# Monthly market blueprint

## Investment management service

September 2021

mazars

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## Foreword

# Can the Fed be the answer to everything?

For a long time our central theme has been the disconnect between the real and the financial economy. Nowhere has this disconnect been made more clear than in the Fed's communication in August. The bullish economic outlook clashed directly with a dovish approach on interest rates. Actions speak louder than words, however, and it is becoming apparent that the world's de facto central bank is positioning for macroeconomic volatility. The data confirmed as much : US payrolls came in at a third of expectations and PMI indices in China and India suggested manufacturing stagnation. Manufacturing reports suggest that export orders are losing momentum, potentially indicating industrial weakness for the west in the next few months. Payrolls continue to be affected by the advance of the Covid-19 Delta variant, which keeps many parents/income-earners in a fluid condition.

Both the Fed and the ECB have been hesitantly talking about tapering asset purchases. In this volatile environment, however, it is difficult to see how central banks can reasonably justify the removal of ultra-accommodation. On the other hand, supply-driven inflation, a result of shortages and economic arrhythmia, could well continue to advance.

Despite the welcome dovish stance, investors need to remain vigilant. **There is a very thin line between monetary exuberance driving equity and bond prices higher and the markets realising that central banks can neither control supply-side inflation nor exit quantitative easing. It is the thin line that not only separates buoyance from panic, but also one that, if crossed, may lead to a paradigm shift.**

**George Lagarias**
Chief Economist, UK

In other words, it is conceivable that we are drawing closer to the end of a twelve-year course where the underlying tenet of every investor was 'Simply don't fight the Fed'. This tenet may well be replaced with 'The Fed is not the solution to literally everything', opening up a whole world of opportunities -and risks. A paradigm shift is usually a volatile affair. It would allow the central banks' political bosses less leeway to pander to the fringes and assign a greater impact and higher downside to the decisions of governments.

However, we are not there just yet. Investors should remain diversified and patient with volatility. As portfolio managers, we try to ensure that we are active enough to recognise opportunity and that there are more 'bets' in our clients' portfolios other than just equity 'beta'.

Market performance

# The month in review

## Reopening sees investors shed safe haven assets in favour of equities

August is always the month when economic newsflow is fairly light but low trading volumes can cause some outsized price swings. Fortunately, this August brought benign market conditions that can be characterised as a risk on environment in which equities performed well and bonds fell slightly.

Markets focused on the further reopening of the global economy and the efficacy of the vaccines rather than Delta variant of Covid and the supply chain disruption it is causing. Economic data remained strong in August and although some economic data, such as PMI survey data, moderated it remains at high levels which still points to further GDP expansion in the coming months.

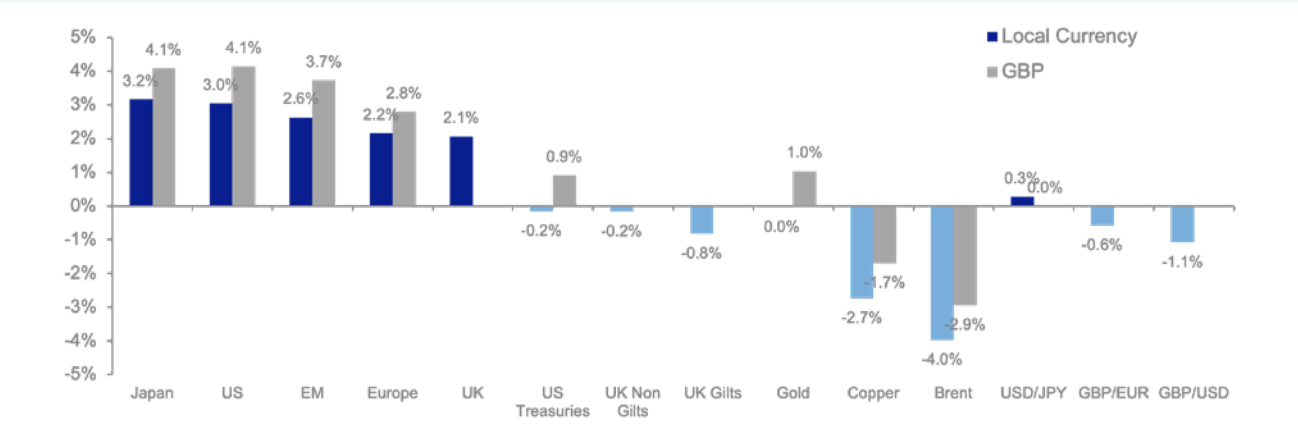
Developed equity markets all posted solid gains in August, with the UK rising +2.5%, the US rising +2.7%, Europe also rising +2.5%, and Japanese equities up +1.5%. In the UK it was the domestically focused mid cap companies which performed especially well, reflecting the indications that the withdrawal of the government's furlough scheme will not cause large disruption in economic activity.

Emerging Markets saw a modest fall of -0.2% but this can be attributed to the largest constituent of the EM complex, China, where the government's continued assault on certain sectors of the economy, including its large technology sector, saw prices fall further.

Government bond prices fell in August as a natural consequence of investors' preference for riskier assets. In the UK the 10 year gilt yield rose slightly to 0.58% while in Germany the 10 year bund yield rose by almost 4bps, to -4.2%. In America the move in treasuries was more significant as the Federal Reserve showed more signs of looking to taper its QE purchases, and the 10 year US treasury bond yield rose from 1.22% to 1.31% over the month.

In the commodity space, oil and metals fell while posted a small gain of +0.2%. The British pound fell slightly against the other major currencies.

### Basic asset classes




Charts Source: Mazars Calculations

# Changes in our Strategic Asset Allocation

## Outlook and portfolios

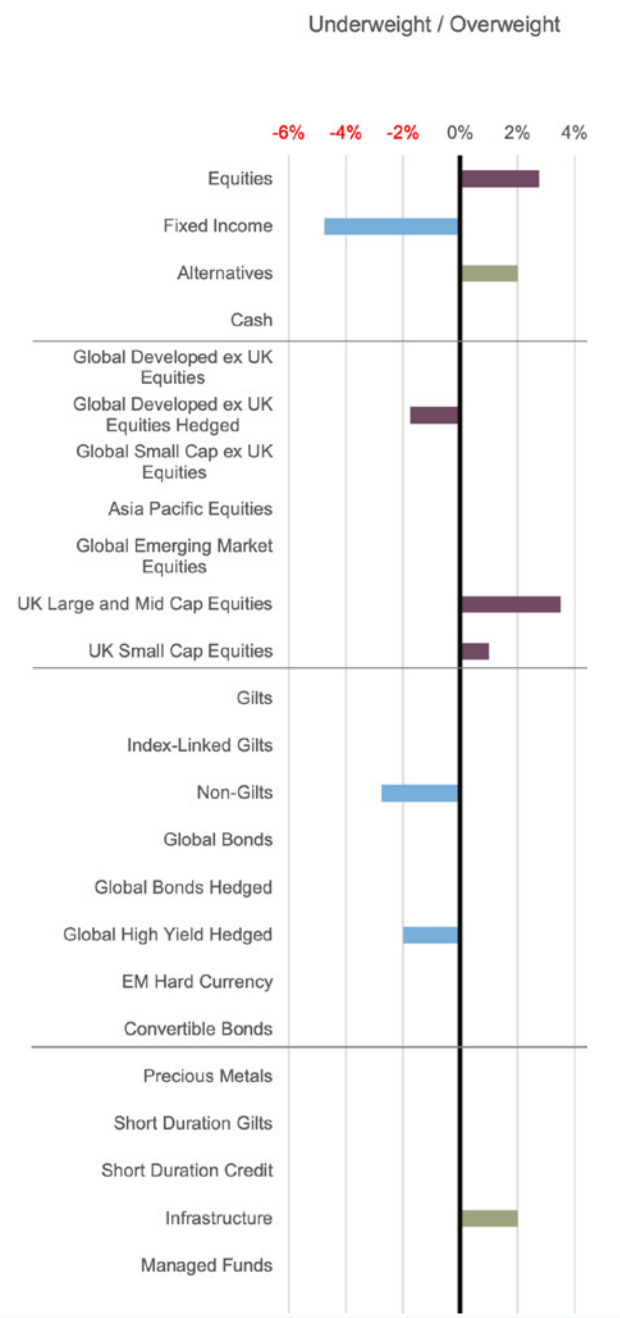
Our fundamental expectations are unchanged in that to us equity markets are expensive relative to their historic valuations but bonds even more so. Central banks have an interest in keeping financing costs low despite robust growth leading to inflation concerns, because the levels of government debt in developed economies is so large that it may not be sustainable if servicing costs ballooned.

Given this uneasy equilibrium, we remain underweight bonds and overweight equities. We feel that the low yields on fixed income securities do not justify the potential for capital loss as the market begins to price in higher rates. We also see that while equities could suffer from an untimely withdrawal of stimulus from central banks, they will benefit from economic growth and increasing corporate earnings as the business cycle unfolds.

Within equities we are overweight UK equities across all capitalisations, which are attractive due to their low valuations relative to other geographies and provide exposure to the cyclical recovery of the global economy through the large weight of financial and energy companies. The other area where we have a notable overweight is infrastructure, which we believe will benefit from the fiscal stimulus expenditure planned in Europe and the US, as well as the necessary investment over the coming years that will be needed to meet global environmental targets. We are overweight precious metals which should act as a hedge against unexpected economic disappointment and a ballast within portfolios in the case of market volatility.

Some positioning in portfolios is not captured at an asset allocation level but rather at a fund level. At the end of Q1 we added the Dodge and Cox US Stock fund, which, despite the resurgence of growth-oriented equities over the last month, we expect to perform well as value stocks benefit from the cyclical upswing post pandemic.

### Mazars balanced portfolio as of 3 June 2021



Risks

# The risk of inflation

2021 is the year of recovery after a period when global economic growth faltered at the swiftest pace since WWII. Overall, asset prices have kept climbing as policy makers actively sought to avoid market panics. As countries are exiting lockdowns, the key determinants of economic activity on the demand side will be repercussions of the Delta variant and the extent of stimulus and its impact on inflation. Economic decoupling and pressures on the supply chain will be the key focus on the supply side. There are two key risks for markets right now: the possibility of the return of long-term inflation and a pickup of the pandemic, especially in the emerging world.

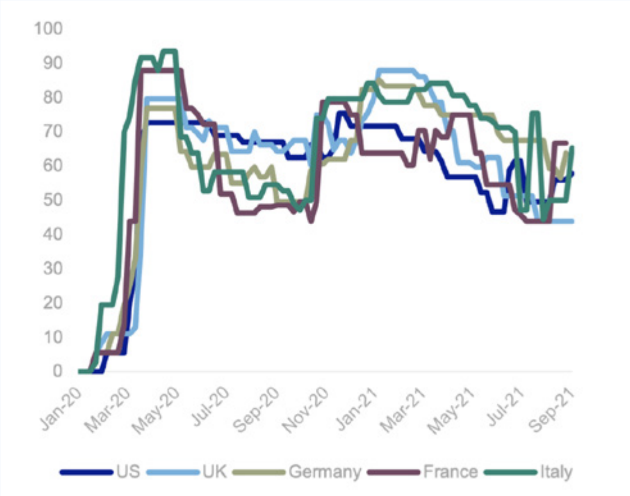
Markets continue to focus on quantitative easing, with investors convinced, for now, that central bank risk suppression is potent enough to weather any economic headwinds. The rate at which monetary and fiscal stimulus will be withdrawn is the main risk for the upcoming economic recovery. Stock prices are near or at all time highs, but earnings have yet to catch up to expensive valuations and are creating a ceiling against further breakouts. Global bond yields began to climb on inflation fears earlier in the year, however the move proved temporary with the market thinking that inflation pressures will recede, as long as fiscal stimulus is withdrawn as well. At any rate the Fed has signaled it will tolerate higher inflation for now.

We feel that overall risks are more global than local. A resumption of the pandemic with a more aggressive variant may continue to disrupt supply chains, especially those based in the emerging markets. While we don't believe that lockdowns will re-emerge

The key risk for investors is an inflation-driven paradigm shift. If stimulus causes higher inflation, central banks will have to rethink a 12-year monetary accommodation regime. Taken further, if growth supports even higher and resilient inflation central banks will undoubtedly have to adjust. At the time of writing, all key risks are kept in check due to the blanket of liquidity provided by policy makers to markets. We will be vigilant for signs of a significant shift in policy.

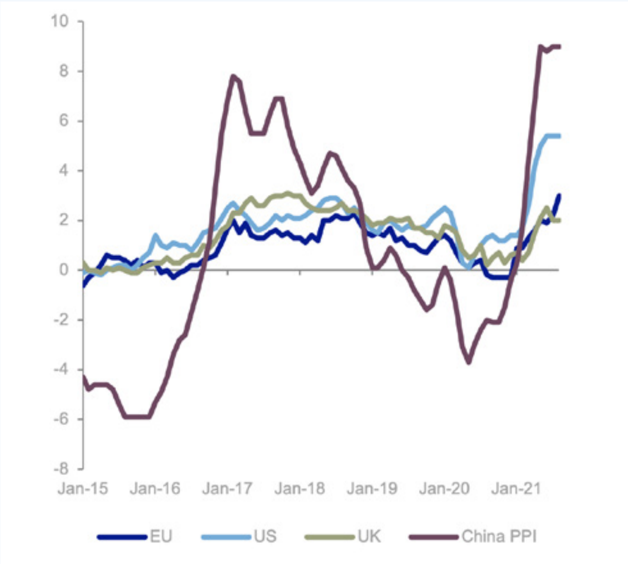
## Delta variant is a possible threat to the recovery

**Global stringency conditions remain elevated**




## Inflation is rising across the board

**Western economies CPI and Chinese PPI inflation**




Charts source: Mazars calculations

# Macroeconomic backdrop
## Global

**For the period, global stocks rose by 2.5% (3.6% in GBP). The highest performing sectors were Telecoms and IT while the worst performers were Energy and Materials. Equities were trading at 20.15x times forward earnings, 21.7% above long term average. Gold fell 0% and oil prices fell 7.4%.**

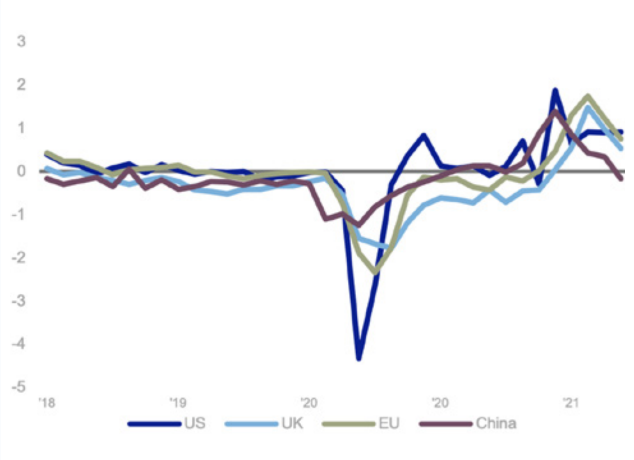
Economic performance has picked up significantly in the past few months, both in terms of services and manufacturing. Momentum, however, has stalled as the Delta variant continues to advance and supply constraints may already be impacting demand.

Momentum has stalled both for manufacturing and the services sector. Developed markets are still rebounding but Asian manufacturers are exhibiting signs of contraction on a monthly basis. The rates of new orders, especially export orders, for both services and manufacturing are lower. Demand for employment remains robust across the board, but the dislocations caused by the pandemic have made supply of workers more difficult, resulting in upward wage pressures. Inflation is further exacerbated by persisting supply chain arrythmias, which have driven the cost of exported goods much higher. Input prices haver risen almost universally. However, central banks have prioritized weathering macroeconomic volatility as opposed to attacking inflation. As a result, monetary and fiscal policy remains accommodative for many regions across the globe, which has consistently fed into the prices of risk assets.

Outlook: Global equities have been trading upwards in the past few months, as earnings begin to catch up to expensive valuations and central banks have remained dovish. The effect of supply chain disruptions, global imbalances and lingering problems in the services sectors post-summer are still issues economists and investors will have to contend with. Portfolio managers can, by and large, rely on central banks and governments to support risk assets, but should still be on the lookout for risks which might demand more aggressive policy approaches, or even transcend the ability of policy makers to deal with them.

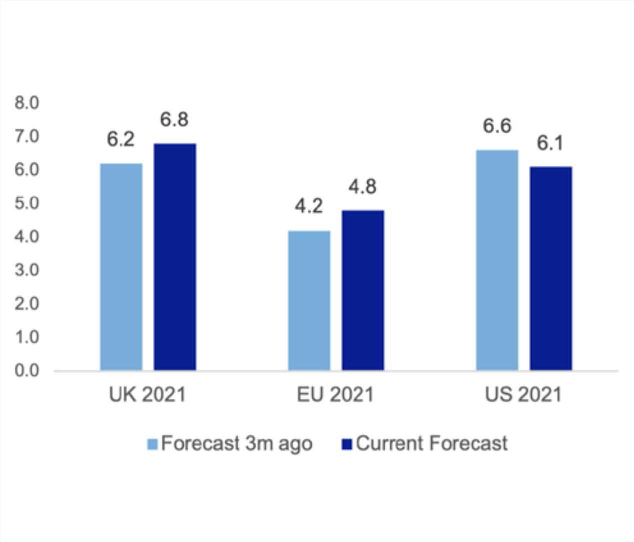
### The acute phase of the recovery may be over

**Z-score of leading indicators**




### Economic forecasts improve

**Bloomberg forecasts from economists**



# Macroeconomic backdrop
## UK

**UK equity markets continued their strong start to the year, up +0.4% in June. The best performing sectors were healthcare and energy, with the worst performing housebuilders and financials. UK equities are now trading at 13.6x forward earnings, below their long term average.**

In the UK, August saw two themes continue to playout. The first is the continued relaxation of Covid-related restrictions in light of the advanced stage of the vaccination effort. The second was the shortages and not being able to get people and things into the right place as the pandemic continues to affect the supply of good and labour. Behind the headlines however, mid-cap companies outperformed internationally focused, larger peers, underscoring the UK's faster economic growth and the reduced restrictive measures.

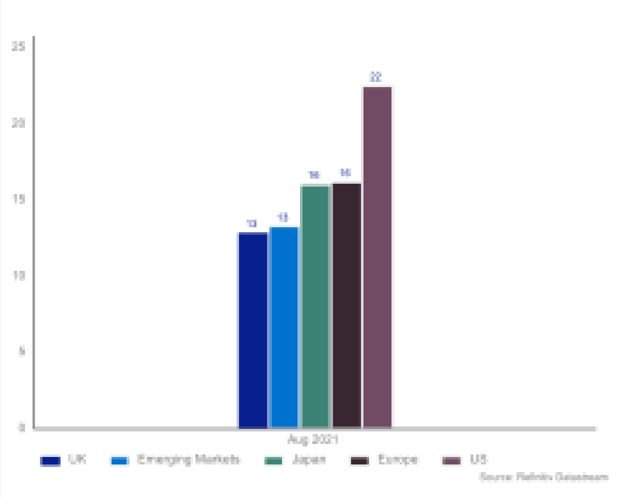
In August, Covid cases continued to rise but the UK government stuck to the roadmap of reducing restrictions. In the month of August the number of daily Covid cases rose approximately from 26,000 to 34,000 but hospitalisations remained steady. The latter metric is the biggest factor affecting Covid restrictions due to the risk of the NHS becoming overwhelmed and as it hadn't increased the government was able to reduce quarantine requirements for people travelling from abroad.

The shortage of HGV drivers has been widely reported, caused by fewer EU workers and bottlenecks in the issuance of new HGV licences, leading to a 40% pay rise in some cases. Snippets like this will continue to fuel the inflation debate but until the furlough is removed at the end of September and bottlenecks in supply chains resolve themselves one still cannot say with certainty whether inflation will persist.

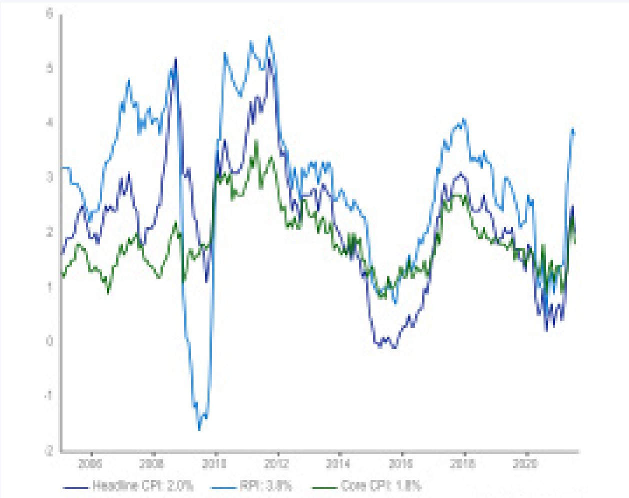
Looking at equity markets we have seen a decoupling between the outward looking larger UK companies and the inward looking medium sized companies. This reflects the expectation for the UK economy to rebound more robustly than other countries.

**Outlook:** Our stance on the UK relative to other equity markets has not changed in that we still see opportunities in the lower valuations coupled with the dynamic domestic economic recovery post Covid.

### Global equity valuations
**UK discount to global peers**




### UK inflation rising
**Twelve-month percentage changes**




Charts Source: Mazars Calculations

# Macroeconomic backdrop

## US

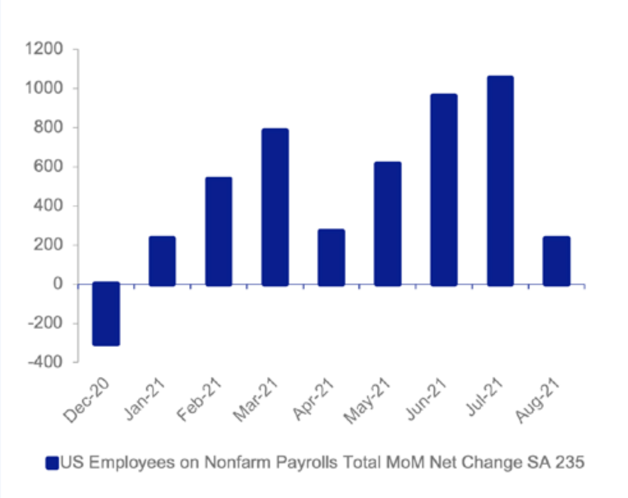
**In August, US stocks rose by 3.2% (4.2% in GBP). The best performing sectors were Financials and Telecommunications, while the worst performers were Energy and Homebuilding. 10Y bond yields rose 2 bps to 1.326.**

Economic activity in the US has continued to improve, with the S&P500 reaching its all time high during the month. Manufacturing activity accelerated, driven by upturns in production and rises in new orders, but hampered by material shortages. The services sector also continued to perform very well. Employment conditions continued to recover, dropping to pandemic era lows of 5.2% with weekly jobless claims also falling to their lowest level since March 2020. Meanwhile, non-farm payrolls in August rose by 235,000, falling far short of the market expectations of 733,000. Investors cheered as they believe that weaker employment will contribute to a more dovish Federal reserve.

**Outlook:** The main factor for economic performance in the next few quarters will be fiscal stimulus, where Joe Biden's proposal to stimulate the economy by an extra $3.4-$4tn could significantly add to inflation, but also spur consumer demand. At the time of writing the Bill was under negotiation, but the US government has had to make significant compromises to the original number.

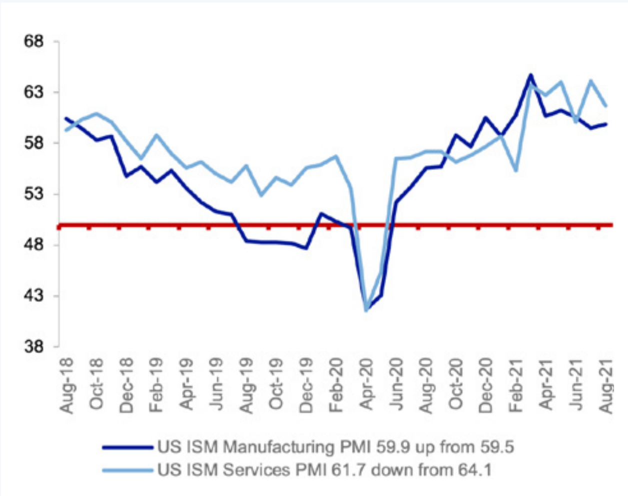
### Tapering just got harder

**US Non-Farm payroll**




### US economic expansion persists

**ISM manufacturing and services (>50 = expansion)**




Charts Source: Mazars Calculations

# Europe

## In August, European stocks rose by +2.6% (+3.1% in GBP). The best performing sectors were IT and Utilities while the worst performers were Retail and Automotives. Equities were trading at 17.95x times forward earnings, 18% above their long-term average.

The European economy is still growing fast but at a slower pace as indicators point towards momentum fading. The Eurozone manufacturing PMI in August stood at 61.4, a six-month low, while the services PMI fell from its 15-year high levels to 59. Manufacturers continue to face significant supply chain disruptions while services are partly affected by a normalisation in activity since the ease of the lockdown measures.

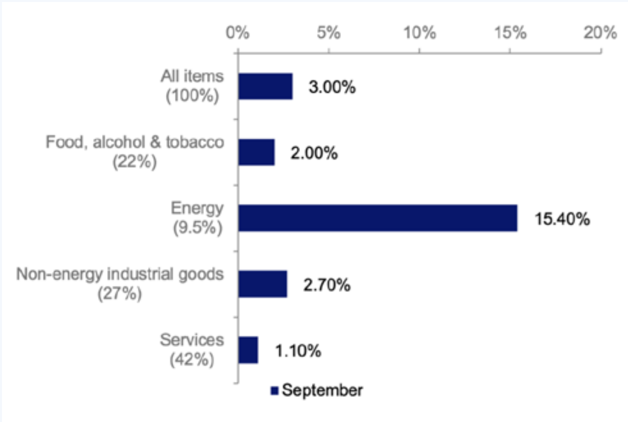
Retail sales in July have fallen by 2.3% month-on-month reversing June's gains while economic sentiment has had its first decline since January 2021. In addition, the inflation rate in August is expected to rise to 3.0% according to flash estimates, up from 2.2% in July and higher than the 2% ECB target. Energy is estimated to be inflation's main driving force, expecting a 15.4% increase year-on-year while core inflation stood at 1.6%, +0.3% higher than July 2021.

In response to higher levels of inflation, ECB policymakers' opinions are still divided on the nature of the price pressures. Some members insist that it is transitory rather than a paradigm shift while more hawkish members suggest reducing the pace of the asset purchasing programme.

The focus has shifted to Germany lately as the elections and economic growth are at the forefront. The latest polls have made election outcomes very hard to gauge as they point towards a free-for-all battle between the CDU/CSU, the SPD and the Greens. The Bundesbank has stated that the 2021 GDP growth rate could fall short of the 3.7% projection partly due to supply problems forcing manufacturing firms to cut down on output.

**Outlook:** The main factor for economic performance in the next months is the impact of supply chain disruptions on European manufacturers as they are significantly hurt by input scarcity and higher costs. German election results could also impact sentiment depending on how 'euro-friendly' the resulting coalition will be.

### Flash: Euro area inflation rate in August
**(Per cent)**




Energy is estimated to be the inflation rate's main driving force, expecting a 15.4% increase year-on-year while, core inflation stood at 1.6%, 0.3% higher than July 2021.

### Euro area PMIs
**(Index, 50 = no change)**


Charts Source: Refinitiv Datastream

# Japan and emerging markets

## Emerging market stocks rose by +0.8% and +1.8% in local terms and Sterling terms respectively. Japanese stocks rose +2.6% and +3.6% in local terms and Sterling terms respectively. The best performing sectors in emerging markets were energy and healthcare while the worst performer was technology.

Most economic data out of China, for the last couple of months, has been disappointing. Fresh outbreaks of the delta variant led to strict closures of cities and ports, resulting in a drop in economic activity. Industrial production increased 6.4% year-on-year(YoY) in, missing market forecasts of a 7.8% rise, and after a 8.3% gain in the previous month. This was the weakest growth in industrial output since August 2020. Retail trade rose 8.5% YoY, easing from a 12.1% gain in the previous month and missing market expectations of 11.5%. This was the weakest rise in retail sales since December 2020. The official NBS Manufacturing PMI fell to 50.1 in August from 50.4 a month earlier. This was the weakest pace of increase in factory activity since a contraction in Feb 2020, amid the Delta variant of Covid-19 outbreaks, higher material cost, and a campaign to reduce carbon emissions. Non-manufacturing PMI for China plunged to 47.5 in August from 53.3 in the previous month, dragged down by tough restrictions.

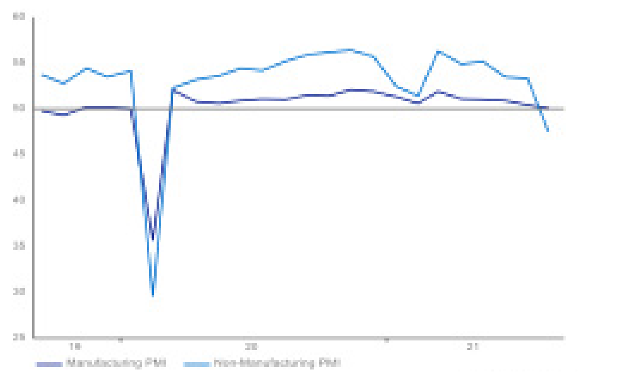
The Japanese economy advanced 0.5% on quarter in the three months to June 2021, beating both preliminary estimates of 0.3% growth and market expectations of 0.4%. Amid mounting criticism of his government's handling of the coronavirus pandemic, Prime Minister Yoshihide Suga announced his intention to resign. News of Prime Minister Yoshihide Suga's resignation contributed to a strong rally in Japanese equities, removing some political uncertainty and raising expectations of increased economic stimulus.

India's GDP rose by 20.1% in the three months to June. The economy contracted by 24.4% in the same period in the 2020-21 financial year.

**Outlook:** With Turkey, Brazil and Russia all having recently hiked their benchmark interest rates, some EMs face tightening economic conditions that may constrain growth for much of the year. The outlook for emerging markets still largely depends on how long the pandemic persists and how effective the vaccination drive within those countries proves to be.

### China PMIs

**China PMIs show some loss of traction in growth momentum**



China's businesses and the broader economy came under increasing pressure in August as factory activity expanded at a slower pace while the services sector slumped into contraction.

### India GDP growth

**India's GDP growth accelerated to record 20.1% in Q2 2021**

India's economy grew at a record 20.1% year-on-year in the April-June quarter, rebounding from a deep slump last year, helped by improved manufacturing in spite of a devastating second wave of Covid-19.

Charts Source: Refinitiv Datastream

# Our themes

# Macro theme 1

## Labour market post Covid-19

### The UK labour market seems to be recovering as hundreds of thousands prepare to leave the furlough scheme. The path towards healing will not be smooth as the pandemic and Brexit pose structural challenges to the labour force.

The Covid-19 furlough scheme is coming to an end in September 30 and the labour market continues to recover. The UK unemployment rate fell by 0.2% hitting a new low of 4.7% for the months of April to June. Similarly, according to the latest report from the Office of National Statistics (ONS) the number of payroll employees rose by 182,000 to 28.9 million in July.

The number of vacancies during May to June hit a record high of 953,000. Although this seems like positive news, the labour market is far from being close to fully healed due to labour supply issues, as worker shortages in some professions make it very hard to fill in the vacancies. The focus has recently been on the shortage of lorry drivers, which is partly due to Brexit and Britons leaving the industry. Coupled with other existing supply chain issues this shortage has severely impacted the supplies of restaurants and supermarkets to name among others.

In addition sectors affected by the shortage of workers face both wage and price inflation. For example, British supermarkets have been promising lorry drivers significant pay increases in order to fill in the large number of current vacancies.

That is partly reflected in the positive annual growth rate of employee pay for the 3-month period of April and June reported by the ONS but that should be interpreted with care. Recall that this is an annual growth rate, which means that we are comparing the current weekly wages with depressed weekly wages in 2020. Thus, a reason why we are seeing wage growth this year is because some wages were falling last year due to the lockdown restrictions.

What's even more important is the most recent inactivity rate for the second quarter of the year . The rate was estimated at 21.1%, 0.9% higher than before the pandemic but 0.2% lower than the previous quarter. In other words, approximately 490,000 workers have left the labour market since the fourth quarter of 2019. That constitutes an alarm for the labour market making it harder to fill the record number of 1 million vacancies.

Firms are worried that the worker shortages coupled with the rising wages and input prices in certain sectors could create further inflationary pressures. In order to mitigate part of the problem, industry bodies have proposed to introduce temporary visas for drivers from the EU to cover for shortages. However, the government rejected this solution and instead proposed to train new drivers, which would take longer to fill the job openings.

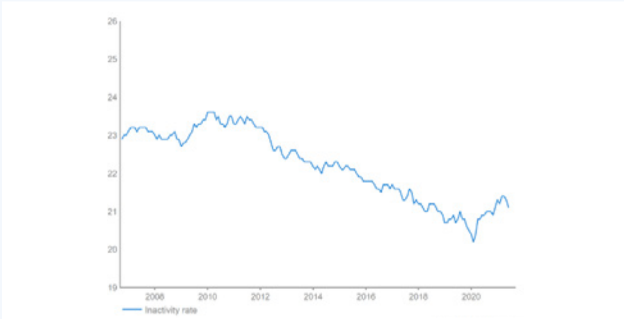
The labour market is recovering indeed, but there are still issues to be monitored. If the labour supply cannot meet the demand for workers this could result in inflationary pressures or even hamper potential future growth.

UK unemployment rate

**(Per cent)**


UK inactivity rate

**(Per cent)**




Charts Source: Refinitiv Datastream

# Macro theme 2

## Why this inflation will not cause interest rates to go up

Milton Friedman famously said that 'inflation is always and everywhere a monetary phenomenon'. The idea is that inflation is really caused by demand in excess of supply. Extra demand is a result of more money in the economy than necessary. If one, the theory goes, only discourages consumption, by raising interest rates for example, then demand–and inflation–go away.

This thinking is probably not appropriate for the era we live in.

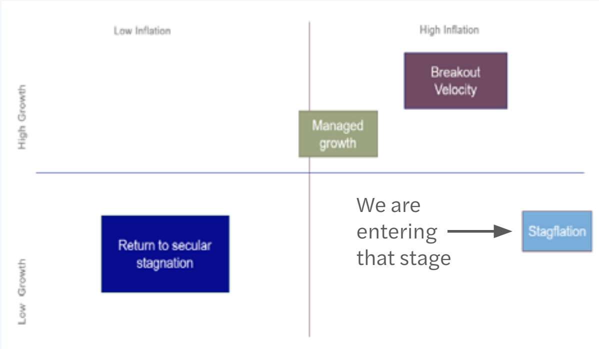
Global lockdowns stressed supply chains to near breaking point. Despite vaccination progress across the G7 and gradual exits from lockdowns of the world's largest economies, global supply conditions remain erratic and demand precarious. This is causing further strain on damaged supply chains. The pandemic has rolled back globalisation, the key driver of lower prices across the world for decades. Supply chains are not only more localised, but also unable to cope with the spike in demand from the developed world as G7 nations simultaneously woke up from the pandemic-induced coma with an appetite to spend. Producers are reporting significant shortages in materials, causing price spikes in most global markets. Frictional unemployment is rising, especially in lower paid jobs, as a lot of skilled and unskilled workers are reluctant to go back to their previous employment. As a result, companies are being forced to pay higher wages and offer permanent jobs to lure workers back, especially in hospitality services.

Apart from supply issues, inflation is being driven higher by pent-up demand across the developed world. Companies which had exhausted their inventories didn't stock up, uncertain about the lockdown measures. As stringency conditions ease across the board, the race to re-stock, along with the extra demand, is causing a surge in input prices.

Higher demand for goods and services and lower supply of both plus labour shortages are an explosive cocktail for higher prices, which may look bigger under the magnifying glass of the current news cycle.

Mr Friedman, the great economic guru, whose thinking continues to underpin most policy makers in the post-Gold Standard era, could not have envisaged either a situation where excess money did not mean excess demand, or where inflation was the result of an unprecedented disruption of supply chains.

### Our four basic scenarios on growth and inflation




If central banks raised rates now to curb the demand part of inflation they would endanger post-lockdown consumer buoyance. The whole point of using such a blunt instrument to control the economy and prevent it from overheating is to discourage consumption. But to do that, one would have to observe the return of normal consumption patterns and then be certain that the current demand spike is sustainable and above trend. Neither of these conditions currently apply.

Higher interest rates will not fix broken supply chains. They will not help workers return to the hospitality industry. And if they discourage traumatised consumers, the Fed runs the risk of that trauma adding to that of the 2008 global financial crisis, further hurting long term demand patterns.

**Supply chain disruptions and frictional unemployment are textbook examples of slack in the economy, which Fed Chair Mr. Powell and co. expect will be resolved in the next few months, or even a year from now. The Fed has lived with higher inflation before and it has indicated that it doesn't expect a rate hike until 2023.**

# Macro theme 3
## China in the age of slower growth and regulatory crackdown

In the minds of investors China has long been synonymous with the rise of the middle class as the country moves from an export led economy to one reliant on consumption. However, more recently China has attracted attention for more negative reasons, including slowing economic growth and a government crackdown on certain businesses' activities. As investors we have to decide whether the long term appeals of investment in China are diminished or whether what we are seeing now is simply growing pains that must be endured.

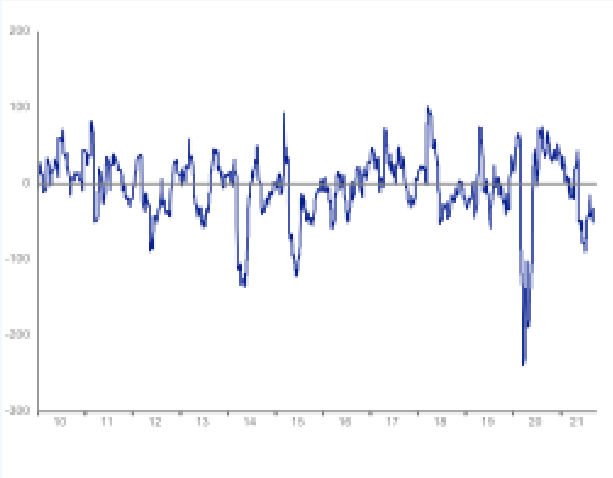
China's ability to still post 2.3% economic growth in 2020 when the global economy fell -3.2% was taken by some to be further proof of the inevitable "rise of China" which saw its middle class swell from 80m in 2002 to 200m people in 2020 and will see the size of its economy overtake the US in this decade.

However, Chinese economic growth is showing signs of slowing as credit growth within the economy appears to be falling and PMI survey data points to contracting economic activity. On top of that, the reopening of western economies means that those consumers who have been spending money on goods while lockdowns were in place will now be able to spend money on services, which have not been available during the pandemic. This tilt away from goods is likely to negatively impact China's exports.

In the news China's economic slowdown has been covered less than the government crackdown on certain industries, such as technology companies or education providers. This is seen as a Chinese government which is hostile to the interests of private investors in favour of creating a more cohesive society which has spooked investors.

Investors allocating capital must weigh up the long term appeal of China with the near term headwinds. The headlines are alarming and the troubles seem significant but the Chinese equity market has already fallen approximately 25% from its recent high leading some to think that the bad news is already discounted by the market. Our diversified portfolios will always contain some allocation to China and we are among those weighing up the current economic situation while we consider our allocation.

### China Economic Surprise Index
**Negative territory**




### China equities
**25% lower than 2021 high**


Charts Source: Refinitiv Datastream

# Income – What next for income investors

## Dividends are likely to grow as companies become more confident about their revenues post Covid. However, many companies will be reluctant to return to previous levels of dividend yields, instead preferring to only gradually lift their dividends.

We continue to look at company dividends and this month we discuss what people should expect from dividend yields, as well as other forms of capital return, and how these can impact share prices.

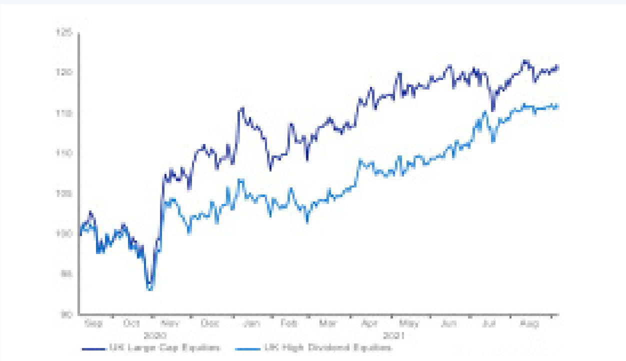
In the midst of the Covid crisis, facing an uncertain future, companies cut their dividends to shore up their balance sheets. Sometimes this was to avoid insolvency, sometimes it was prudent given the extreme uncertainty of the time. Now were are coming out of the pandemic and economic activity is normalising one may expect that in aggregate dividends could return to their prior levels, however this is unlikely to be the case for some time yet as companies enjoy the leeway that not having to payout all their spare cash to shareholders gives them.

The upshot of this is that dividend cuts which occurred during the pandemic are unlikely to be fully reversed in the near future. While in many cases dividends have been reinstated and increased in 2021 companies will enjoy the flexibility that paying out less to shareholders gives them: it leaves more money to pay down debt or invest for growth. In the future dividends will likely increase but in some cases will not reach previous levels for many years, or capital return will come via more flexible means such as buybacks, where there is less expectation for it to repeat and grow each year.

For income investors there must be some acceptance that in an era of conservative dividend payouts and low bond yields income levels are reduced. However there are always opportunities somewhere and at this point it makes sense to look towards companies that have high free cash flow yields as these will be likely to return cash to shareholders in some form, such as a dividend or a share buyback. In fact, one does not have to only be interested in income to place such a trade as announcements of higher dividends usually leads to an upward rerating in price thereby also satisfying investors who look for overall capital growth.

### UK High Dividend stocks have lagged the broader index post-pandemic

**UK large cap index vs UK high dividend equities**



### UK corporate dividends are not anticipated to rebound to prior levels

**UK Equities 12 Month Dividend Expectations**


Charts Source: Refinitiv Datastream

# Fixed income spotlight

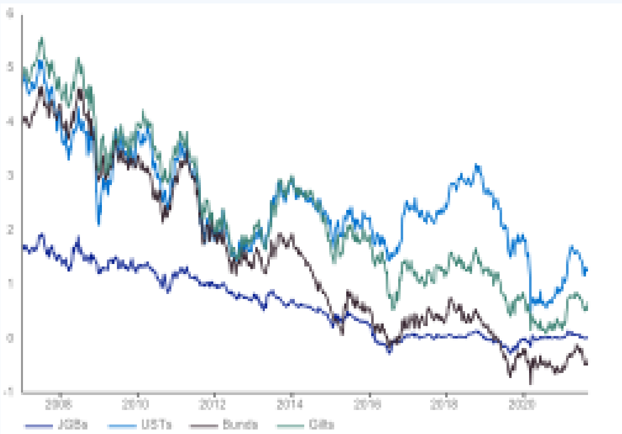
## Fed maintaining control of the yield curve?

**It would be fatuous to say that yield curves are in any way normal. They haven't been since global monetary authorities took extraordinary measures in order to prop up the global financial system in the wake of the Global Financial Crisis. Therefore we have seen a decade of extraordinarily low yields and extremely flat yield curves.**

It is apparent that the Fed is attempting to normalise the US yield curve. It is also apparent that it has generally done a better job than its peers in other developed regions. Not only have yields there remained at a somewhat more normal levels, they have also managed (most of the time) to keep the yield curve positive sloping – in other works longer yields at higher levels than lower yields.

### US yields highest amongst developed regions

**10Y Yields per cent**




Source: Refinitiv Datastream

Why is this important? The prime reason is that a positive sloping yield curve makes lending profitable, as banks are able to borrow short term savings at a lower rate than they charge for longer-term loans, which encourages them to support the economy.

All this said, the Fed would clearly like a greater degree of normalisation, and especially a steeper yield curve. They have been 'supressing' the short end of the yield curve through low interest rates and continued high levels of quantitative easing (the buying of Treasuries and other bonds). They have also been 'talking up' the longer end of the yield curve by insisting that interest rates in the future will be higher.

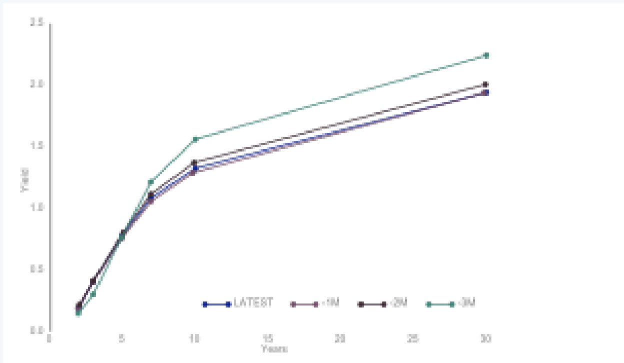
The difficulty the Fed faces is convincing markets, which have become accustomed to such low interest rates, that they can follow through on any rate hikes. There have been various attempts to begin a rate hiking cycle, particularly in the 2016-2018 period, however continued low growth levels meant that even before the Covid crisis the Fed had to again take rates to record lows. Why will this time be any different?

The reality is that central banks can only do so much, since rates are generally driven by factors outside of their control. Should growth continue to be weak and inflation fall away, markets will see through any 'hawkish' comments – indeed the US yield curve has flattened recently as US economic data has disappointed. On the other hand should inflation spike significantly higher and prove longer lasting, the Fed would likely have little choice but to start raising rates, even though this current bout of inflation is a lack of supply as opposed to excess demand.

The conclusion? The Fed, and central banks in general have the ability to suppress the yield curve in the absence of inflation, however any attempt to increase (and normalise) yields in a controlled manner is fraught with risks.

### US yields curve has flattened on weak economic data

**Yields per cent**



Source: Refinitiv Datastream

# ESG investing

## While the trend of Environmental, Social and Governance (ESG) investing, has been gaining momentum for years, this year the pace of green change has been rapidly accelerated as a by-product of the pandemic.

While the trend of Environmental, Social and Governance (ESG) investing, has been gaining momentum for years, this year the pace of green change has been rapidly accelerated as a by-product of the pandemic.

ESG or ethical investing has now become a trend the investment industry can't afford to ignore. The pandemic has fuelled investor demand. Figures from Morningstar show flows into European ESG funds have reached an all-time high, attracting €52.6bn during the third quarter of 2020, helping grow overall assets across ESG funds to a record €882bn.

Opportunities for sustainable investment used to be scarce, but today it is hard to find a business that does not have an ESG policy. For example, 90% of companies in index of America's largest companies produced sustainability reports in 2019 and 81% of the leading UK companies have some form of emissions reduction target.

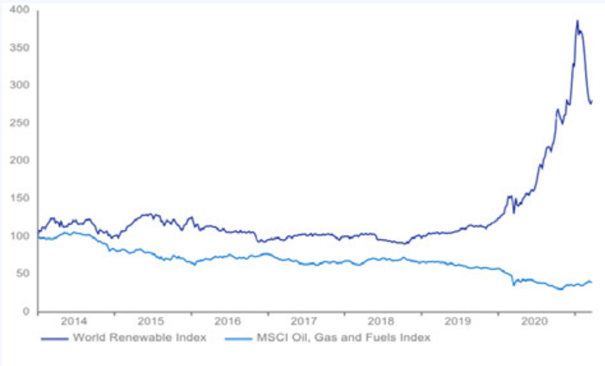
While the focus of ESG investments has largely been on environmental impact and climate change, this year we saw the 'S' in ESG come to the forefront. The social aspect of ESG was not well defined from an investment perspective but Covid-19 has definitely changed that. From early on in the pandemic, major shareholders urged company bosses to make timely payments to employees and suppliers during global lockdowns, even at the risk of losing dividend payments. Even social movements such as Black Lives Matter pushed companies to do more on racial injustice and called for greater disclosure of their staff's racial mix. Most companies will now be expected to not only disclose data on gender diversity but also racial and ethnic diversity.

As the focus on ESG investments increases, we can also see a shift in policy makers worldwide. In Europe, the EU taxonomy, which came into force this year, established an EU-wide classification system or 'framework' intended to provide investors with a common language to identify to what degree investment activities can be considered environmentally sustainable.

In the UK, chancellor Rishi Sunak announced the launch of Britain's first ever "green gilt" and also pledged that Britain will be the first G20 country to make large companies report their climate change exposures by 2025. China, the world's biggest producer of greenhouse gases, has said it will cut its carbon dioxide emissions to nearly zero by 2060. The US is also expected to re-join the Paris climate accord under Joe Biden, who has also called for a transition in America from fossil fuels to renewable energy.

### Renewable stocks have significantly outperformed traditional energy stocks

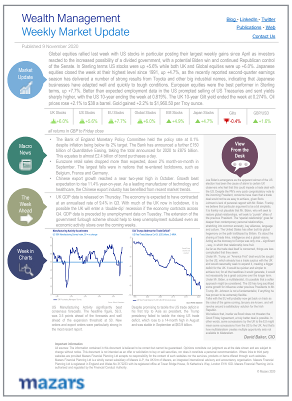
**Global renewables vs oil and gas since 2014**



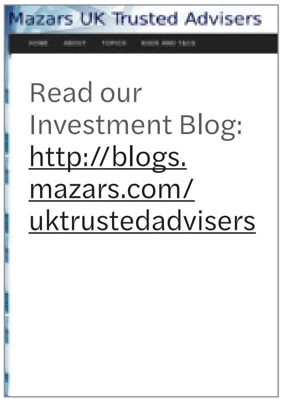

Over the last few years, there has been a dramatic shift in investments into renewable energy vs traditional oil and gas companies.

Source: Refinitiv Datastream

# More reading...



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