up prices. These issues are slowly being resolved but it is unlikely we have seen the peak yet and inflation data could reach uncomfortable high levels in early 2022 before we eventually see them start to decline. The big debate in 2022 will be how central banks react and whether they have left it too late to start the rate rising cycle.

On a more positive note, one surprising feature of 2021 has been the recovery in dividend payments. After a dismal 2020 for income investors where UK dividends declined by 44%, encouragingly payouts have recovered much more strongly than anticipated in 2021. The strong economic recovery has enabled many companies to reinstate their dividends and an increasing number of special or one-off dividends have emerged as a means of companies making catch-up payments on those missed the previous year. Dividend increases have been driven by the mining and oil sectors where surging commodity prices have led to bumper profits providing a welcome kick-start to their dividend policies, whilst banking sector dividends have also meaningfully contributed to the recovery. Dividends for the FTSE All Share Index in 2021 are expected to be around 35% higher than the previous year, which is incredible progress given the events of 2020, although they are still expected to be around 15% lower than 2019 levels. Going forward the dividend recovery may be more muted as some of the big dividend hitters such as Royal Dutch Shell and BP have fundamentally rebased their dividends, whilst it is likely GlaxoSmithKline will follow their lead when it demerges its Consumer Healthcare business in mid-2022. Equally the bumper one-off dividends are likely to have been just that, one-offs to catch up for missed payments in 2020, and it is unlikely we will see this boost continue in 2022. The good news is that payments have recovered much quicker than expected and going forward dividend policies will be much more sustainable and pay-out ratios less demanding.

So as we enter our third year of living with Covid-19, what can investors reasonably expect in 2022? Coronavirus and its evolution obviously remain the key risk to economic recovery and ultimately stock market returns. The economic recovery has been exceptionally strong, supported by highly accommodative central bank policies and we know that this will start to ease. However, it is important that this should stay supportive and any tightening is very much an easing off the accelerator rather than slamming on the brakes. We also know company fundamentals are strong, as evidenced by record company earnings, even in the face of rising input prices. Taken together, this backdrop should remain supportive for equities in 2022, although returns are likely to be more moderate than the double-digit returns we experienced in 2021, whilst the prospect of higher interest rates poses a headwind for government bonds and fixed interest markets.

Portfolios

Pleasingly the Beckford James portfolios delivered positive performance across the board in December to round off another year of strongly positive returns. Taking its lead from the strength of the UK market, the Income portfolio was the best performing portfolio for the month, up 3.96%, and unsurprisingly was the best performing portfolio of 2021 with a return of 15.47%. The strong performance of some of the UK and Global equity income funds were the main drivers of returns for the month, namely GAM, JO Hambro and Artemis, whilst property funds also meaningfully contributed to returns.

In the Growth portfolios, those with the greatest exposure to equities delivered the best returns and those with less equity exposure and higher fixed interest were the weaker performing portfolios, however all portfolios delivered positive returns. Growth 9 slightly outperformed Growth 10 due to a couple of funds which delivered negative returns which slightly held back returns where a greater weighting to these is held. The pattern of returns is similar on a 12-month view, with the higher risk profiles delivering higher returns than the lower risk portfolios. Finally, the Ethical portfolio delivered 1.08% in December and a was one of the strongest portfolios for the year as a whole, delivering a 12.49% total return in 2021.

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