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Keeping you informed matters

Economic review

July 2021

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Outlook

The inflation debate has dominated central banker and investor attention alike, creating a volatile period for both bond and equity markets over the second quarter. The Delta Covid variant also remains a focus for markets, bringing new waves of cases globally, including those countries with high vaccination rates.

Market returns have continued to be driven by a broadly positive macro environment over the second quarter, with hopes for a strong recovery into the second half as Covid restrictions are lifted and businesses reopen. Strong technical factors have also been driving returns, particularly in fixed income markets where yields have fallen back over the last three months.

Central bank balance sheet buying since the start of the pandemic has continued to supress yields and priced many government bonds out of the market. This has led investors to take on more credit risk to achieve higher yields, and as the surge in global money supply continues, this is also finding its way into equities.

This level of stimulus and support that continues to drive returns creates an uneasy balance for markets. The overriding macro situation is unlikely to get much better, with rising-but-transitory inflation, accommodative monetary conditions and intentions for further fiscal stimulus from governments, all creating healthy corporate and household balance sheets.

But we are cognisant that while this is positive for risk assets, valuations are optically rich and could prove fragile. Interest rates and inflation could manifest ahead of expectations if central banks turn hawkish too soon and we've already seen how bond tapering can send a negative signal. As Q2 earnings season kicks off midway through July, traders will be watching closely for references to supply shortages, production bottlenecks and pressure on margins in earnings reports.

After a decade of low inflation since the global financial crisis in 2008, the balance between inflationary and disinflationary drivers is increasingly defining investment strategy. Ageing demographics, growing debt piles, global debt inequality and a world producing more goods at lower prices are keeping global inflation rates low. But the offset comes from the potential damage exuberant fiscal and monetary policy can have addressing the very same issues. All of this as we try to buy growth to recover from the Covid created issues last year and repair the disruption to global supply and demand chains.

Recently there has been significant comment in the financial press concerning the value v growth stocks debate. "Value" refers to companies that have steady, predictable models but look cheap relative to their earnings and growth potential. "Growth" relates to companies that might have high valuations by comparison to earnings but have strong potential for revenue and income growth.

We have seen the swift economic recovery put the brakes on the "value" rally that began last year when the vaccines were announced. These unloved and under owned stocks enjoyed a fantastic cyclical recovery over the start of the year, but investors are now returning to quality and "growth" stocks in a 'catch-up' trade. Expectations are being lowered for growth into 2022 and beyond. As such, investors are reining in their exposure to economically sensitive companies.

While we are broadly agnostic on the value vs growth style biases, we recognise that as inflation fears wane and economic growth expectations come down, it is this environment which sees the quality and growth names outperform. But this is not to say that the value names have had their moment in the sun and it's time to sell, rather it emphasises the need for a more balanced approach.

There are risks to the recovery that are known but it is the unknowns that we are also positioning for. We could try to hedge against these unknowns before they adversely affect markets, but the risk is we pay for the insurance now and it expires before the event. Hence we prefer to remain diversified in our strategies, by both geography and asset class.

The strength of the recovery and economic output will ultimately depend on how quickly consumer confidence can fully recover and upon government and central banks continuing to throw money at the problem. But how wisely they spend this money, will be the deciding factor.

Key facts about the world

United Kingdom

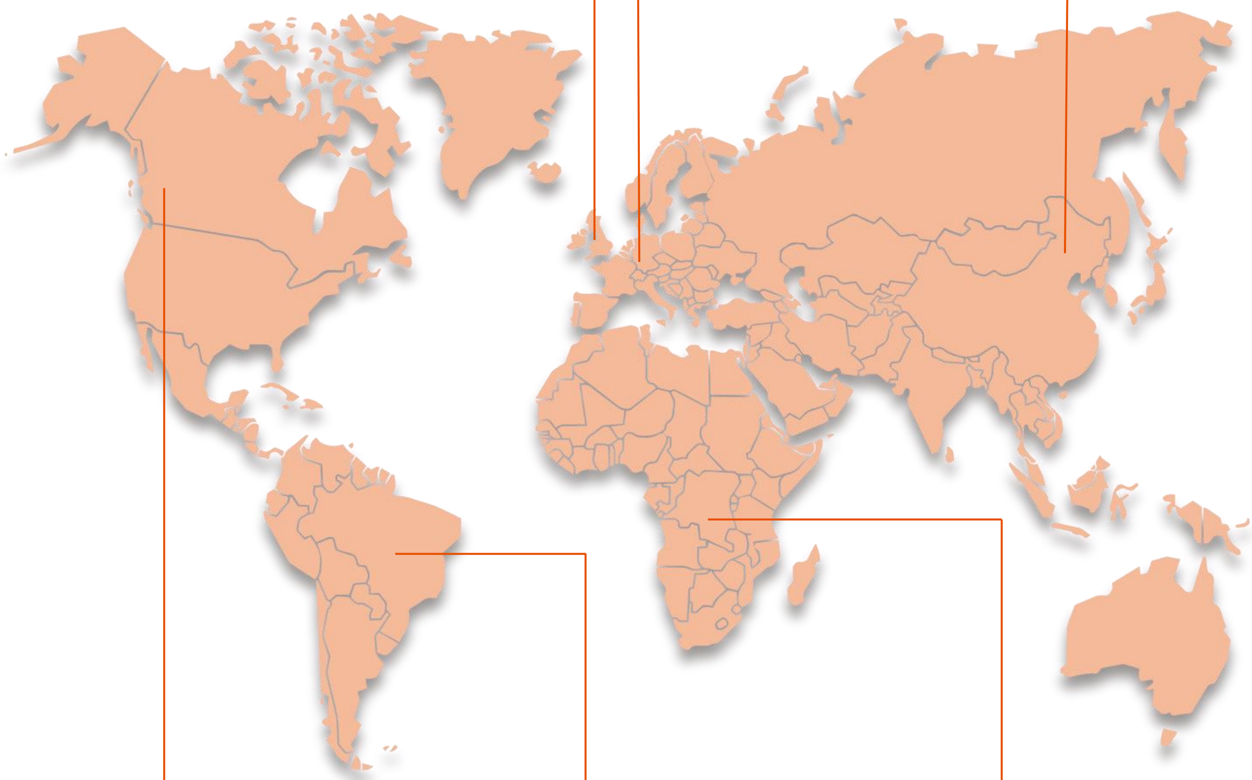
- Inflation could spike to c.4-5% by year end, above the Bank of England's 2% target.
- London returns to life as rents surge 4.3% in June from May, the fastest pace on record as easing of restrictions lures tenants back to the capital.

Europe

- Covid recovery gained momentum in Q2 as vaccination rates increased, but rising virus rates from Delta variant threatens outlook for Q3.
- ECB signals additional measures for 2022 to support the economy.

Asia

- Q2 data expected to show Covid recovery in China easing, with growth at 8% down from record 18.3% gain in Q1.
- India's widening trade deficit and elevated commodity prices see Rupee hit new low having been best performing Asian currency in Q1.



North America

- G20 ministers endorsed a global corporate tax deal - a Biden initiative - minimum rate of at least 15%. Yellen confident lawmakers will approve the budget bill.
- Q2 reporting season likely to see end of the pandemic windfalls as economy gets back to "normal".

South America

- OPEC rift creates risk of oil price turmoil, threatening fragile recovery in many emerging, oil import dependent, economies.
- Mexico prioritises vaccinations for border states in effort to completely re-open the US/Mexico border and reactivate the economy.

Africa

- Former South African President Jacob Zuma jailed. Widespread rioting from his supporters.
- Reform needed in SA as most industrialised African economy contracts most in a century. 1.4m jobs lost as restrictions to curb the virus have weighed on output.

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Q2 Performance Review

Key facts

- Bond markets dictated by inflation and interest rate fears
- Commercial property enjoys renaissance as business reopening gathers pace
- Continued strength in Sustainable investment theme
- Value trade slows but doesn't end as growth returns to favour
- Well diversified, balanced strategies remain with positive macro outlook in equilibrium with number of known risks

In bond markets there was a continuation of performance from Q1 as extremely accommodative monetary policies from central banks has led to lower yields globally. Investors have been forced to either take more risk or more duration to secure extra returns, which combined with rising inflation and interest rate fears has seen our broad exposure perform solidly in our index linked (L&G All Stocks Index Linked +4.2%) and longer duration bond funds (Artemis Corporate Bond +2.6%).

Property investment trusts have enjoyed a renaissance over the last three months, with the BMO Commercial Property Trust in particular returning nearly 30% as restrictions are lifted and businesses are able to reopen. Rent collections have been stronger and the outlook is reassuring providing there are no further U-turns in government policy leading to new lockdowns and closures.

In alternative holdings, the Downing Renewables & Infrastructure Trust released its first quarterly update, defying the wider sector trends (downwards) by increasing NAV by 1.3% as further funds from the IPO are distributed into its diversified energy infrastructure portfolio. Further positive updates are expected as the remaining c.17% of assets are invested and share price performance was solid with a 3.5% increase in the quarter.

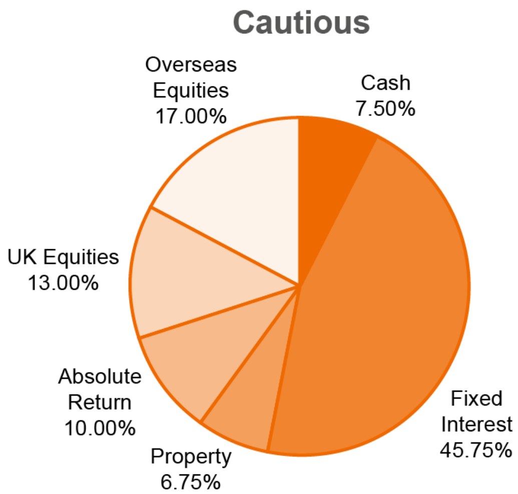
The Loomis Sayles US Equity Leaders fund (+10.4%) returned to favour as investors sought opportunities in the quality and growth equity trade. Similarly, the JPMorgan Emerging Markets fund (+6.12%) performed well, including the sustainable line held in our ethical strategies (+7.49%) reflecting continued strength in the ESG structural investment trend. The Lindsell Train Japanese Equity fund also bucked it's recent underperformance adding a positive return of 0.11% against a fall in wider Japan markets as the recent value trade slowed pace.

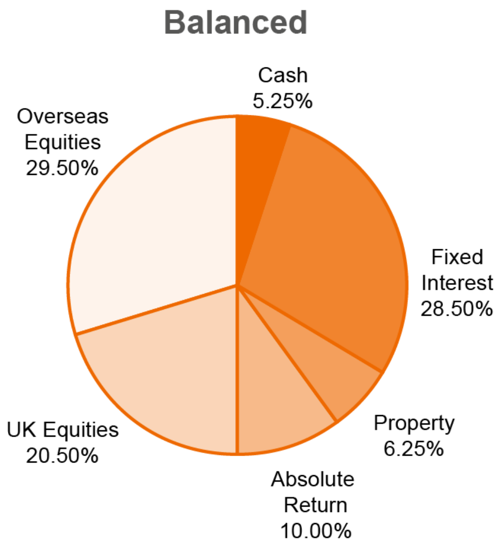
On UK shores, returns from our fund selections have been positive as the economy begins to recover. The balance between value and growth styles has ensured consistent performance and when blended with the other asset classes and the returns achieved, the second quarter closed on a positive note, having recovered well from Q1.

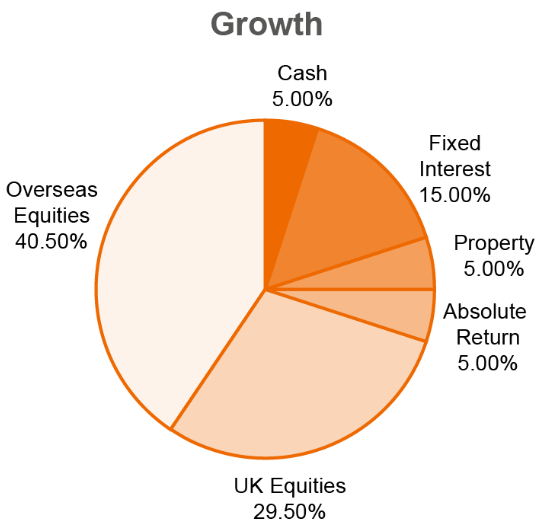
SECTOR	Q2 2021	1 year to 30/06/21	1 year to 30/06/20	1 year to 30/06/19	1 year to 30/06/18	1 year to 30/06/17	5 years (annualised)
IA OE UK Index Linked Gilts	4.0%	-4.3%	11.2%	9.0%	1.9%	6.8%	4.8%
IA OE £ Corporate Bond	1.7%	3.5%	5.7%	5.6%	0.7%	6.8%	4.4%
IA OE Property	1.6%	1.0%	-4.3%	0.8%	6.5%	5.4%	1.8%
IA OE UK Equity Income	5.0%	25.4%	-13.7%	-2.5%	6.2%	19.4%	6.0%
IA OE UK Smaller Companies	8.0%	50.9%	-6.4%	-6.2%	16.9%	36.6%	16.2%
IA OE North America	7.9%	27.3%	8.5%	11.4%	12.5%	23.3%	16.4%
IA OE Europe Excluding UK	7.1%	23.7%	1.0%	3.3%	3.3%	29.2%	11.5%
IA OE Japan	-0.4%	13.1%	7.9%	-3.4%	10.7%	24.9%	10.3%
IA OE Asia Pacific Excluding Japan	2.9%	26.9%	2.6%	4.3%	7.4%	28.6%	13.4%
IA OE Global Emerging Markets	4.7%	28.3%	-3.3%	6.1%	4.1%	27.0%	11.7%

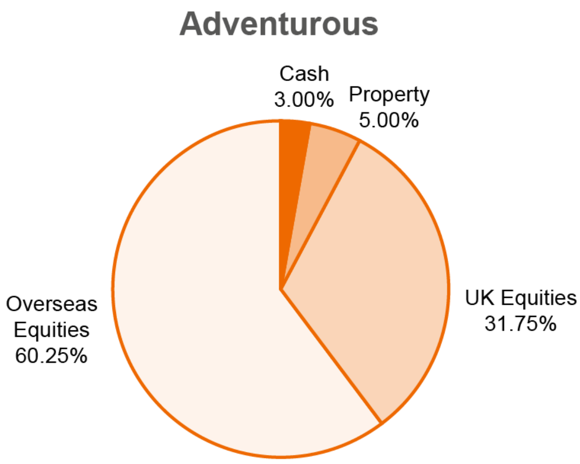
Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

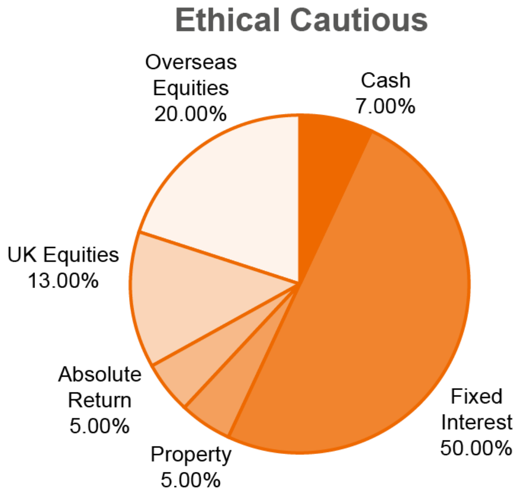
The positioning of our strategies

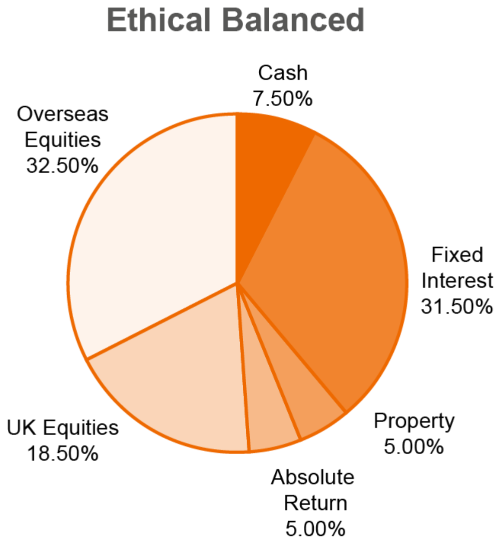


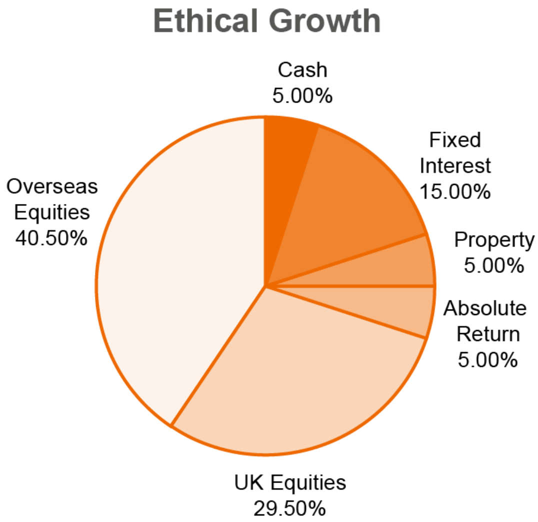


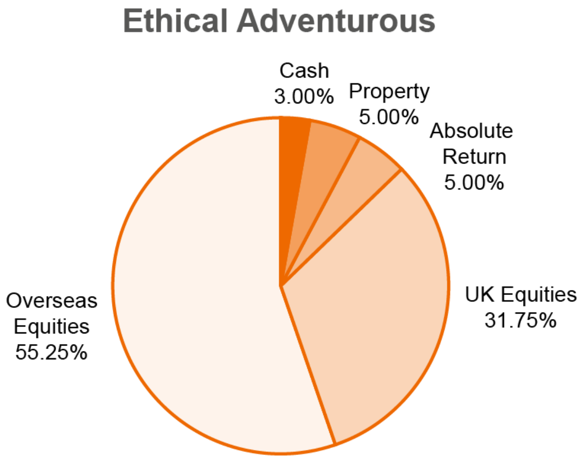





Ethical Cautious
Cash 7.00%
Fixed Interest 50.00%
Property 5.00%
Absolute Return 5.00%
UK Equities 13.00%
Overseas Equities 20.00%


Ethical Balanced
Cash 7.50%
Fixed Interest 31.50%
Property 5.00%
Absolute Return 5.00%
UK Equities 18.50%
Overseas Equities 32.50%


Ethical Growth
Cash 5.00%
Fixed Interest 15.00%
Property 5.00%
Absolute Return 5.00%
UK Equities 29.50%
Overseas Equities 40.50%


Ethical Adventurous
Cash 3.00%
Property 5.00%
Absolute Return 5.00%
UK Equities 31.75%
Overseas Equities 55.25%

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Opinions constitute our judgment as of this date and are subject to change without warning. The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance is not a reliable indicator of future results and forecasts are not a reliable indicator of future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down. The information in this document is not intended as an offer or solicitation to buy or sell securities or any other investment, nor does it constitute a personal recommendation.

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