Mazars Wealth Management investment newsletter

Spring 2021

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Foreword

Rising concerns for the prospects of inflation dominated the first quarter of 2021 and caused bond market yields to rise in both the US and the UK. As a result, US treasuries lost over -5% of their value (in Sterling terms) during the period, whilst the loss on gilts was even greater at just shy of -7%. Though some had feared that rising bond yields might undermine the lofty valuations on equities, stock markets continued to rely on the gradual emergence from lockdowns in some parts of the world to support optimism resulting in global equity returns of over +4.6%, again in Sterling terms. The US again led the way with returns over +6%, with the UK not too far behind at +5.4%. Gold, which had offered considerable protection during the sell-off a year ago, continued to struggle even in the face of rising inflation expectations, losing over -10% in the quarter.

The case for rising inflation has solid foundations, and perhaps the bigger question is whether the world sees a short-term bout of transitory inflation or a more established pattern of price rises extending into the medium term. Inflationary pressures can broadly be sorted into three areas. Firstly, the frictional effects of the Covid-19 pandemic and the associated disruption to global supply chains. Secondly, an expectation that (some) consumers have cash burning a hole in their pockets and will want to spend it once lockdowns ease. And finally, that in addition to well established loose monetary policy, fiscal expansion is now a significant force, at least in the US. Companies are already reporting an increase in the prices they are having to pay across their supply chains, and we suspect that consumer psychology and willingness of governments to continue spending beyond the pandemic will be crucial to determining what type of inflation the world sees, and for how long.

Support for the economy in both monetary and fiscal forms remains necessary to prop up the economy which is still hampered by the effects of the pandemic, and we think that the danger of stimulus being withdrawn too quickly is an unlikely risk. We do though expect to see differing approaches to government spending around the world and don't necessarily expect President Biden's recent stimulus package to be imitated in other countries, particularly in the EU. Similarly, divergences in monetary policy are starting to become evident with the US Federal Reserve and the Bank of England seemingly unconcerned with the recent rises in yields, whereas by contrast the European Central Bank will look to ward off tighter financial conditions.

Underpinning all other considerations is the market's continued optimism for the reinvigoration of the global economy as the worst of the pandemic passes. This is of course a brave assumption, particularly given the difficulties of vaccine supplies, the scale of the global vaccination program required, and the possibility of virus mutations. Challenges in this area might give markets cause to question current valuations.

At our April meeting the Investment Committee voted to make changes to our portfolios which move closer to our new strategic asset allocation. These changes include a greater weighting to overseas equities (with some currency hedging) and a move away Sterling denominated debt towards a more diverse range of bond investments. Within our tactical positioning we hold the view that what worked well last year may not do so this year, and therefore favour the UK geographically, and have increased our weighting to 'value' stocks.

I hope you find this newsletter interesting and relevant to you, and I would very much welcome any feedback you may have. Please do feel free to get in touch with your thoughts either by phone on: **020 7063 4259**, or by email on: **david.baker@mazars.co.uk**.

Economies and markets in brief

Global yields rising on expectations of inflation

Global yields, especially in the US, have risen significantly year-to-date in response to increased fiscal spending and central banks appearing happy to let inflation run. In the US, President Biden signed a $1.9tn Covid bill, with Democrats expected to push for a further $3tn infrastructure bill. At the same time interest rates remain at rock bottom levels, with the Federal Reserve 'dot plot' indicating 2023 is the first time we should expect a rate rise in the US. With supply chains damaged by the Covid crisis, markets are expecting these measures to result in a return of inflation. However, with global debt so high, it remains to be seen how high yields can (or will be allowed) to rise.

Government bond yields at pre-Covid levels

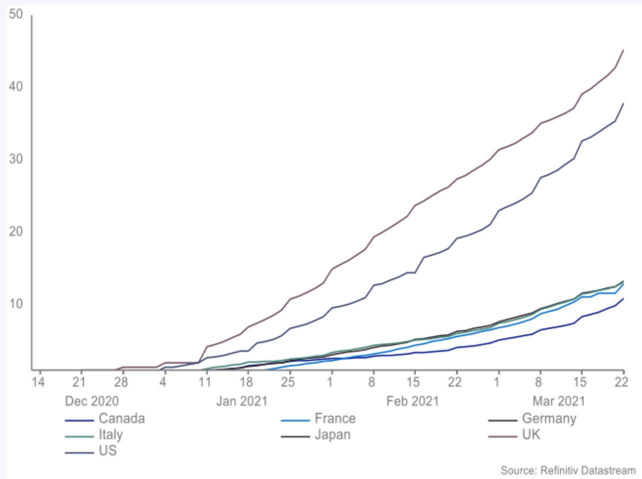
10Y yields, percent

Vaccine nationalism rising from uneven roll-outs

Unsurprisingly there have been snags in the production of the various vaccines, with deliveries to some countries not meeting originally promised levels. Unfortunately, this is leading to delays that are somewhat less innocent. The EU has prevented the export of some AstraZeneca jabs produced in the Netherlands, as citizens in the bloc grow frustrated at the slow roll-out of the vaccination programme there. Meanwhile, India has banned the export of millions of doses overseas, with pressure to make sure its own citizens are vaccinated. Vaccine nationalism, like economic nationalism, is likely to lead to a reduced overall supply, especially since most vaccines have components produced in various different countries. If they won't export to each other, very little will be produced.

UK is top of G7 Covid-19 total vaccines administered

Percent of population

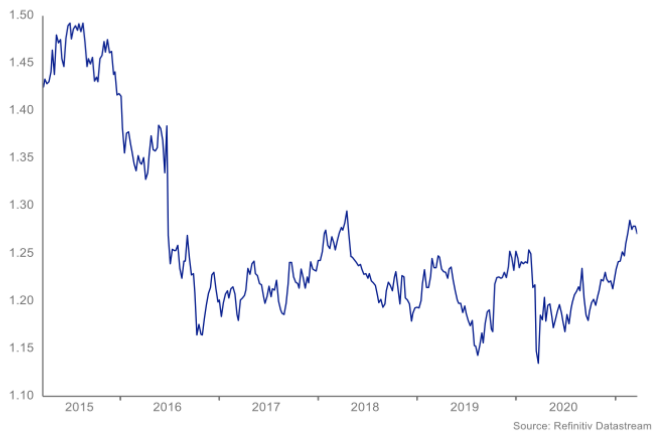


Sterling strength on improved outlook

Sterling has risen steeply this year, primarily due to the vaccine roll-out that sees it only behind Israel and the UAE in terms of percentage of population vaccinated. Currency strength is largely based on the relative strength of an economy compared to others, so the prospect of a re-opened economy, with many others still largely closed due to stubbornly high Covid levels, makes sense. For the past few weeks, the currency has been at the top of the range of where it has traded since the Brexit referendum, so any break-out to the upside would be a significant event.

Sterling is near its highest point since Brexit

GBP vs average of USD and EUR



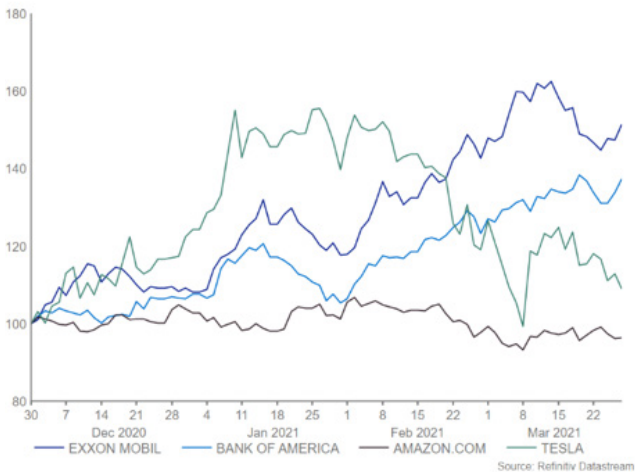
Will the rotation into value continue?

The year of the vaccine

Successful vaccines, the passing of the US election and an increasing belief in strong global growth in 2021 have all come together to spur global equity markets and risk assets higher over the past few months. After a decade of fast-growing technology companies dominating the markets, a strong economic recovery could cause a major shift. Value stocks - or cheaper shares such as banks and energy firms - have handsomely outperformed fast-growing stocks such as the big tech names in 2021 so far. Stocks such as Bank of America and Exxon are beating the likes of Tesla and Amazon.

Banks and energy stocks gain on recovery hopes, outperforming tech

Equity returns in USD, rebased to 100

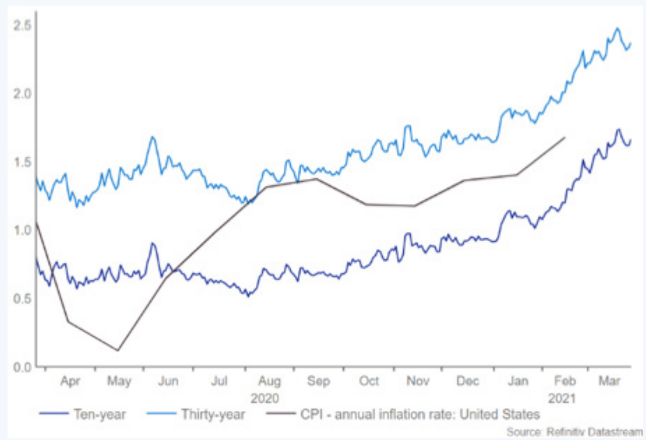


And then there are rising bond yields and inflation...

US Federal Reserve Chairman Jerome Powell suggested that the central bank would let inflation run hotter if it helped achieve full and inclusive employment. Recent concerns about inflation have driven bond yields higher. This month yields on the benchmark US 10-year treasury climbed to 1.75%, the highest since January 2020, while the 30-year treasury yield jumped to 2.5% for the first time since August 2019. Higher inflation, after all, often comes with an uptick in economic growth, which should benefit value stocks that are economically sensitive – like those of banks and energy companies – more than those that aren't, like tech. That's reflected in share price moves this year too: US energy and banks stocks have outperformed tech stocks by 33% and 16% respectively.

Treasury yeilds soar as markets digest economic recovery prospects

Increasing yields spark inflation fears



Can the rotation sustain itself beyond 2021?

While it remains to be seen how long value leadership will last, many of the drivers that led investors to flock to growth stocks have reversed and now favour value stocks. The jury is still out on whether we will see a generalised correction in stock markets, and there would have to be the prospect of interest rate rises or other monetary tightening before that occurs. We believe that even if a rotation takes place there will be winners and losers among both growth and value shares – they will not all go up, nor all go down. For instance, over the past year, people have made themselves even more familiar with digitisation through shopping online and working from home. Therefore, technology shares and other growth companies could continue to serve investors well even in a post-Covid world.

Value stocks are leading the recovery since December 2020

US value vs growth performance, rebased to 100

Convertibles bonds – in focus

What is a convertible bond?

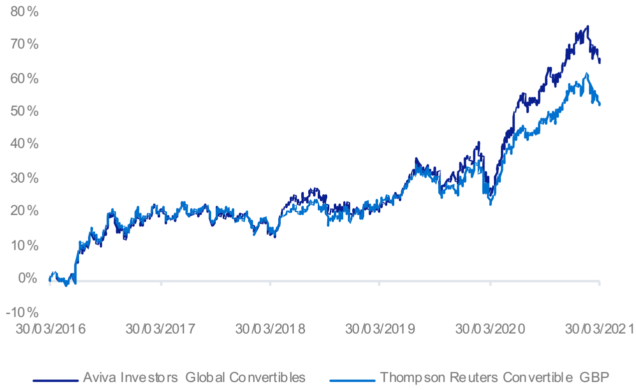
A convertible bond is technically a debt instrument that can be converted into a predetermined number of equity shares, at the discretion of the bondholder, should the equity price reach a certain level. Due to its hybrid characteristics, the price of a convertible is sensitive to the price of the underlying equity, in addition to changes in interest rates and the issuer's credit risk.

Why do we use them?

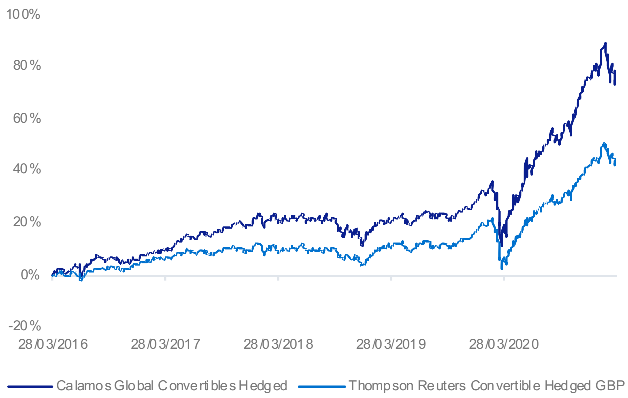
The hybrid characteristics of convertibles provide investors with several benefits. For example, their equity behaviour makes them less vulnerable to rising rates, while allowing the investor to participate in the upside of the stock's price. In addition, their fixed income nature establishes a floor when equities move downwards, offering greater downside protection than a stock. Such characteristics can lead to diversification benefits providing us with the possibility to reduce our portfolios' overall volatility.

Our approach

The start of the year 2021, as part of a change to our Strategic Asset Allocation, marked our first investment in a convertible bond fund. We selected Aviva Investors Global Convertibles managed by David Clott and Shawn Mato. Over the next quarter we aim to split our exposure in convertible bond funds between Aviva Investors Global Convertibles and Calamos Global Convertible run by Eli Pars. Both funds have exceptional track records, especially under the current management teams.



Source Financial Express Gross Returns in Sterling from 28/03/2016 to 28/03/2021



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Jargon Buster – SDGs

The Sustainable Development Goals are 17 global goals designed to be a 'blueprint to achieve a better and more sustainable future for all'. The SDGs were set in 2015 by the United Nations General Assembly and are intended to be achieved by the year 2030. They intend to reduce poverty and improve 'health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests'.