MMWealth
Chartered Financial Planners

Keeping you informed matters

Economic review

October 2021

Chartered
Financial
Planners

Outlook

"Covid is dead, long live covid." The vaccination campaign continues, but global growth has peaked. Continued accommodative monetary and fiscal policies should keep recession risks at bay, but the inflation and interest rate tightrope that central banks are walking, adds caution to our outlook for Q4.

With the success of its vaccine program, the UK has adopted a "live-with-it" approach as we adjust to life with the virus. While Covid is still very much a risk, now that we're back at work, travel restrictions are being lifted, and with testing and quarantine rules being relaxed, you could be forgiven for thinking the virus has been defeated.

As a sandbox experiment, the world will be watching closely, just as they are with another vaccination leader: Israel. The country that was predicted to be the first to vaccinate its entire population, briefly had the highest per-capita caseload of anywhere in early September. But serious cases started to drop in recent weeks, with more than 3.6 million people (out of 9m) having received a third dose of the Pfizer vaccine. The trajectory of the booster debate in Israel might point to where things are headed in the UK, US and other wealthy nations.

But these successes have allowed investors to revisit their global asset allocations, and regions such as the UK are back in favour. Just as the economy has reopened quickly, corporate earnings and growth expectations have risen sharply. Combined with the cheap valuations on offer, this has also led to an increase in M&A activity. Morrisons, the UK's fourth largest supermarket, was the subject of a high-profile takeover battle with a raft of bids and counter bids, reflecting private equity's appetite for UK Plc. We expect more of this over the coming months and it will be interesting to see how the government and regulators react to protect national interests.

According to estimates from Bloomberg however, the rapid growth enjoyed in places such as the UK has peaked. Real GDP in the G7 rose by 6% in Q3 (down from 6.8% in Q2) and is expected to soften further to 4.9% in Q4, but this is still above trend rate of 1.4%. Not all countries have reached peak growth however, with Japan, Canada, Australia and China projected to grow faster in Q4.

Usually when growth peaks, investors look at the next phase in the cycle and worry about factors that could trigger a setback or even a recession. But growth is coming down from very high levels, and with the continued support of government and central bank fiscal and monetary policy, this shouldn't be a major fear.

However, the risk that policy change is made at the wrong time and level is very real. One factor that could lead to this overreaction is inflation. With households unable to spend during the deepest lockdowns, savings rates soared which led to an initial spike in spending as restrictions were lifted. But the supply chain disruption that has created shortages and price increases should still prove "transitory" as many central banks have gone to lengths to reassure us.

During this period of adjustment, wages have risen sharply in certain sectors which is more of a concern and might not be as transitory. A shortage of workers in the leisure and hospitality sector for example, has been particularly pronounced. But so far, wage growth for high-skilled and salaried employees, who remained in full employment throughout the pandemic, has been flat-to-down. So overall wage growth is currently sideways, as measured by the Atlanta Fed Wage Tracker. While inflation is set to remain higher in the short term, providing this dynamic doesn't alter too much, and as the pandemic recedes, central banks will be able to continue dialling back monetary support. Interest rates should eventually be able to increase, but governments will be very aware of the impact of this on their debt burdens, so don't expect too much too soon.

It would be remiss not to touch briefly on China. We have been asked whether China has become uninvestable, following a raft of regulatory changes impacting sectors such as technology, education and gaming. We try to look past the short term noise surrounding these events and focus on the long term fundamentals. With their new focus on "common prosperity", and with the people demanding change, aren't the Chinese Communist Party simply doing what the rest of the world's leaders would love to do? Interesting politics isn't always bad for investing, we just need to understand and appreciate the risks in order to try and avoid the potential pitfalls.

Key facts about the world

United Kingdom

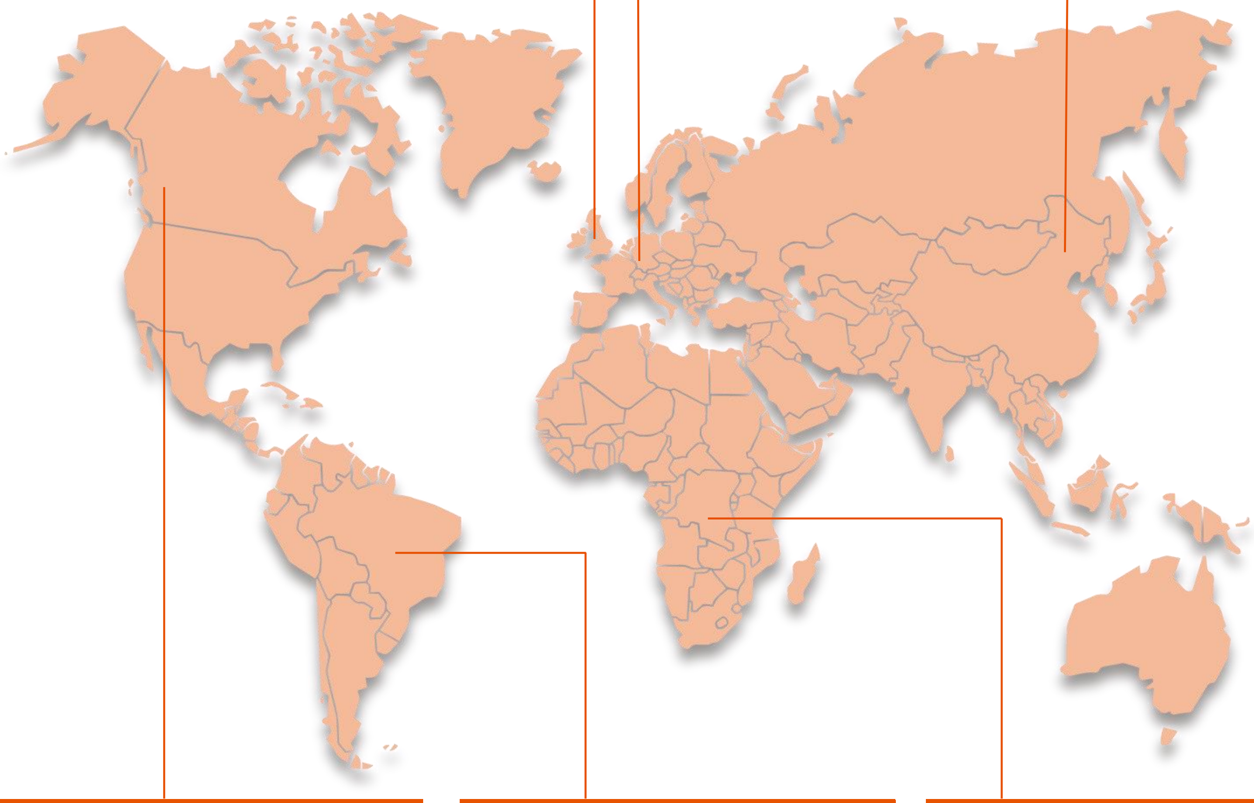
- UK economy is facing the double-whammy of supply bottlenecks and inflation
- Higher domestic energy prices, regressive shifts in the tax and benefits system and disruptions to supply and output to continue

Europe

- Ireland relents and joins 130 nations following OECD's recommended minimum corporate tax rate.
- European vaccination rates surge bringing prospect of widening economic recovery into Q4

Asia

- Chinese stimulus on the way as Ministry of Finance expresses intention to ramp up fiscal spending
- Unfathomable a few months ago, India is currently vaccinating 7.5m people per day, over 45% have had at least one shot



North America

- The Fed will formally announce the tapering of asset purchases in November, stoking worries of a replay of 2013 Taper Tantrum
- But the Fed is unlikely to start hiking rates until late 2022 or early 2023

South America

- Brazil becomes second country behind the US to pass 600,000 Covid-19 deaths, but hopes grow as vaccine rollout gathers pace
- Brazil and Argentina agree framework to lower Mercosur tariffs by 10% to increase trade – Mercosur also includes Paraguay and Uruguay

Africa

- Congo to renegotiate $6bn infrastructure-for-minerals deal with Chinese investors following anti-corruption report
- Pandemic pushes South African joblessness to record high, with more than third of labour force unemployed

Q3 Performance Review

Key facts

- Rising inflation risk, weakening economic growth – stagflation?
- Government bonds offer little/no protection, but yields could still turn lower
- Look for attractive equity valuations, not just value over growth
- Central banks cautious of raising rates too soon for fear of harming recovery
- Risks mounting, but opportunities still exist to rotate strategic allocations in shorter term

The rising fear of inflation has driven a decent move higher in bond yields everywhere. In this environment, we favour bonds that can perform well with rising rates ahead, with lower duration risk such as High Yield bonds. The performance from our fixed interest allocations has therefore been mixed over the quarter, with positive returns from the AXA and Royal London short duration strategies both up 0.6%, versus the Lyxor Core UK Govt Bd fund, down -1.9%. Bond naysayers maintain that at current levels of yields, Treasuries and such offer little protection as a hedge. True, but if risk does turn, we could see bond yields heading back to the bottom of this year's range, so we maintain our defensive exposure in government issues for now.

Fears of delta variant outbreaks led to a pause in the equity 'value vs growth' trend over the summer, but we believe there is room for this to develop further in both the US and Europe, where the valuation gap is still wide on an historical basis. We have therefore introduced new positions in Europe with the iShares Core Euro STOXX 50 ETF and Premier Miton European Opportunities strategies. We continue to assess ideas for attractive valuations in US mid and smaller companies to run alongside the Loomis Sayles US Equity Leaders position (+2.2%), which continues to provide a consistent and solid exposure to core large cap US equity markets.

The risk scenario for the UK is that policy tightening (fiscal and monetary) and the supply squeeze, undercuts growth going into 2022. We have therefore maintained a balance and anticipate bouts of volatility, but believe the high conviction stock pickers, such as L&G Growth Trust (+2.4%) and domestically focused strategies like Jupiter UK Smaller Companies (+4.1%) will continue to perform strongly.

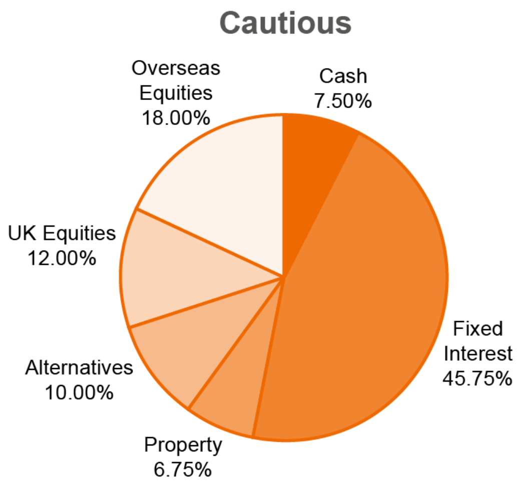
Property has been challenging over the last year, but there has been recovery in values recently. While we continue to see the advantages of some Real Estate in portfolios, we have been reducing BMO Commercial Property and Standard Life Property Trust (+7.5% and +3.3% respectively in Q3) to limit exposure in this illiquid asset class.

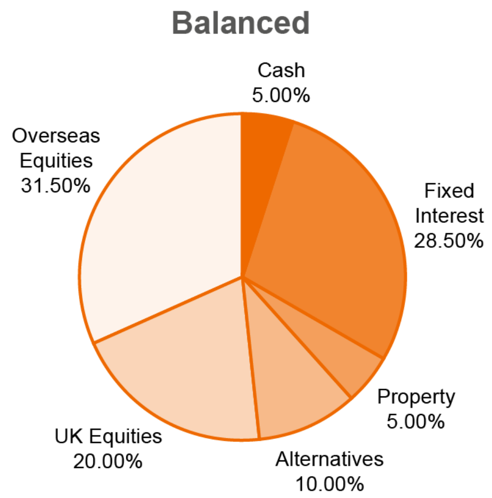
Once the inventory shortages are addressed over the next few quarters, a future concern might be oversupply and a resurgence of deflationary pressures, especially if the policy environment is tighter. Today is a far cry from the rapid recovery, boosted by fiscal largesse and free flowing liquidity seen in 2020 and in this environment we believe it deserves more caution until the inflation debate is clearer.

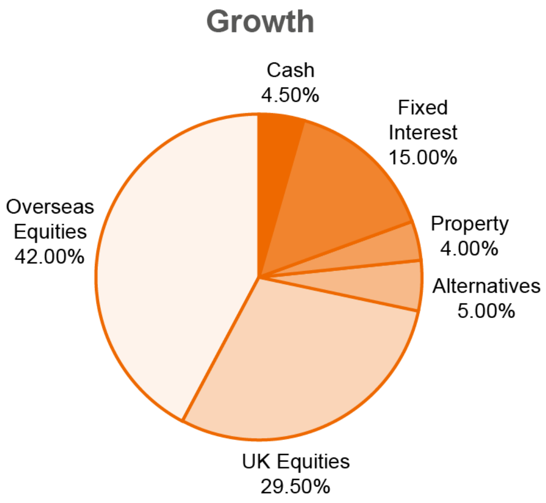
SECTOR	Q3 2021	1 year to 30/09/21	1 year to 30/09/20	1 year to 30/09/19	1 year to 30/09/18	1 year to 30/09/17	5 years (annualised)
IA OE UK Index Linked Gilts	2.0%	-0.7%	1.3%	19.1%	1.3%	-6.8%	2.5%
IA OE £ Corporate Bond	-0.5%	1.2%	4.3%	9.0%	0.1%	0.8%	3.0%
IA OE Property	2.1%	3.4%	-4.3%	-0.3%	5.8%	7.5%	2.3%
IA OE UK Equity Income	2.3%	32.7%	-17.4%	-0.1%	3.5%	10.8%	4.6%
IA OE UK Smaller Companies	3.9%	48.8%	0.0%	-7.1%	10.5%	25.2%	13.8%
IA OE North America	2.6%	25.2%	9.3%	7.4%	19.7%	14.5%	15.0%
IA OE Europe Exc UK	1.6%	22.4%	3.2%	2.2%	1.9%	22.0%	9.9%
IA OE Japan	7.1%	16.5%	5.7%	-1.1%	12.6%	13.3%	9.2%
IA OE Asia Pacific Exc Japan	-4.4%	15.4%	8.1%	5.8%	3.7%	15.6%	9.6%
IA OE Global Emerging Markets	-4.8%	17.2%	1.6%	6.4%	-1.4%	17.6%	8.0%

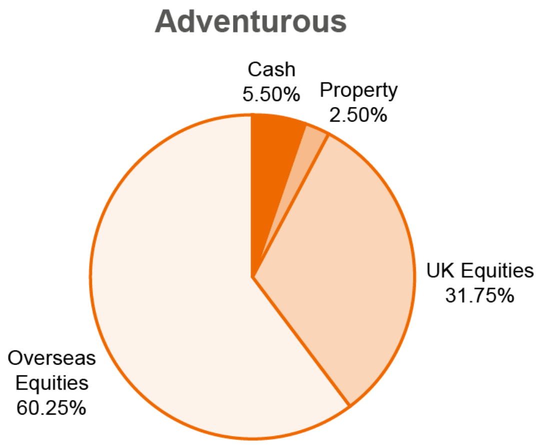
Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

The positioning of our strategies

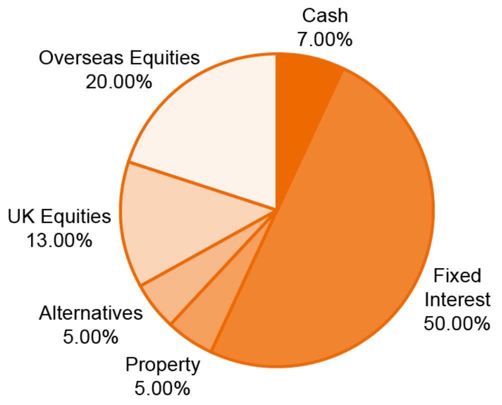




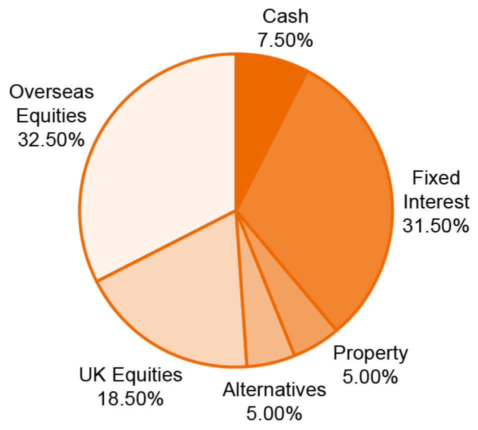




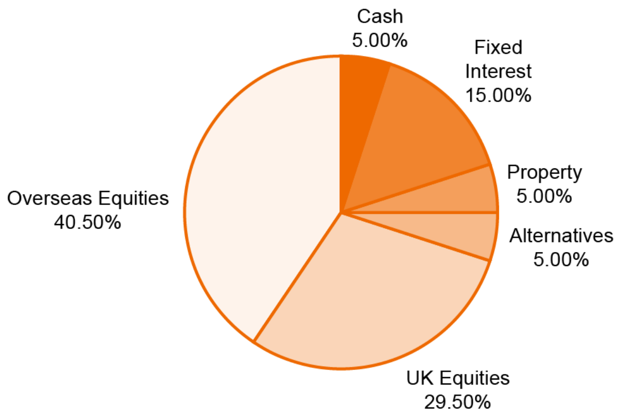
Ethical Cautious



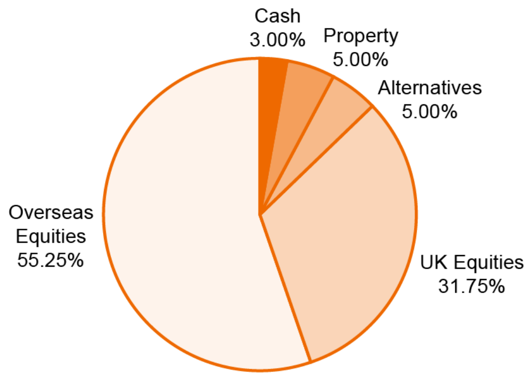
Ethical Balanced



Ethical Growth



Ethical Adventurous



MMWealth
Chartered Financial Planners

Disclaimer

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.

MM Wealth Ltd Wellbrook Court, Girton, Cambridge CB3 0NA 01223 233331 info@mmwealth.co.uk