QUARTERLY MARKET OVERVIEW – JULY 2021

"Out of darkness cometh light"

"Out of darkness, cometh light"; sounds somewhat biblical and is the motto of Wolverhampton, although I feel it is apt for this latest update. It still feels we are emerging from a long hard "winter", and as we enter "spring" it brings optimism and signs of good things to come.

It seems incredible that 18 months ago we were aware of COVID, but really had no idea what the future would hold. What is amazing is the speed with which a vaccine has been developed and administered.

The table below shows the share of people who have received at least one dose of the COVID-19 vaccine as at the end of June:

United Kingdom	65.28%
North America	41.98%
Europe	40.03%
South America	27.91%
Asia	23.20%
Africa	2.58%

In the UK 48% of people are fully vaccinated, in North America this is 32% and Europe 26%. However, we can see there is a massive divide between developed and non-developed economies, and it is thought it will take perhaps two years for the world to be fully vaccinated.

There is little doubt that we must live with this virus and the different variants for many years to come, but we can now look forward.

As we exit of this recession, there are already discussions on when the next one will be, when interest rates will rise and the subsequent inflationary pressures. Anyone doing work on their house will have seen the effect of these pressures in the cost of materials. The hospitality sector is finding it hard to recruit staff and containers are stuck in the wrong parts of the world forcing up shipping costs.

Additionally, commodities like oil are having a mini boom which increases inflation. We believe much of this pressure will smooth out and although we may see higher inflation figures in the short term this will drop back.

It is possible interest rates will go up at some point but when and at what speed is one for debate. The reality is that interest rates need to rise and for economies to overheat for a recession to hit. We are far from this point and therefore to assume another recession in the next couple of years might be premature.

We are just at the start of a recovery; there remains much stimulus to economies and returning to the analogy at the start, we are only in “spring” when things are coming to life. We have “summer” to come and then “autumn” before a “winter”, which all seems a long way away.

In summary, we are cautiously optimistic the vaccine programme in developed economies is gathering pace, there is enough pent-up demand to generate a mini boom and although there are inflationary pressures, we believe this to be transitory. We know interest rates will rise at some point, but we should not expect massive rate rises in the near term, and recessionary fears can abate while we continue the recovery. Markets will of course fluctuate during this time, but that does not indicate a recession.

So, lets enjoy the spring and the summer that follows!

George Ladds

George Ladds, Director, July 2021

SUSTAINABILITY

We have had some interesting discussions around sustainability and whether it is just a fad. We do not believe that is the case, the momentum to tackle climate change and social inequality is here to stay. But there are some harsh realities when we talk about change.

In Germany it is estimated that around 25,000 people are employed in the coal industry, and they are the fifth largest consumer of coal in the world. To change overnight might be good for the environment but it directly impacts society and therefore there must be a transition not only from fossil fuels to renewables but also for people and society and that will be as much of a challenge.

It is also important to understand that oil and mining will still be needed as the world transitions. We recently joined a talk with the CEO of BHP, and he explained how the business delivers inputs into many of the things we need in our daily lives. The drive to electric vehicles, renewable energy etc needs more iron ore, copper, nickel etc and therefore it shows that there is also a balance between the drive to a carbon natural world and the materials we still need.

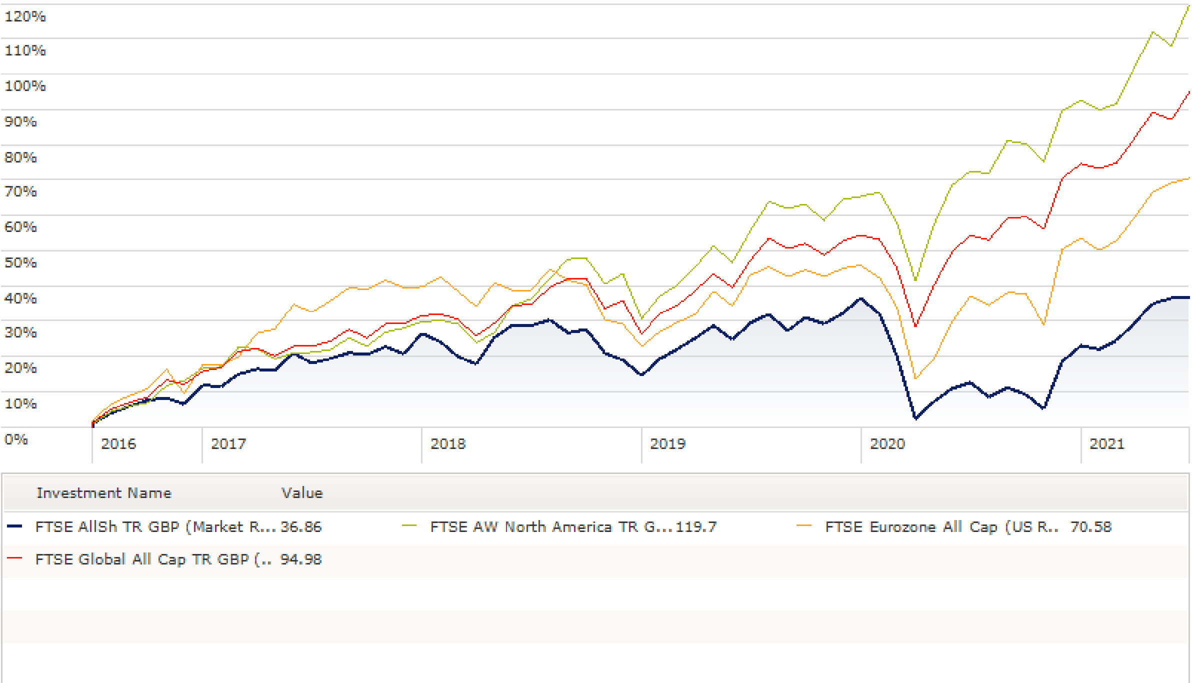
In a recent talk from L&G the speaker claimed that the pandemic is a symptom of how we have disrespected our planet, and saving the environment is for everyone's future. We must change as we are using resources faster than they are being found. Certainly, for me when I hear things like this, I feel that I am not doing enough but the reality is that we cannot all be eco-warriors, but we can all make small changes.

This ultimately leads to opportunities, and we have seen the power of intellect over the last decade with behemoth tech companies getting bigger and stronger. However, we are also seeing this intellect being channelled into creating solutions to the world's problems, whether this is renewable energy, better water systems, recycling of metals etc and this is where we could see the greatest opportunities over the next ten years.

In summary, we do not believe this is a fad. This is not just about the environment but also inequality and there is a big enough drive to make change happen. Companies on the wrong side of change will suffer, whether this is by ignoring the need to change practices to be better for the environment, or in the way they treat staff. Some may argue against the power of social media, but the reality is that companies can suffer negatively when they do things wrong. Change does come from us, but tech is creating solutions, and this could open a fascinating decade for companies that we perhaps have not heard of.

US, EUROPE & UK

Five year returns 1 July 2016 – 30 June 2021



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It is amazing to think that five years have passed since the UK voted to leave the European Union, and what a rollercoaster ride it has been since! According to data from Artemis, Sterling is down -6% vs the Dollar, but up +5% against the Euro. The FTSE 100 is up +12% vs the S&P500 which is up +101% and Europe's Stoxx 600 up +32%.

The UK is still unloved, but a lot can change in a relatively short period of time. Coming into the COVID crisis the UK Government seemed beset with criticism, but memories are short and the vaccination procurement and roll out programme have been second to none.

Additionally, Government support (although facing some criticism) has protected jobs, and although there are still 2 million people on furlough it is felt that peak unemployment figures will be significantly lower than feared. It is estimated that 1 million people returned home during the COVID crisis creating job shortages, especially in the hospitality sector, where in some parts of the country businesses cannot get any staff.

There are signs of optimism in the UK. The contraction in the first quarter was smaller than expected, households are becoming increasingly more likely to spend built up savings from during the lockdown and businesses are signalling a greater willingness to invest in the near term. Also, businesses have shown they could become more adaptable through lockdown which helped the economic data.

The Government will spend and much of that will go towards the green economy and levelling up the north/south divide. It is felt that the UK is entering a boom period propelled by lower-than-expected unemployment figures, better than expected economic data and a strong vaccination programme.

There are concerns that levelling up the north/south divide could damage the chances of the Tories being re-elected. We think it is worth comparing to the Thatcher era, which dominated politics for over 10 years, and the Tories even longer. When Thatcher seemed down and out in the early 1980s then the Falklands War happened, and everything changed. COVID is Johnson's Falklands War and though they may lose by-elections, the Tories are unlikely to lose the next general election.

In summary, we are positive in the short to medium term about the outlook for the UK.

Turning to Europe, which is playing catch up with most economies still emerging from lockdown, however there are positive signs. Like the UK, the contraction at the start of the year was smaller than expected and the manufacturing PMI data has been strong for most of the year. That said, the service sector is taking longer to recover. The vaccination programme is now in full swing with most of the larger EU member states vaccinating a larger share of their respective populations daily than both the US and the UK.

In all the noise about poor vaccine uptake, many will have missed the arrival of Mario Draghi as Prime Minister in Italy, which has become one of the most credible nations in the EU. We can expect to see domestic reforms which will make this an economy to watch over the coming years. The UK's relationship with Germany will change with the elections in September with a new leader, and France face elections in April 2022.

In terms of Europe in the short to medium terms it is worth reflecting on the importance of the European Recovery Fund. This is a crucial part of the overall recovery, and the staggered approach to the money coming to different states means the recovery could stretch for several years. We have also indicated that new tech will drive the green economy, and this does not rest in the US but in Europe where some of the global businesses sit. We therefore believe this is an exciting opportunity for Europe over the next decade or more.

As 2016 was an important year for the UK, so it was for the US. Just when we thought it was safe to go in the water, the Trump shark returns. He and his rallies are back; whether this is a campaign for the 2024 Presidency, only time will tell. But for now, it is all about Joe Biden's fascinating proposals that are worth spending some time on.

The Democrats gained a clean sweep and have said they want to address the inequality that has divided the US for decades. Inequality is not just centred on the US, with riots around the world increasing by 282% in the last decade according to the Global Peace Index. There is no doubt that the growing income and wealth inequality was amplified by the COVID crisis. Biden wants to change this by driving growth and redistribution of income.

The first stimulus package of $1.9 trillion was just the start and was there to facilitate a broad-based recovery as well as tackle inequality. To finish the job, they want to secure a further $4 trillion package. Some of the areas Biden would like to see change include:

- Increasing the minimum wage to $15 per hour and end tipped minimum wage
- Building modern and sustainable infrastructure in some of the most deprived areas
- Expand child tax credit, earner income tax credit and child and dependent car tax credit

To pay for this some of the areas of tax rises/reform would include increases to the top personal income and corporate tax rates.

To achieve this, he must work with a tiny majority, and perhaps not all the plans will come together. The belief is that if it does then it will support economic growth and make the US more resilient.

It is worth reflecting that this recession is like nothing else we have seen, and the importance of these stimulus packages cannot be underestimated. Retail sales since 1 May 2020 are up 51.2%, and over the past 24 months are up 10% p.a. The average between 2014 and 2019 was 3.6% p.a. This increase has been driven by re-opening and government stimulus. If the packages stall, then we could see the mini boom start to dissipate and this could mean the recovery is shorter than expected. This a big difference to Europe where their support package continues and will be spread over a few years.

In summary, the US is fascinating on paper, and we are seeing a strong recovery, how long this will last depends on how much Biden and his team can do.

Overall, if we look at the short to medium term there is much to be positive about across Europe, the UK, and the US. Governments will spend their way out of this.

Inflation remains the big worry, and many believe this to be short term (transitory) but if this is wrong and it stays high, what does this mean? Have central banks got it wrong? There are signs that the UK has already started tapering so they can raise interest rates, the Fed have indicated rates might go up in 2023 which means they need to start tapering perhaps next year. It is like a giant Ponzi scheme and one wrong move could have a significant impact across the globe.

However, in the short to medium term, we are positive. Economies are entering the “spring” from a long hard “winter”, which will drive growth as economies reopen. Longer term it is harder to predict. It is important to separate the global recovery from stock market returns. Performance may be harder to come by and although we are seeing a rotation to those companies that suffered due to COVID, we think fundamentals will become key drivers again. We also think that new tech delivering solutions to the green economy or society will be the focus of the next decade which could benefit Europe where many of the global leaders are found.

EMERGING, ASIA AND FRONTIER MARKETS

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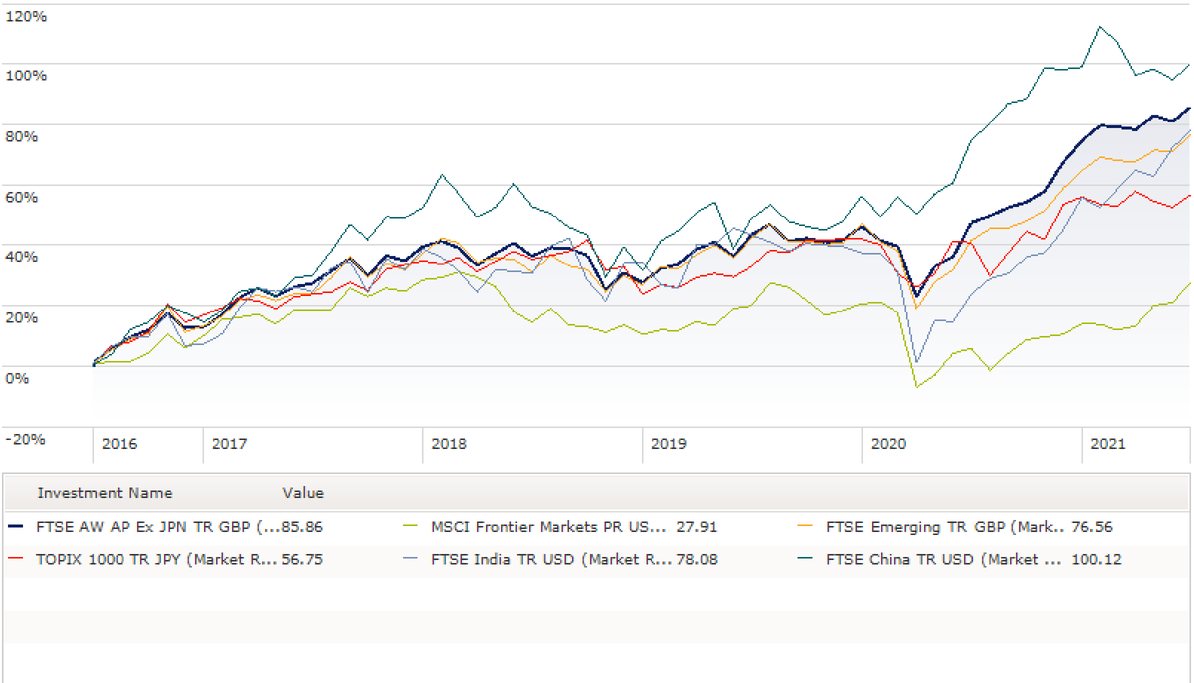

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We have always believed in the long-term value that comes from Asia and Emerging Markets, but the journey is never smooth. Emerging Markets and Asia were relatively robust compared to Developed Markets in 2020. This has reversed slightly in 2021 but they should benefit from the recovery in Developed Markets and the increase in global demand. Additionally, many large central banks within emerging markets have already started tightening, which is supportive of currencies and another positive factor, and then finally the drive for commodities is good for some economies.

This is not just about the short term; it is worth reflecting that some emerging markets have leapfrogged toward the technological frontier. For example, Kenya adopted smartphone banking for microlending. “Aadhar” in India uses biometric identification to enable direct transfers of financial and medical data.

Beyond this, in 2014 China surpassed the US and Japan in patents, and in 2019 China produced 10,000 more patents than the US. Russia has outpaced Germany and the UK for many years and in 2019 India overtook Germany and the UK. Innovation is broadening out.

Turning to China there are some short-term challenges.

Firstly, Beijing has begun a tightening policy after the expansion during the crisis saw growth in credit stock of over 30% of GDP. Secondly, several new announcements about tech regulation have generated worries about Beijing's reform agenda. And third, the vaccination programme has been slower than many of the developed economies. However, longer-term we remain positive on the outlook.

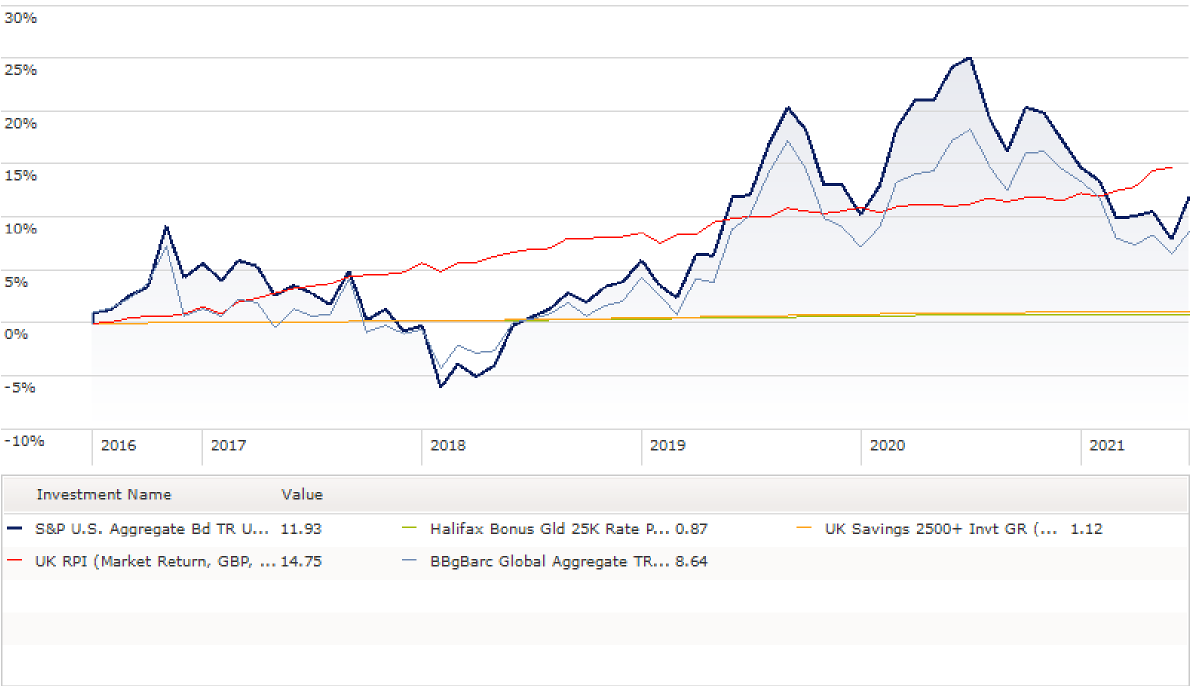
It is worth reflecting briefly on Japan who have been slow with the vaccine rollout. This is likely to mean the economy will contract and could fall into a technical recession. Additionally, investors have enjoyed political stability for several years, but this has come to an end, and it is expected that the new Prime Minister will be out by September. This does not bode well for future reforms.

India has battled with the Delta variant and President Modi has seen his popularity slip. But there are signs of a recovery as infections recede. Economic data has rebounded as exhibited by many frequency indices such as rising power demand and increasing TomTom congestion. Foreign investors have started to come back into the Indian stock market with inflows of $1.1 billion in May; a 14-month high.

In summary, there are challenges in the short term whether it is Brazil, India, Japan, and China but long term these are innovative economies and much of the technology is ahead of developed markets. Over the medium term the story remains positive and many of the economies will benefit from the global growth story.

CASH

Five year returns 1 July 2016 – 30 June 2021



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We are now all used to low rates of return on cash. It is worth reflecting that even if rates start rising in 2022 or 2023, they are coming from a near zero base and therefore it will be many years before we get to 'high' rates, even then those rates may be only 2% which is a far cry from the high numbers in the past.

Holding cash short term is important for liquidity purposes, but over the longer term must be questioned especially if inflation rises strongly.

CONCLUSION

We are optimistic in the short to medium term in developed economies because as economies open there will be a natural re-bound trade. The UK has a chance to bounce back from the negative sentiment over the last five years.

We think Europe might offer more opportunities than the US over the long-term due to its recovery fund and being global leaders in green energy. So far Biden has managed to get about $579 billion through on his infrastructure bill so he is significantly short of where he would like to be, however if that gets close to the $4 trillion mark then this must be good for the US.

Inflation is a worry because there are many different scenarios to consider. On the counter argument it is worth remembering that inflation is a function of a stop start recession. If you close everything and re-start, then that naturally creates inflation. In the US, the stimulus came out at the same time as the economy opened creating an overlap and pushing up inflation. However, does rising inflation continue and the likely answer is no.

We have debated when interest rates will go up and perhaps the question should be; are central banks independent? They state they are, but it is unlikely governments want rates to rise because that increases the amount they must pay on their debt.

In terms of the shift to ‘COVID losers’, we think this is short term and the question will return to which companies can grow earnings over the medium to long term. It does mean that returns will be harder to drive forward, but all evidence points towards companies that can grow earnings doing better.

Turning to emerging markets we think short term there are challenges but longer term the story remains robust and many these economies will benefit from the global recovery.

In summary, let’s enjoy the spring before we start worrying about the winter!

Source: Charts have been sourced from Morningstar. Any reference to a fund or share is not a recommendation to buy or sell that asset. Past performance is no guide to future performance and investments can fall as well as rise.