Harwood
Wealth Management Group Ltd

Quarterly Update

Q2 2021

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- Wellian Investment Solutions Limited.

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INTRODUCTION

In the early months of 2020, we witnessed forest fires in Australia, a US drone attack which killed a high-ranking official of the Iranian army – prompting fears of military conflict a terrorist bombing of an oil refinery in Saudi Arabia and (last but not least) Covid-19 moving from a Chinese epidemic to a global pandemic causing widespread panic, economic shutdown, worldwide lockdowns and a year that will be remembered for a very long time. Thankfully the corresponding period of this year didn't surprise us in the same way, but outgoing President, Donald Trump kept us on our toes when at a speech he urged his supporters to march on mass to the Capitol building and disrupt congress whilst they were ratifying the approval of Joe Biden to become the next President. Unfortunately, many took it literally and the Capitol building was stormed, and it took several hours before things returned to normal. Unfortunately, lives were lost, and Washington entered curfew.

Britain has now formally exited the European Union and must fend for itself. In a completely unsurprising set of events immediately following the exit, lots of issues arose for importers and exporters of goods and services and as sure as night follows day, news reports of carnage at the ports and truckers (both British and European) being stuck on the surrounding motorways for days on end covered our TV screens and peppered our newspapers due to a lack of correct paperwork and a shortage of customs officials.

Towards the end of the March of this year, we witnessed a 1,300 feet long container ship (one of the largest in the world) get blown off course and as well as running aground managed to entirely block the Suez Canal which impacted - for the week it was stuck - something like 10% of global trade. As the traffic jam of roughly 400 other ships piled up, oil prices rose, as did market nerves. One article that was published whilst the problem was ongoing suggested it could well be inflationary and for each day the vessel remained in the state it was global trade was being affected to the tune of $400 million per day. Although the canal is now free again for safe passage, the Ever Given and its cargo worth hundreds of millions remains side-lined whilst the dispute of who pays what to whom gets sorted.

In the final quarter of last year, the Covid vaccine roll-out started and gathered significant pace in the UK and US during the first quarter of this year, although Europe has lagged somewhat due to concerns relating to a very small proportion of people (less than 20) suffering blood clots (from the more than 30 million injections presently administered). Economies are still not open though (but they are slowly opening) with things likely to improve dramatically by the end of the first half of this year (assuming the direction of infection continues the path it has taken over the past couple of months). In the UK the cheer will be heard far and wide on June 21 when (hopefully) the economy finally fully opens (…OK, when the pubs finally fully open)…

From a capital markets perspective, things were broadly good in the three months to 30 April. Soothing sounds from central banks across the world suggesting interest rates were not going to rise any time soon (regardless of what happens to inflation) combined with an extra $1.9trn stimulus package in the US and a budget in the UK that was not overly taxing suggests that "risk on" remains the mantra. The extra stimulus from the US – which has literally come in the form of a cheque to American households, combined with other cheques and tax credits last year has accounted for between 10% and 15% of US GDP which should provide the much-needed kick start the economy needs to get over the shock of 2020. Biden hasn't stopped with the first stimulus package and is actively talking with Congress to get more bills through to boost the US economically. Watch this space.

The "year-on-year" numbers in 2021 will be surprising to many and will have both positive and negative effects. Stock markets fell very rapidly in Q1 2020 (and rebounded strongly over the following 3 quarters – representing the much talked about "V-shaped recovery") so please be aware when looking at tables and charts – 2020 was very much the exception, not the rule. For example, inflation is a rolling 12-month number, and there was a period in 2020 when spot prices of a barrel of oil went from $50 to -$40 in a matter of days. Oil is presently about $60 and arguably a move from $50 to $60 is not a lot, but a move from -$40 to +$60 is significant – especially as oil and its derivatives have a large impact in the inflation basket. This is known as "base effect" and it will take some time for it to work its way through the system but in the meantime, expect to see some shocking inflation headlines to come our way this year. We expect the policy makers to look through these numbers and see the numbers as they are and not change interest rates.

In the US, fears of President Biden taxing the big tech companies to pay for the covid pandemic put the brakes on "growth" stocks, combined with a fear of how would the stimulus cheques be paid combined with printing of debt forced the 10-year bond yield to back up through the 1.50% level towards 1.75% although it has since settled at lower levels which caused many market participants to sell down their exposure to government bonds and rotate their equity portfolios towards more cyclical (and smaller cap) companies. Many commodities (gold being an exception) rallied in response, and "value" investment managers performed very strongly indeed.

All of this "printing of money" has seen demand for alternative assets and asset classes get more interest as many no longer believe in the quality of fiat currencies. Bitcoin has now passed $1trn of "worth" (whatever that actually means) with the value of the cryptocurrency gyrating over the period from $40,000 at the beginning, falling to $30,000 (that's a 25% fall) and rising to $60,000 (a 100% rise) towards the end of this three-month period… The latest speculative craze – NFT (Non-Fungible Tokens) recently saw a digital artist – known as Beeple – recently sell a work of (digital) art for $69m through Christies which makes the piece the third most expensive sold by a living artist. It was, also the first NFT sold by the auction house. Funnily enough, the buyer of the piece made his fortune investing in Cryptocurrencies…

As we look forward, we think capital markets will become more volatile as greater uncertainty enters the psyche of the market participants as questions surrounding interest rates, inflation, currencies and economic growth get asked. The counter argument is that GDP and corporate profits will sky-rocket compared to 2020 as the economies of the globe open up again and the recession of 2020 – although deep – was short lived – and we head into growth mode again. One thing is for certain – it will certainly not allow us to be complacent in our investment thinking and outlook.

Looking at the returns of numerous indices over varying time periods, the first quarter of 2021 saw a number of indices register double-digit returns – the Russell 2000 Value – an index of stocks that display "value" characteristics of a 2000 stock universe (US companies, smaller cap) registered a return of almost 20% for the three months in question, and over 60% for the past 12 months. 12 months ago, the index has lost 26% in the previous year… The "losers" over the quarter were most definitely the government bond indices.

Sector Analysis

Top Performing **31/01/2021 - 30/04/2021**		**Top Performing** **YTD 2020 (30/04/2021)**	
UK Smaller Companies	15.98%	UK Smaller Companies	16.60%
UK All Companies	10.91%	North American Smaller Companies	13.28%
UK Equity Income	10.80%	North America	11.32%
North America	10.60%	UK All Companies	10.10%
European Smaller Companies	9.94%	UK Equity Income	10.09%
Worst Performing **31/01/2021 - 30/04/2021**		**Worst Performing** **YTD 2020 (30/04/2021)**	
UK Gilts	-5.29%	UK Gilts	-6.82%
China/Greater China	-4.66%	UK Index Linked Gilts	-5.66%
UK Index Linked Gilts	-3.02%	Global Emerging Markets Bond	-2.69%
Sterling Corporate Bond	-1.91%	Sterling Corporate Bond	-2.68%
Global Emerging Markets Bond	-1.66%	Global Bonds	-2.09%

Data from FE fundinfo 2021, dates as above.

FIXED INCOME

Sterling Bonds

Bond markets had a dramatic start to the year which saw bond yields rise during this time. The main drivers were optimism over the vaccine roll-out programmes in the US and UK, as well as concerns about the inflationary impact of the economic stimulus being provided by central banks and governments. Against this backdrop, corporate bonds held up reasonably well. The more interest rate sensitive investment grade market saw the weakest returns. However, high yield credit spreads continued to tighten.

The big focus for bond markets was President Biden's US$ 1.9 trillion fiscal stimulus package, which was in addition to the US$900 billion of stimulus agreed last year. This unprecedented amount of liquidity being provided to the US economy has raised inflation expectations. Bonds with longer maturity dates (which are typically more sensitive to inflation) have seen the biggest rise in yields.

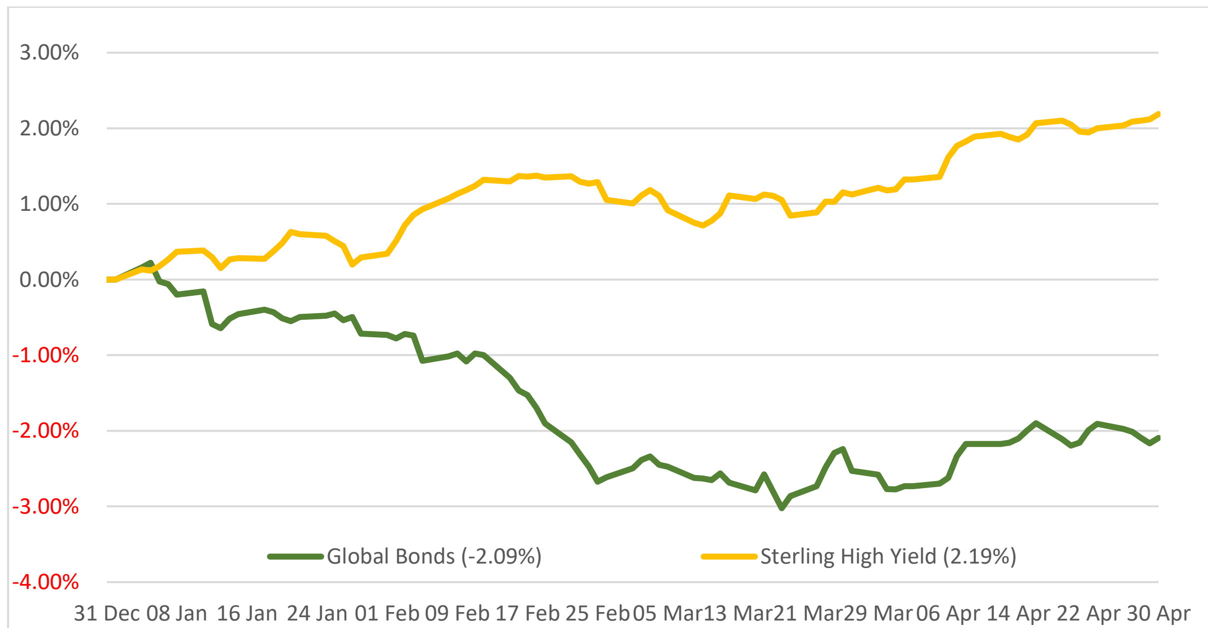
The US Federal Reserve has sought to reassure financial markets about this rise by reiterating its commitment to keep interest rates low as policymakers believe it will be some time before the US economy generates growth substantial enough for it to consider tightening policy. Nonetheless, the market has begun to bring forward its expectations of when the Fed will begin hiking interest rates again with a partial hike now starting to be priced in for late 2022. In contrast, the majority of committee members of the US Federal Reserve still expect US interest rates to remain on hold during 2023.

Although the impact of the US$1.9 trillion package has yet to be felt in the inflation numbers, inflation remains an important focus for bond markets for the remainder of the year, as they will decide on whether the US Federal Reserve really will hold interest rates steady if growth and inflation does pick up sharply.

Sector comparison: Global Bonds and Sterling High Yield – 3 month performance

31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Sterling High Yield – YTD performance

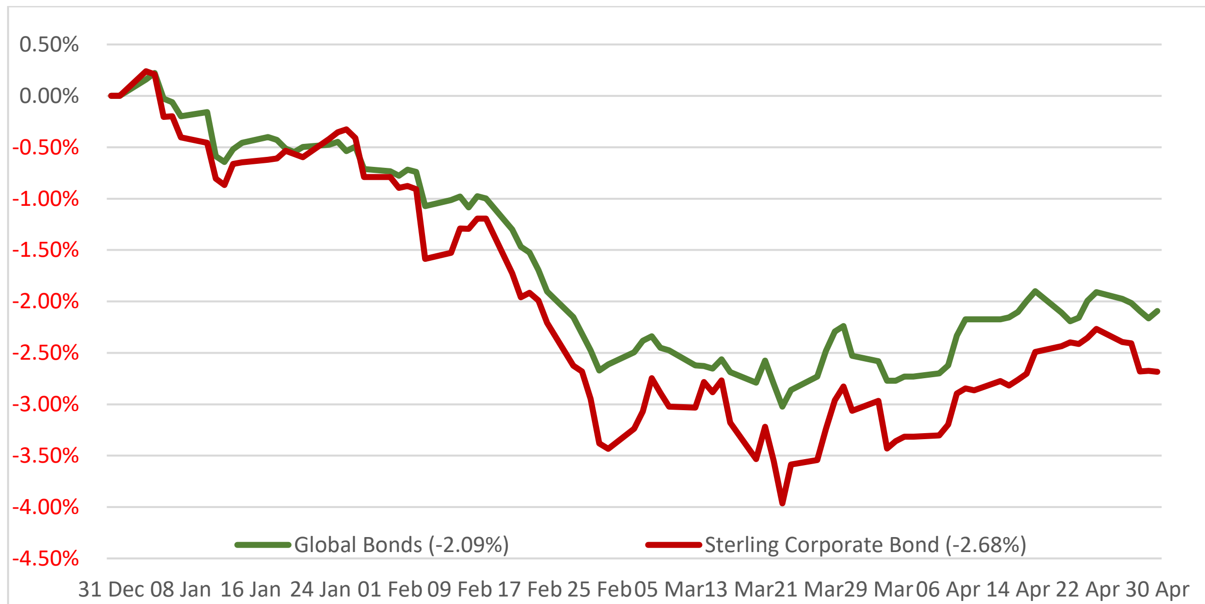


31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Sterling Corporate Bond – 3 month performance

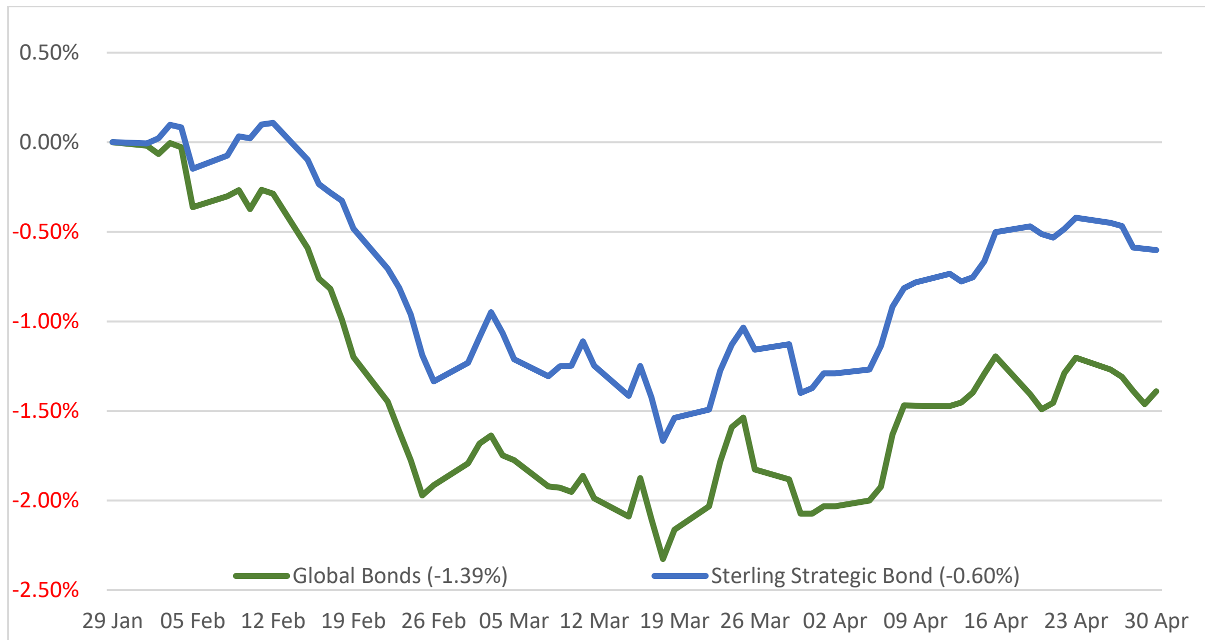
31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Sterling Corporate Bond – YTD performance



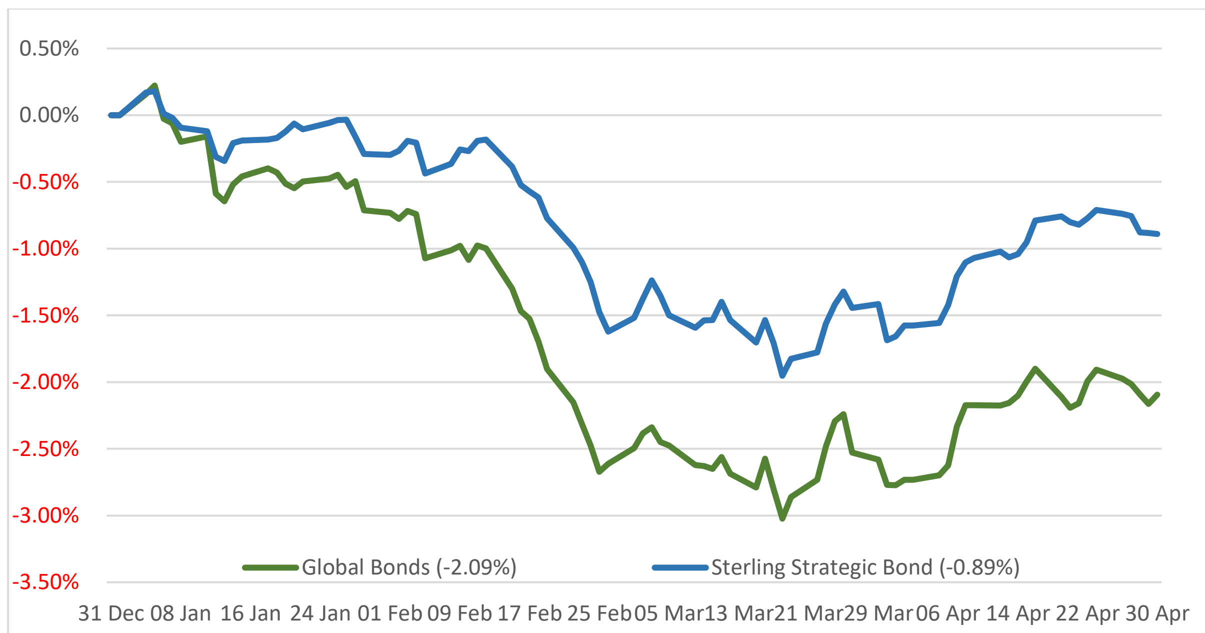
31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Sterling Strategic Bond – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Sterling Strategic Bond – YTD performance



31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

Global Bonds

As is the case with the US being the largest equity market, it is the same when it comes to bonds, and the saying “when America sneezes, the rest of the world catches a cold” so it is always useful to understand what is going on in the US bond market when considering the wider global bond market. Fixed Income investing is relatively simple to understand in essence. Governments and companies offer a set rate of interest for a set amount of time before paying back the principal amount borrowed. Depending on the length of time and the quality of the borrower depends on the rate of interest (known as the coupon) demanded by the investors. Because the coupon is fixed (hence “fixed” income) the biggest fear for investors in the asset class is the relative attractiveness of the real rate of “income”. The real rate takes into account base rates and inflation. If interest rates and inflation are rising, the real rate of income falls, and to compensate the price of the bond falls.

The Federal Reserve last year shifted its outlook with regard to how interest rates are to be managed in relation to managing inflation in the economy. Rather than having a target inflation number, it moved to an average inflation number. For many years, inflation has been below the target inflation number which correspondingly now means that there is a lot of room for inflation to go above the historic target number before the average number rises which then forces interest rates to rise. Therefore, this has changed the risk/reward dynamic in the eyes of the bond market investors which has pushed prices down to correct the “coupon” rate accordingly. For example a bond with a price of 80 and a coupon of 5% provides investors with a different income stream than investing in a bond at 100 with a coupon of 5%.

Over the last couple of months, the yield on the US bond market has been ticking upwards – suggesting there are inflation fears starting to build and therefore investors want to be rewarded accordingly. For instance, the 10Y US Treasury has seen the yield move to about 1.60% (up from 0.90% at the beginning of the year) and the 5Y US Treasury has moved to 0.80% from 0.35%. There is certainly nothing to be hugely worried about, but the markets do tend to look forward… The Federal Reserve governors have also made a lot of noises suggesting that interest rates are not going to rise until 2023 which puts a great deal of uncertainty into the minds of bond market participants.

This has basically forced up the yields across the globe, with the UK, Europe and Japan seeing their bond market yields increase too, although Europe still remains negative (which ultimately means that if you loan money to Germany for instance to buy some of their sovereign debt, you get no interest and a guaranteed loss on the amount you lent. Doesn't feel like a good deal to me…).

When equity markets become increasingly volatile, the safe harbour status of government bonds come into play; they act as great diversifiers and the odds of a government going bust and not repaying their debt is very low for the vast majority of countries. Besides, when it comes to a bond maturing – if a government doesn't have the cash to repay, it just borrows more and pays off the older debt!

A number of Governments (and companies) issue Index linked bonds. Instead of having a "fixed" coupon, it is variable and aligns itself to an inflation index (for instance, the main ones in the UK are the Retail Prices Index (RPI), Consumer Price Index (CPI) the Harmonised Index of Consumer Prices (HICP) – all of which measure the prices of different baskets of goods and therefore have different outcomes accordingly). The bonds have a fixed life like conventional bonds although principal repaid is the inflation adjusted number. Should inflation fall between inception and maturity, the amount returned will be less than the amount invested.

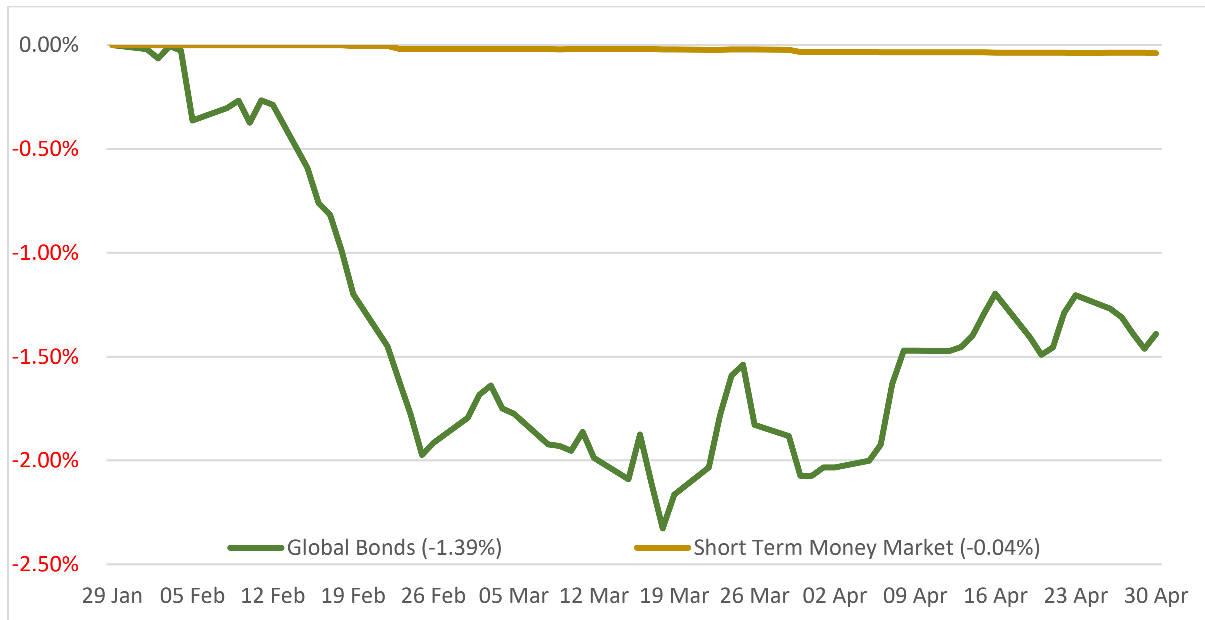
Inflation is likely to be higher this year compared to last – by its nature. Inflation is a year-on-year number and updated monthly. As economies open from covid lockdowns, there will be money spent. The leisure industry will get back on its feet (having been decimated a year ago), the hospitality industry will welcome customers back for the first time in a year. People will use their cars more. Shops will open, stimulus cheques in the US will be spent and so on….. Demand will be high – compared to last year. On the other hand, supply is likely to be subdued – not as many things have been made due to lockdown so expect prices to rise. This is therefore inflationary. The question then becomes "do you think this inflation is transitory or structural" and this is a great unknown. With the Federal Reserve going to let inflation run higher than average before interest rates rise, many fixed income investors have shifted their gaze to the index-linked market as a diversifier and protector of income. In the last quarter, investors in global inflation linked bonds have fared much better than investors in global sovereign (conventional) bonds, albeit the former having registered a slight positive return compared to a loss of about 3.50%.

Most emerging market countries access the global capital markets by offering their debt in "hard currency". Hard currency is US Dollars. Emerging Markets tend not to have the ability to control their domestic currencies and therefore are forced to offer their bonds to international investors in the good old "greenback" which reduces some of the risk for these investors. Coupon rates for Emerging Markets tend to be higher than mature, developed economies which relates commensurately with the risk of lending to less developed countries but the principle of investing in debt remains the same – time horizon, inflation rate and expectations, interest rate and coupon of the country offering the debt.

In the last quarter, investors in Emerging Market debt would have seen a negative return – aligned with the prior commentary relating to global bonds and the fear of inflation. Emerging Markets tend to start with higher inflation than developed markets and even if the real yield is similar to the US, the coupon will be higher. Do not necessarily be fooled by a high coupon rate. If an emerging market has a 7% coupon and the US bond has a 2% one, but the former has 6% inflation and the latter 0.5% inflation, the better "real" return is available from the US bond. As the US bond market fell in capital terms over the quarter, it made sense that the hard currency bonds of Emerging Markets fell too. Emerging Market bonds in local currency fared much worse – in essence doubling the loss of the hard currency over the period registering a loss of around 5%.

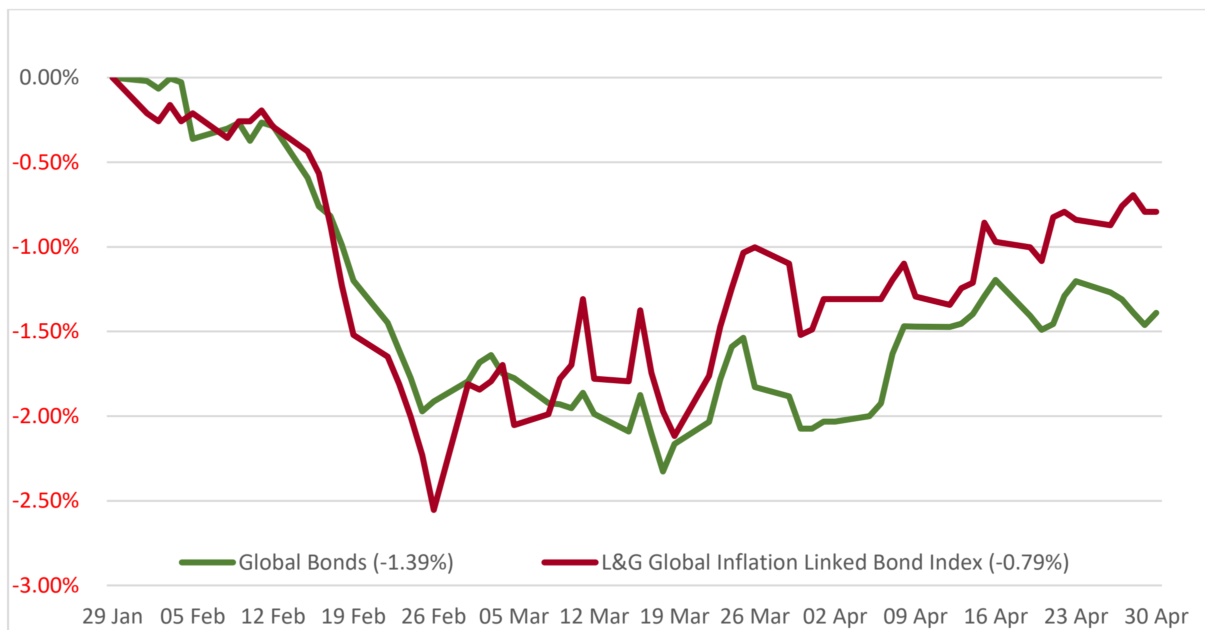
Over the long run, emerging markets tend to have faster growth rates, so even though the risk from investing in bonds can be high, if interest rates and inflation can be brought under control (they've made huge progress over the past 20 years or so) the potential for the upside in terms of reward is high too.

Sector comparison: Global Bonds and Short Term Money Market – 3 month performance



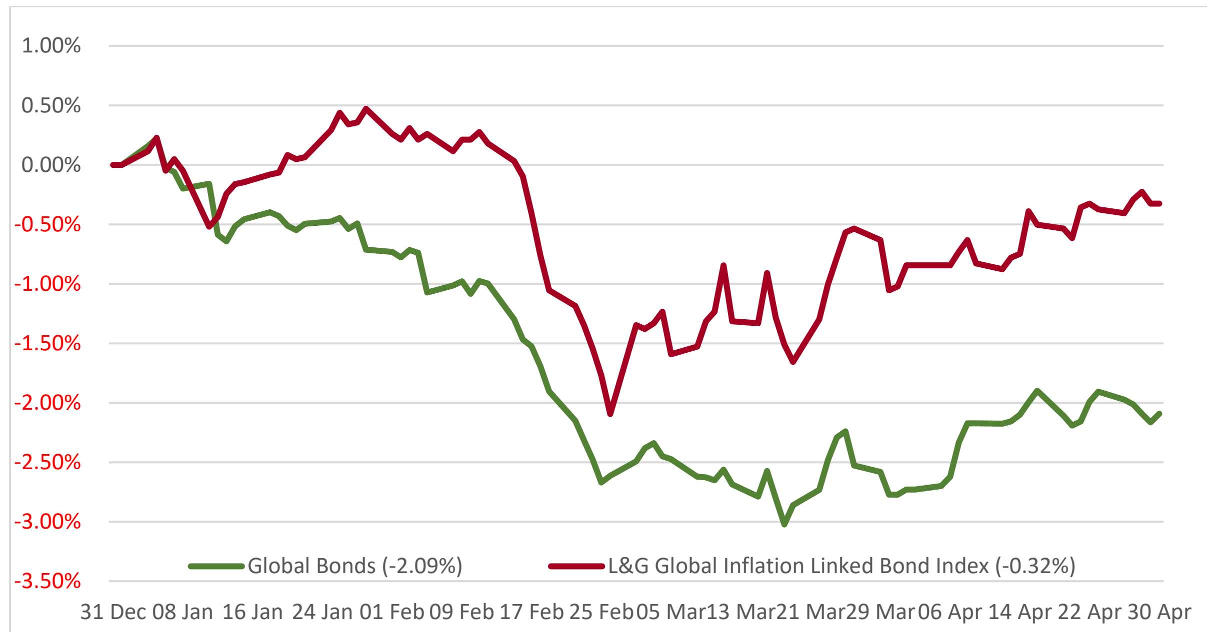
31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Global Inflation Linked Bond Index Proxy – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global Bonds and Global Inflation Linked Bond Index Proxy – YTD performance



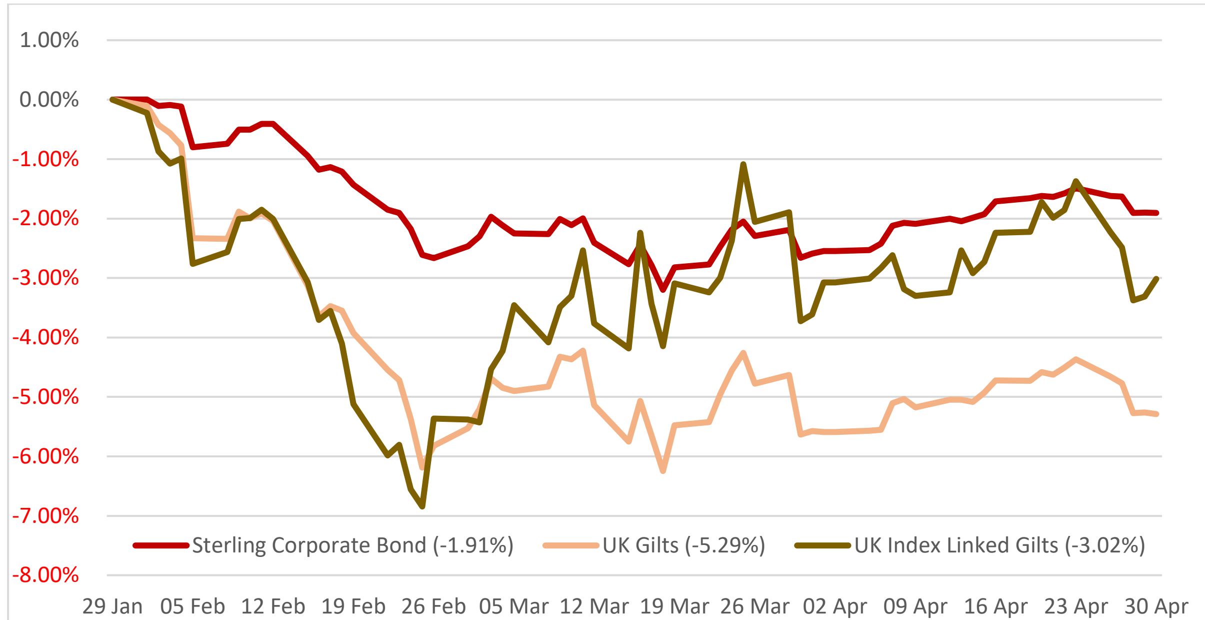
31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

UK Gilts

UK government bonds had a particularly torrid three months as the success of our vaccination programme improved investor confidence and removed any expectation that the Bank of England would move to negative interest rates in an attempt to restart the economy. On the back of these expectations, Gilts prices had strengthened over 2020 but as attention shifted to when rates might move upwards instead, the reversal of fortunes saw investors suffer the worst start to a year in two decades.

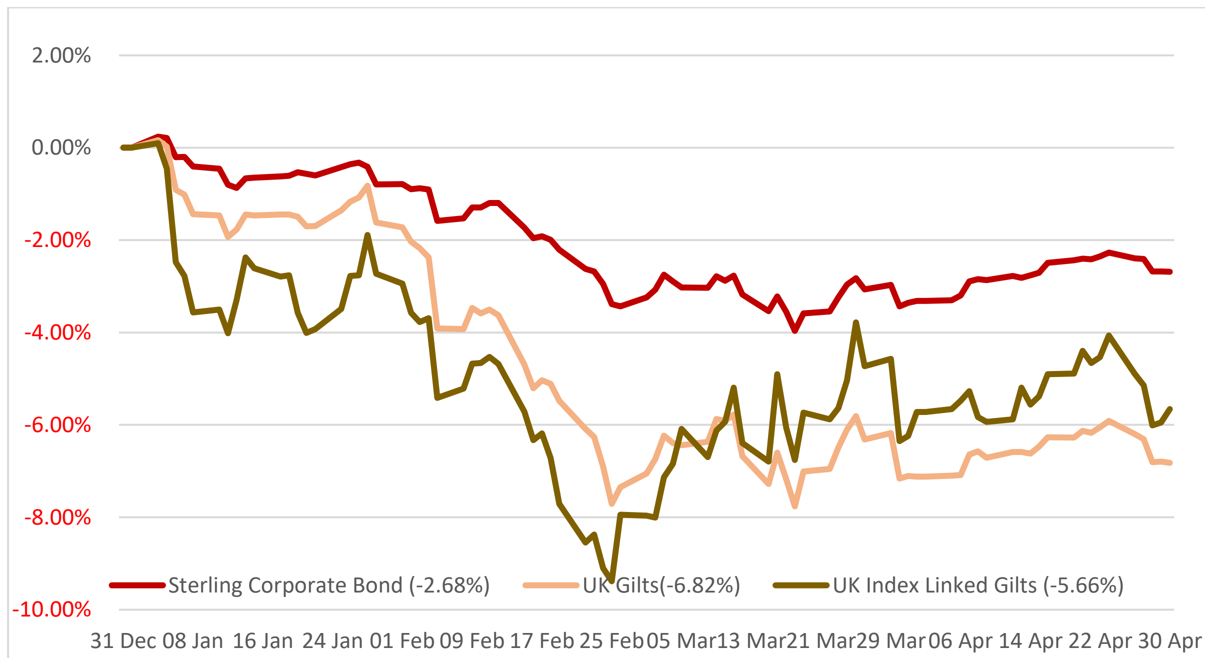
The poor performance of Gilts exceeded those of other European government bonds, and expectations are that this trend will continue due to the relative strength of our vaccination effort. This is likely to be magnified in the longer term end of the market with gilts with a shorter time to maturity less affected by the current situation.

Sector comparison: Sterling Corporate Bond, UK Index Linked Gilts and UK Gilts – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Sterling Corporate Bond, UK Index Linked Gilts and UK Gilts – YTD performance



31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

DEVELOPED MARKET EQUITIES

UK

UK Equities performed well. The 'overlooked' UK has been one of the better places to be in the first quarter of the year. Within the global context of the Coronavirus pandemic, the UK is now on the road to gradual easing of the third lockdown restrictions that offer glimpses of cautious optimism. On the vaccination front things are going well in the UK. More than half of the UK's adult population had already had at least one dose of the vaccine putting it way ahead of the US and Europe.

Coronavirus spending by the UK government is forecast to equate to 17% of GDP in the present fiscal year, and with a large proportion of UK debt held by international investors, this could weigh on the value of the currency. The UK is not alone in having stimulus packages and the big question is can the economy grow quick enough looking forward to cover the cost?

Rishi Sunak's second budget as Chancellor included an extension to various Coronavirus-related support measures until September 2021. Also, the Chancellor plans to raise corporation tax by 6% to 25% from 2023 raising an additional £22 billion in revenues.

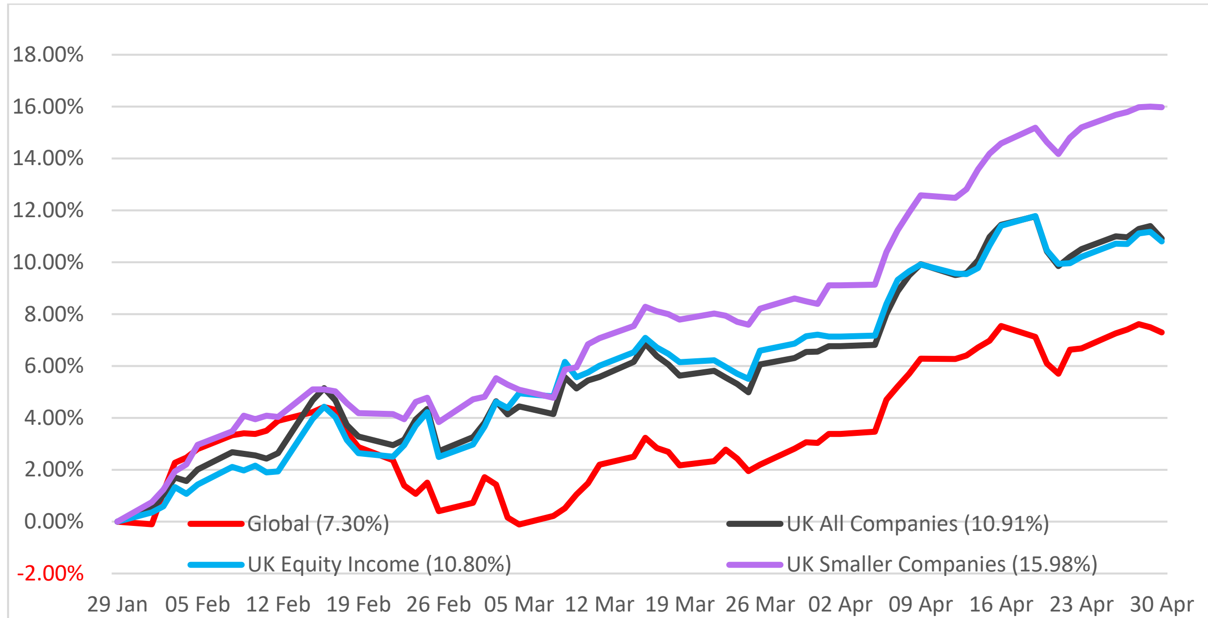
As lockdown suppressed economic activity, the service sector was affected the most, reflecting restrictions on service industries such as the retail, hospitality, and accommodation sectors. On the positive side, high levels of household savings and growing consumer confidence could potentially propel spending higher once lockdown restrictions are fully eased. Unfortunately, this might be the second summer when Britons choose the UK for a "staycation" as the travel restriction uncertainty remains at this time.

Trade fell between the UK and EU in the early months of this year with exports to the EU down 41% and imports down 29% in January alone. However, the import data is skewed due to stockpiling towards the end of 2020. A survey from the Institute of Export and International Trade indicates that around 20% of UK firms have stopped trading with the EU and half of these firms will stop trading with the EU altogether. The longer-term effects are certainly still to be seen.

Over the review period, the total return from the FTSE 100 index was positive, due in part to a strong March. The UK is an above average dividend yield payer, and after dividend cuts (and suspensions in some cases) last year, April saw some relief for income investors who cheered the decision by Royal Dutch Shell (one of the largest dividend payers in the UK) and Unilever to increase their dividend payments. At the other end of the market capitalisation spectrum, small cap investors fared even better, as potential for further upside exists as the economy rebounds after the lockdown.

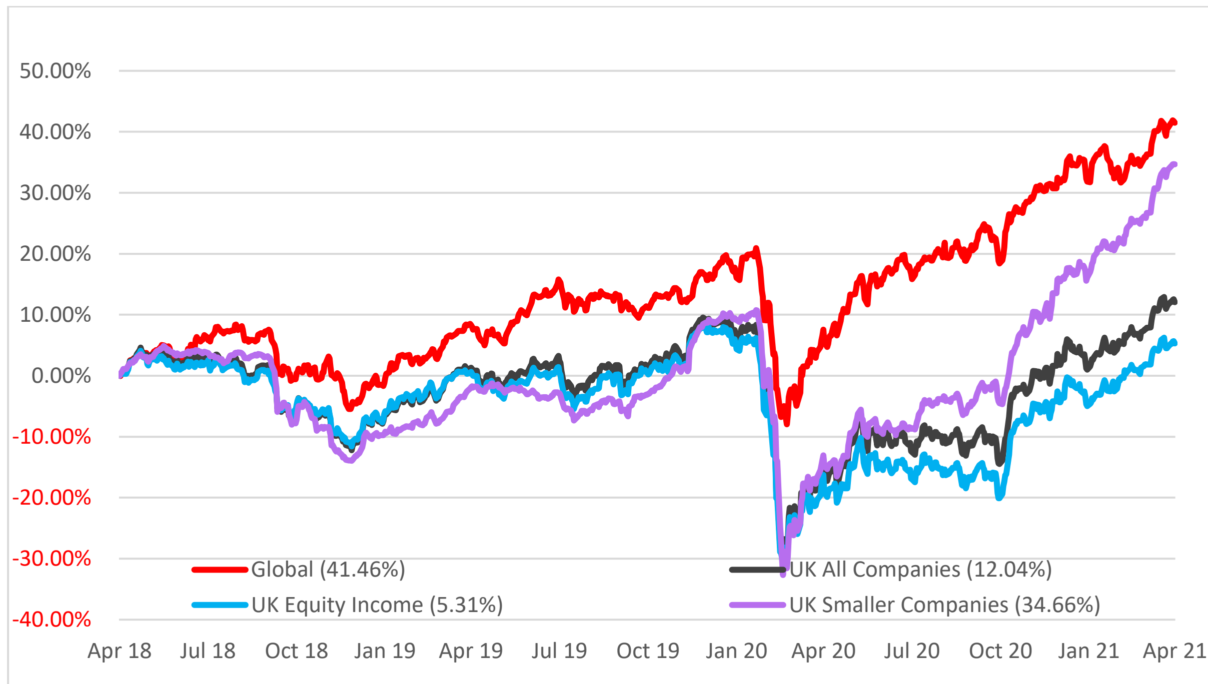
The end of Brexit uncertainty should reduce the risk premium on UK assets. UK equities are an attractive play on the global cyclical recovery. Industrials, financials, retail, services (that make up the bulk of our market) are the typical “cyclical” sectors, whose performance tends to resemble the overall health of the economy. They do well when times are good – hopefully, the prospects for the UK economy will only get better from here on.

Sector comparison: Global, UK Equity Income, UK All Companies and UK Smaller Companies – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global, UK Equity Income, UK All Companies and UK Smaller Companies – 3 year performance



30/04/2018 – 30/04/2021 Data from FE fundinfo 2021

Europe

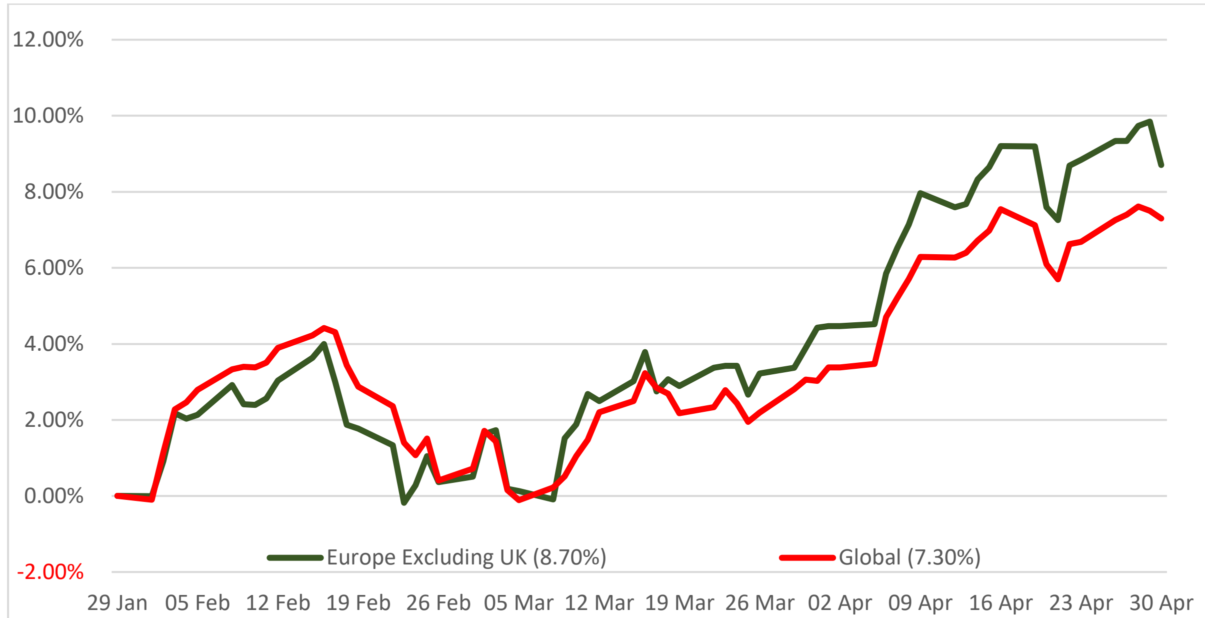
European equity markets posted strong returns over the quarter driven by positive earnings announcements and a continued pick-up in economic and survey data across the region, as the regions cyclical positioning helped it outperform the broader global sectors. Of the major EU countries, France posted the highest returns of over 34% during the quarter, while Germany, Spain and Italy all delivered double-digit returns too.

Economic data across the region showed positive signs as the Eurozone composite PMIs (Purchasing Managers' Index) readings came in well above consensus. The surveys are typically considered a key leading economic indicator due to their strong correlation with subsequent GDP growth – a level above 50 indicates that the economy is likely to expand whilst a reading below that suggests growth will slow down. The composite index climbed back into expansionary territory after rising from 48.8 in February to 52.5 in March.

The manufacturing component continued to impress most and reached an all-time high of 62.4 – with Germany also at a record 66.6 and France at a very strong 58.8. Strong export demand remains one of the key factors behind current manufacturing strength, as European corporates benefit from the strong rebounds in China and the US. Services also improved as the German index climbed back above the all-important 50 mark after rising to 50.8. However, the Euro area aggregate remains in contraction territory at 48.8. Services is one of the most sensitive areas to Covid restrictions and is likely to take longest to recover.

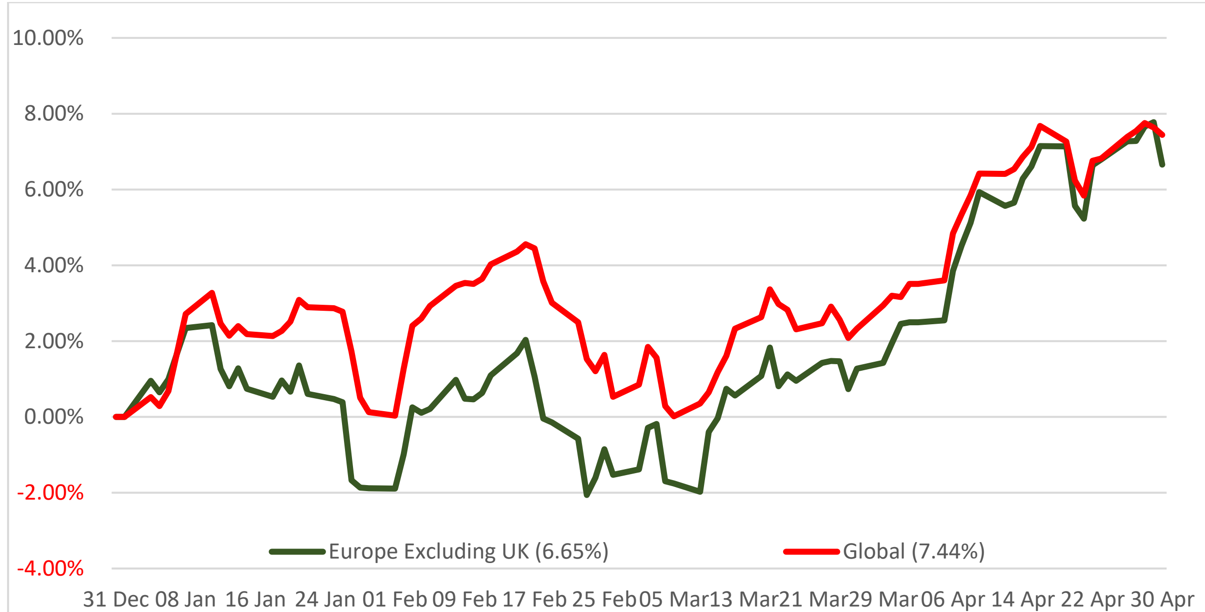
European countries have struggled to varying degrees to get on top of recent Covid-19 outbreaks, but cases in the region are heading in the right direction. The start of the year saw a surge in cases across the region, along with a slower than expected vaccine rollout, which forced several countries to extend or introduce fresh lockdown measures. In France, President Macron announced a one-month nationwide lockdown. In Italy, the government put all regions in the "red zone" – the highest tier of restrictions. Similarly, Germany also extended its partial lockdown. The recent acceleration in the rate of vaccinations is welcome and gives confidence that the economic recovery can begin in earnest in the second and third quarters of the year as restrictions are loosened.

Sector comparison: Global and Europe Excluding UK – 3 month performance



31/01/2020 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global and Europe Excluding UK – YTD performance



31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

US

In the last three months, there was a significant rotation in the main indices which is probably worth noting. The much more “industrial” index – the Dow Jones – registered a very strong performance – around 10%, whereas the index that is known best for high growth and technology names – the NASDAQ (the index that has been the main driver of market returns over the last decade or so) remained flat. The NASDAQ index contains 100 stocks, the Dow Jones just 30, and for completeness sake, there are a couple of stocks that are in both indices and how the indices are calculated are slightly different too, but it certainly seems like there are changes afoot in the world’s largest stock market.

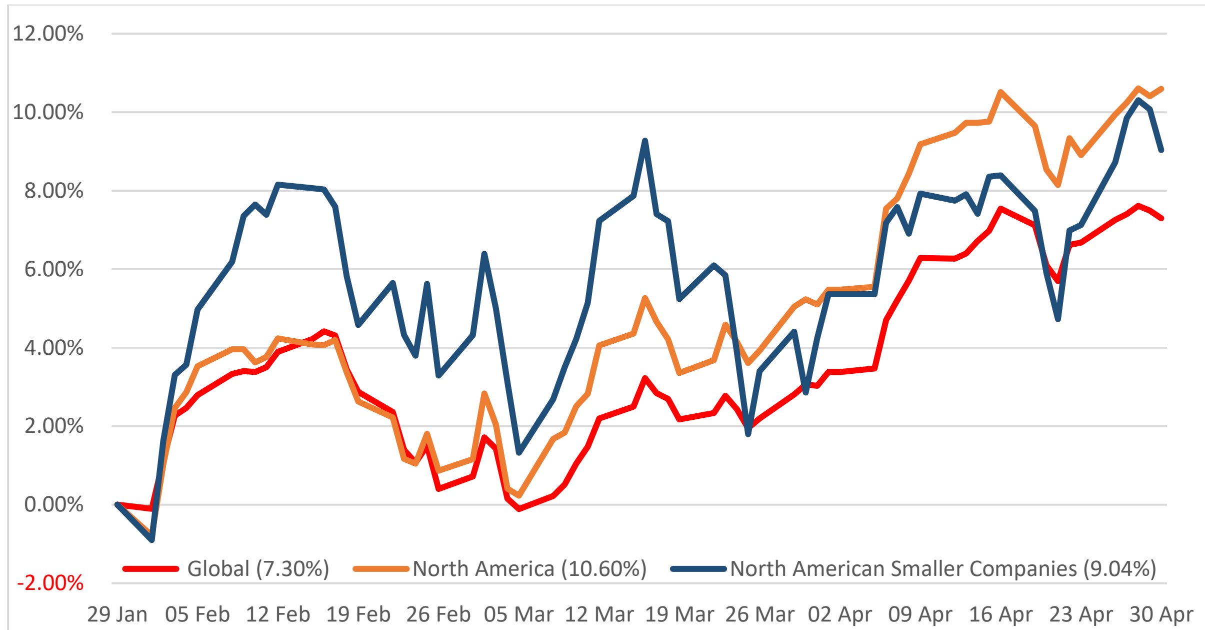
To put the numbers in some perspective, the Dow Jones Index is up around 175% in the past ten years, whereas the NASDAQ has powered ahead to the tune of 475% and arguably there is some “catching up” to do (although please remember this does also work in the other direction – if the latter index falls more than the former then the differential closes too….). The largest names in the NASDAQ index are household names such as Apple, Microsoft, Amazon, Tesla, Facebook and the parent of Google (Alphabet). The largest names in the Dow Jones Index are arguably quite different businesses, but also household names and includes businesses such as Goldman Sachs, Coca-Cola, Caterpillar, Boeing, Home Depot, Nike and Walt Disney.

In the last quarter stocks in the Energy, Financials, Materials and Industrial sectors were the ones that drove the returns. Although we cannot guarantee these will be the drivers of returns in the future, it does seem like the market is broadening out and the wider characteristics of the market are commensurate with the beginning of a new economic cycle.

The much more broadly diversified index – the S&P500 – delivered returns much more closely aligned to the Dow Jones over the last three months, albeit slightly behind, but slightly ahead over the last decade.

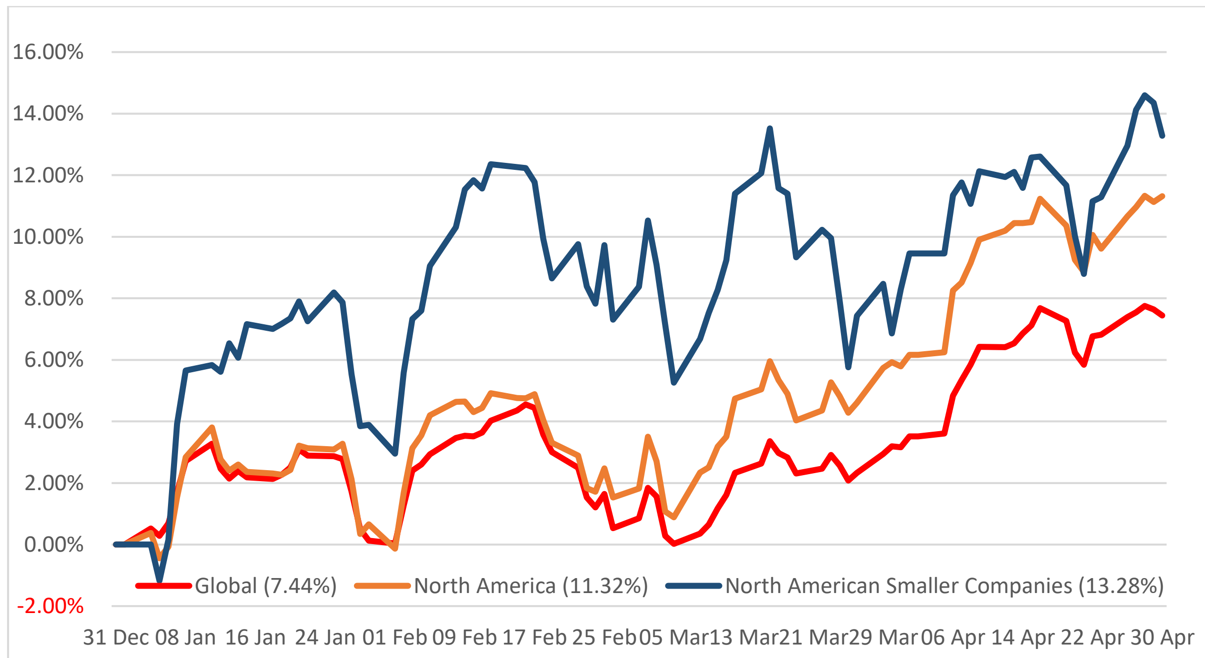
Many commentators are suggesting the recent shift away from high growth tech names towards the more cyclical names is due to a number of factors such as a change of President and the potential of tax changes to cover the stimulus relating to Covid; a shift from the Federal Reserve relating to inflation targeting; valuation differences; increased volatility and so on.

Sector comparison: Global, North America, North American Smaller Companies – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global, North America and North American Smaller Companies – YTD performance



31/12/2020 – 30/04/2021 Data from FE fundinfo 2021

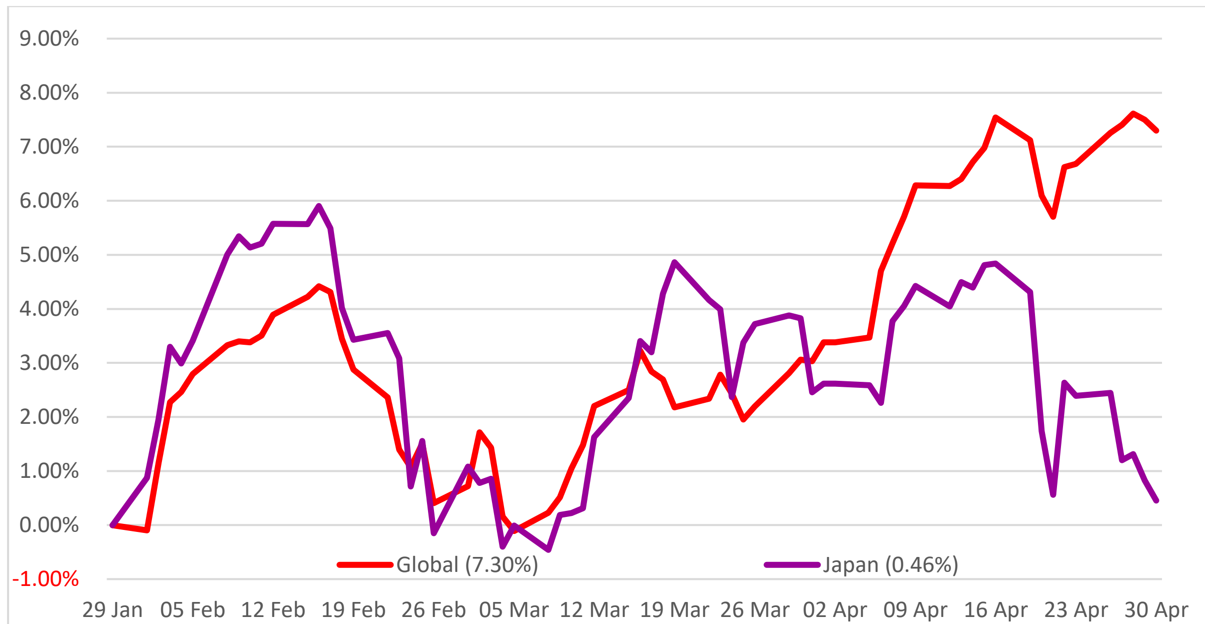
Japan

As a country, Japan has weathered the Covid crisis better than most. In part this is due to their experience with SARS outbreaks over the years along with their excellent health care system. However, despite their infection rates remaining much lower than most other counties, this does not mean that they were immune from the effects of the pandemic. With an economy that is heavily focused on exports, as other countries locked down their economies, it had a knock-on effect on Japan as well. Conversely, as vaccination programmes kicked in, this boosted Japanese equities and in February the Nikki 225 breached the 30,000 point for the first time in 30 years.

More recently volatility has returned as Covid cases spiked with the government acting quickly to lock down affected regions. With the already delayed Olympics just a few months away, concerns have been raised about a vaccination rate which at sub-2% is far lower than other major nations. More positively, the employment rate increased in March to a level not seen since April of 2020 and manufacturing levels have seen three months of growth, the best run since 2018. In addition, progress on corporate governance reforms is still being made which gives us reason to be positive about the region.

One factor that might determine the success of investing in the country is the choice between selecting a Growth or a Value approach, or indeed a combination. After a long period of outperformance, Growth strategies endured a tough time over the last three months while Value rallied strongly.

Sector comparison: Global and Japan – 3 month performance



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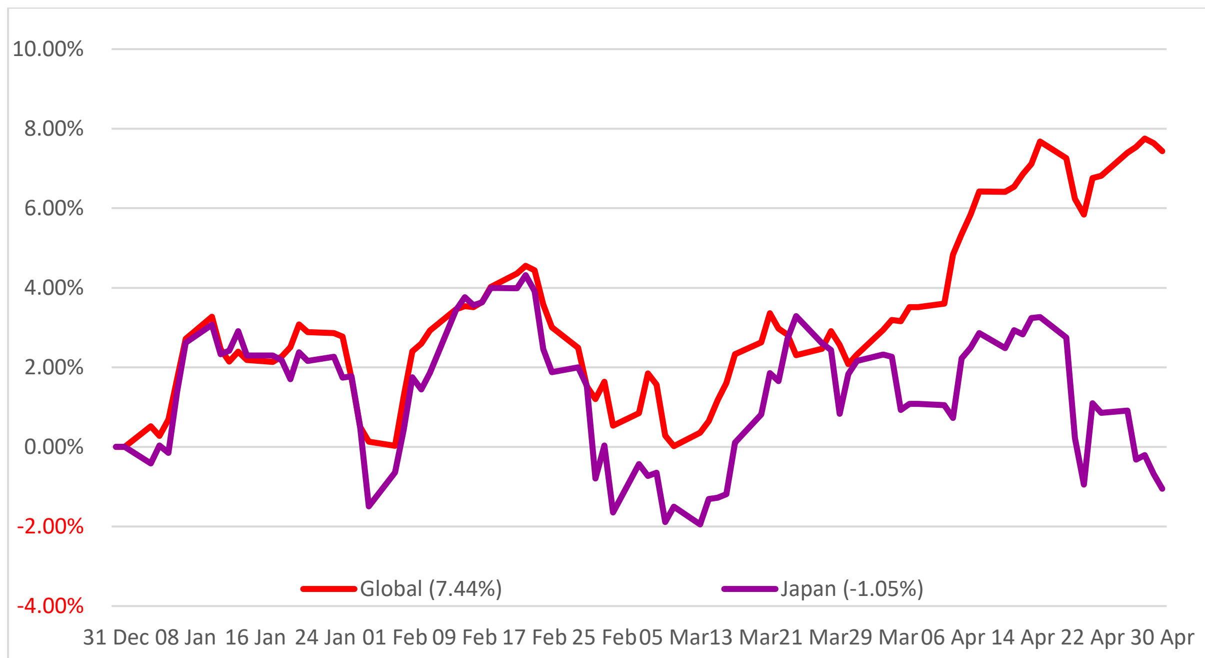
Sector comparison: Global and Japan – YTD performance



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EMERGING MARKETS

On the whole Emerging Markets ended the quarter in positive territory, albeit with some significant dispersions across the regions. The pandemic affected economic growth rates across Emerging Markets, but they weathered the storm well with GDP falling less than in advanced economies. Economies in the developed world look to be in much better shape though, which is a consequence of their vaccine rollout programmes and optimism around vaccination efforts. The pass-through effects of a strengthening US economy gives a positive outlook for Emerging Markets growth in 2021. Not all countries have fared equally when looking at the Pandemic. Russia, Latin America - and Brazil in particular - continue to suffer as infection numbers continue to rise.

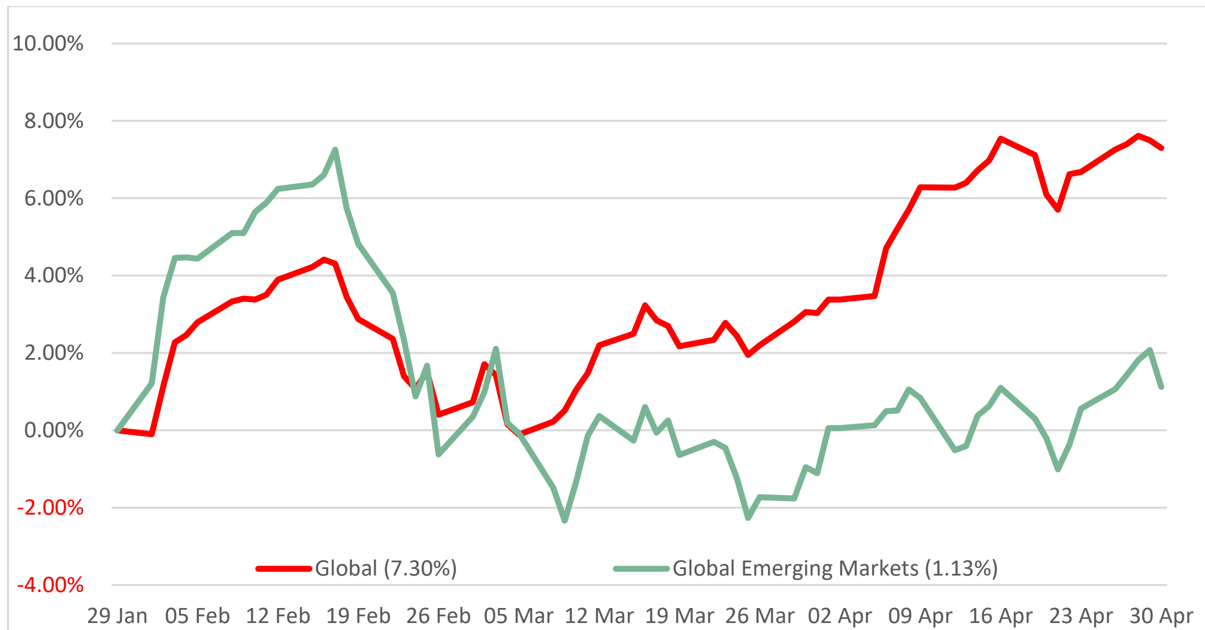
Most Emerging Market central banks left interest rates on hold, while Brazil, Russia and Turkey have increased their interest rates, mainly in response to domestic factors. In Turkey and Argentina money and credit growth has risen significantly, which potentially could be a headwind for their currencies should the Dollar start to weaken.

Given the increases in commodity prices and some shipping costs over the past couple of months, global manufacturing prices have also risen sharply. The Suez Canal obstruction at the end of March, will no doubt contribute to further shipping cost and could impact oil prices and inflation going forward.

Many Emerging Market countries are export-reliant, and their economies were historically driven by commodity-heavy industries although now these account for only 15% of the main Emerging Market index (with consumer and technology companies accounting for more than 50%), and this time around the recovery in commodity exporting regions like Latin America, The Middle East and Russia will be impacted through consumer and financial companies.

Regional performance in Emerging Markets showed greater differentiation: Europe, the Middle East and Africa (EMEA) gained the most, led primarily by Russia as oil prices climbed higher over the first quarter. In contrast, Turkey, with the central bank governor’s unexpected departure, recorded a sharp fall and was the weakest index market. Within Latin America, Brazil has ended in positive territory, Chile, aided by copper price strength, has outperformed the broad index and Mexico, where manufacturing industries linked to US demand, was one of the best performing market indices.

Sector comparison: Global and Global Emerging Markets – 3 month performance



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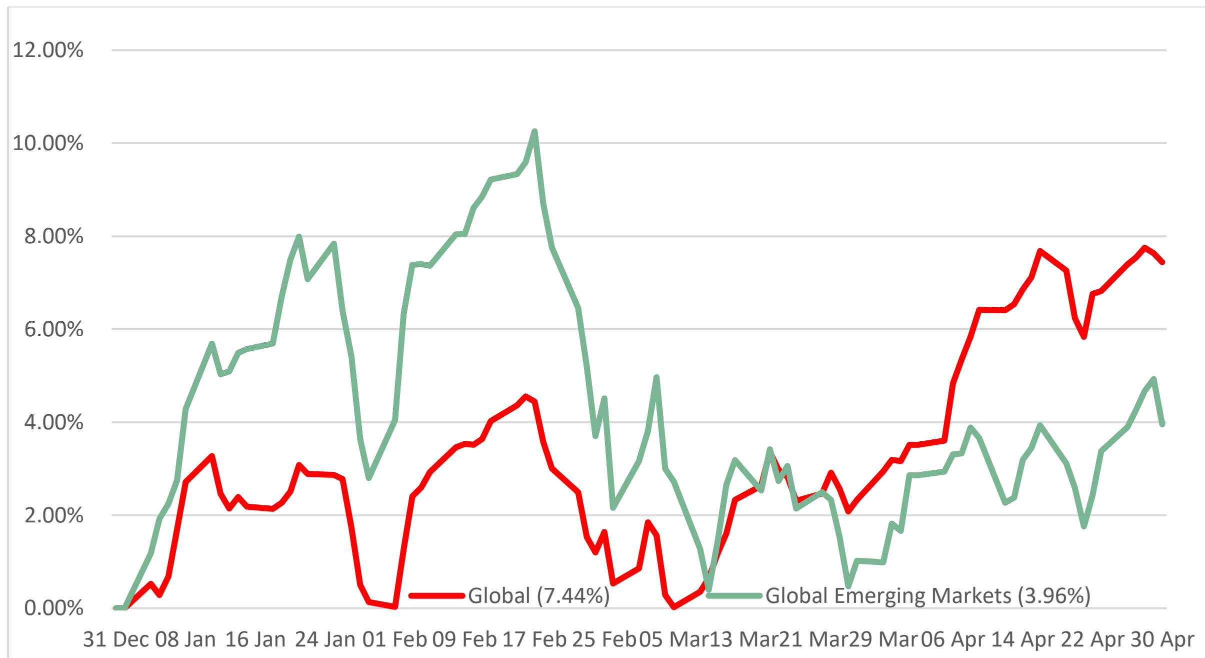
Sector comparison: Global and Global Emerging Markets – YTD performance



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ASIA PACIFIC/CHINA

The returns from the Asia Pacific Region were mixed due to weakened sentiment towards the end of the quarter as slower vaccination rollouts led to the reintroduction of lockdown restrictions in some countries. Many Asia Pacific countries have unquestionably performed better in suppressing the virus when it first struck in 2019, but with varying degrees of success. China looks exceptionally good in terms of the rates reported; their control of external borders has been extraordinary, even if it has dampened some of the activity over the Lunar Year, it seems that Coronavirus infection remains under control. And the same is broadly true for much of Northern Asia but very troubling news coming from Southern Asia, where the virus has mutated into a more infectious variant. India is suffering a disastrous second wave that is overwhelming the medical system. The authorities in some Asian countries cannot close their economies in the way that developed world economies can.

Japan has had very few Coronavirus cases despite not imposing the very strict and economically damaging restrictions that were introduced in other countries. The equity market continued to rally, albeit at a slower pace. Visibility on the corporate profit recovery improved after a strong set of quarterly results. This sentiment was also helped by weakness of the Yen against the US Dollar.

With regards to the vaccine rollout, China has accelerated it considerably in the last couple of weeks, although issues remain elsewhere in the region due to lack of availability.

In China's latest 5-year plan, target GDP is 6% (with a focus on quality not quantity of growth). Economic expansion in the most recent twelve months has been strong. Chinese trade flows had also remained strong, supporting global trade. China started to tighten its monetary policy with the hope to control rapid credit growth, indicating that monetary support could be less accommodative going forward.

The US Securities and Exchange Commission (SEC) adopted a law which strengthened the de-listing risk for Chinese ADRs, hence the US-China tensions remain in the background.

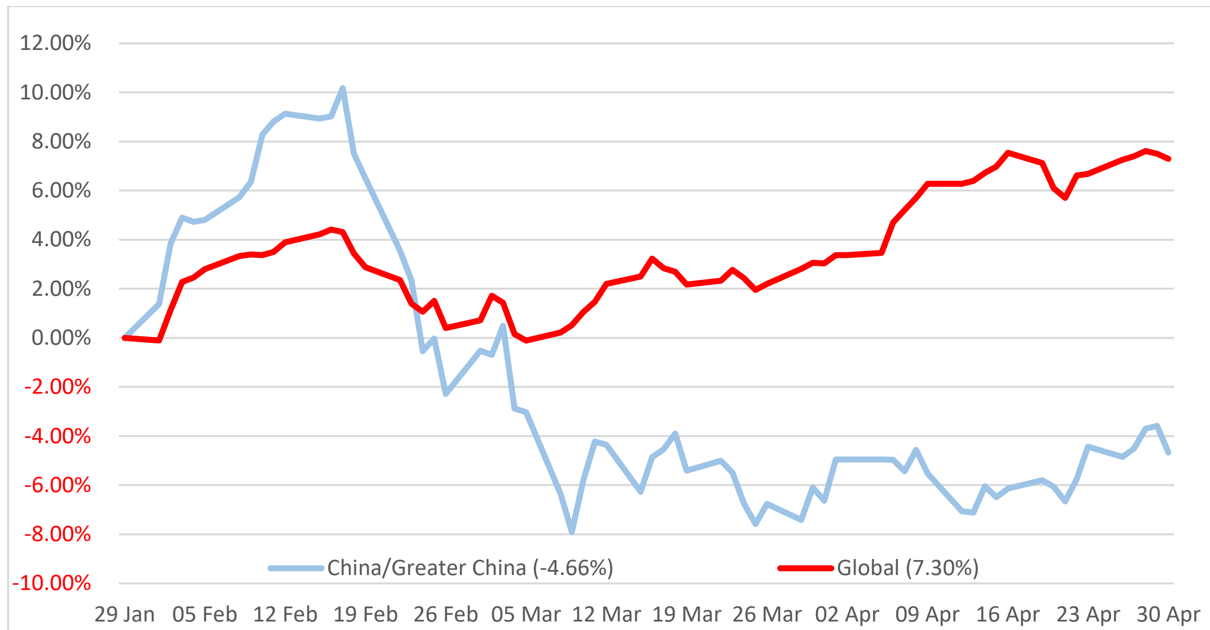
The boom we are seeing in the US domestic consumption from the recent stimulus will not just be contained in the US. Of total imports, 18% come from China and 15% from other Asian regions,

excluding China, therefore, as we see the US boom, it will start to filter out into growth elsewhere in the world.

The rising middle classes in Asia remain a key source of global consumer demand, and China is a much bigger part of the global economy today and will play a bigger role tomorrow in our view. Asia Pacific countries, including China, have increased their contribution to real global consumption growth by 50% over the period of 2011-2019.

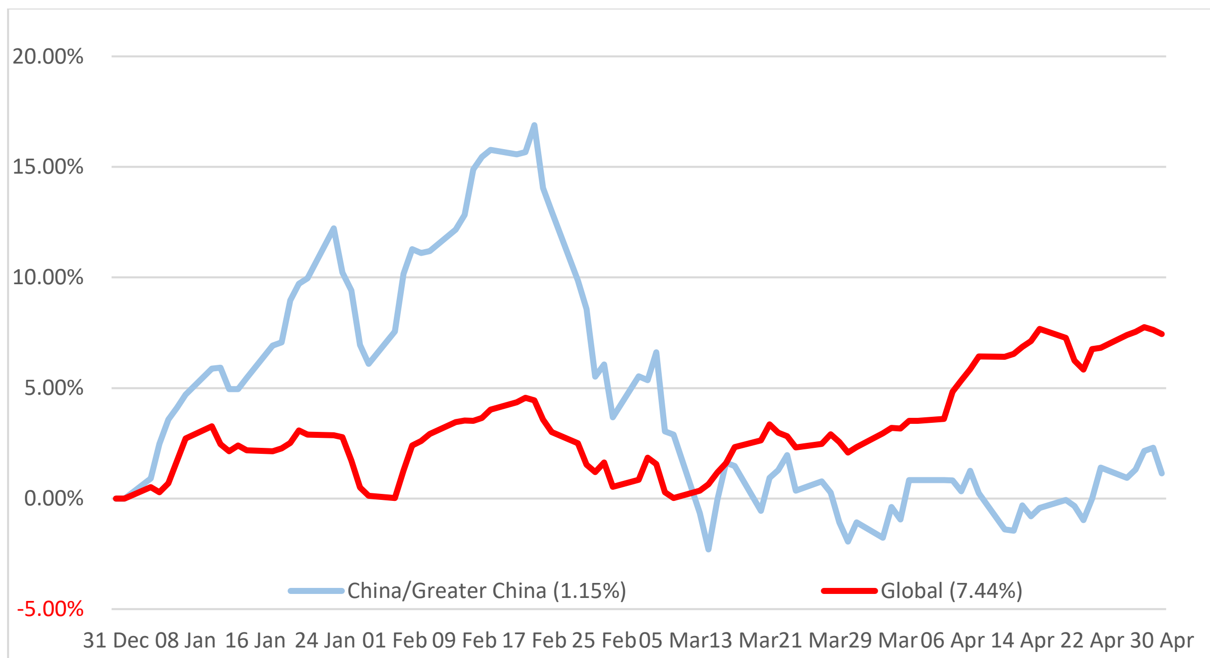
The main Chinese equity market lagged its regional peers due to expectations for policy normalisation, as well as regulatory uncertainty for certain industries. The best performing markets include Taiwan as gains were supported by strong performance from the IT sector, and Singapore, with its bank-heavy market. Amidst concerns over increasing numbers of Coronavirus cases and April being a negative month, Indian equity market also rose over Q1 2021 as a whole.

Sector comparison: Global and China/Greater China – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global and China/Greater China – YTD performance



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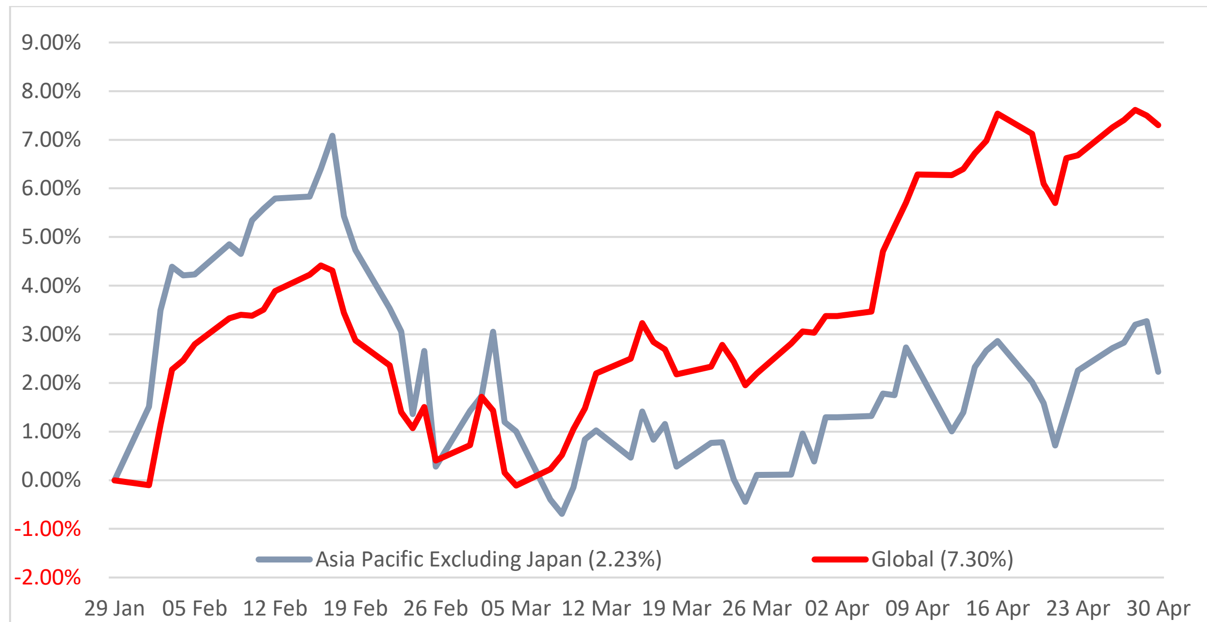
Sector comparison: Global and Asia Pacific Excluding Japan – 3 month performance



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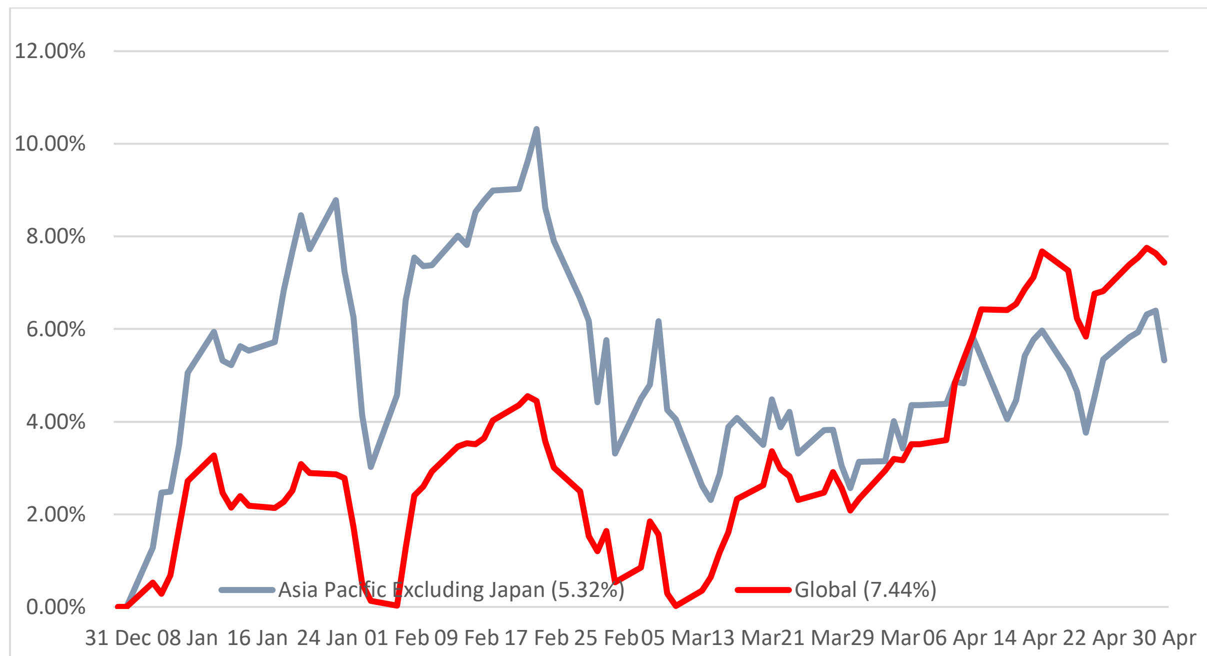
Sector comparison: Global and Asia Pacific Excluding Japan – YTD performance



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COMMODITIES

Investing in commodities can be a very high risk, but also a very high reward investment universe. The "commodities complex" covers energy (oil and gas) metals (gold, steel, aluminium, copper) agriculture (soybeans, wheat, cattle) and so on. It is not a homogenous sector and has many nuances. Many commodities are very much aligned to the economic cycle though and the covid crash re-set the economy and put the world into a very deep, but very quick recession, and as the world emerges from this shutdown, demand for commodities is rising. For instance, the price of copper has risen by about 1/3 in the last quarter, whereas gold has basically been flat. Ethanol prices are up 35%, whereas natural gas is up only 3%. Corn prices are almost 40% higher and so on. In the last 12 months, the oil price is up more than 150% (although there are a lot of extenuating factors that forced the oil price to such a low a year ago) and if you look at the 3-year price of oil (WTI Crude) it is actually down roughly 10%.

When economies grow, and as emerging market economies mature the demand for commodities grow too. Food moves from only being about subsistence for example, roads become paved rather than dirt, transport needs alter and so on. It is a volatile asset class – due in part to its diverse nature.

ALTERNATIVE STRATEGIES

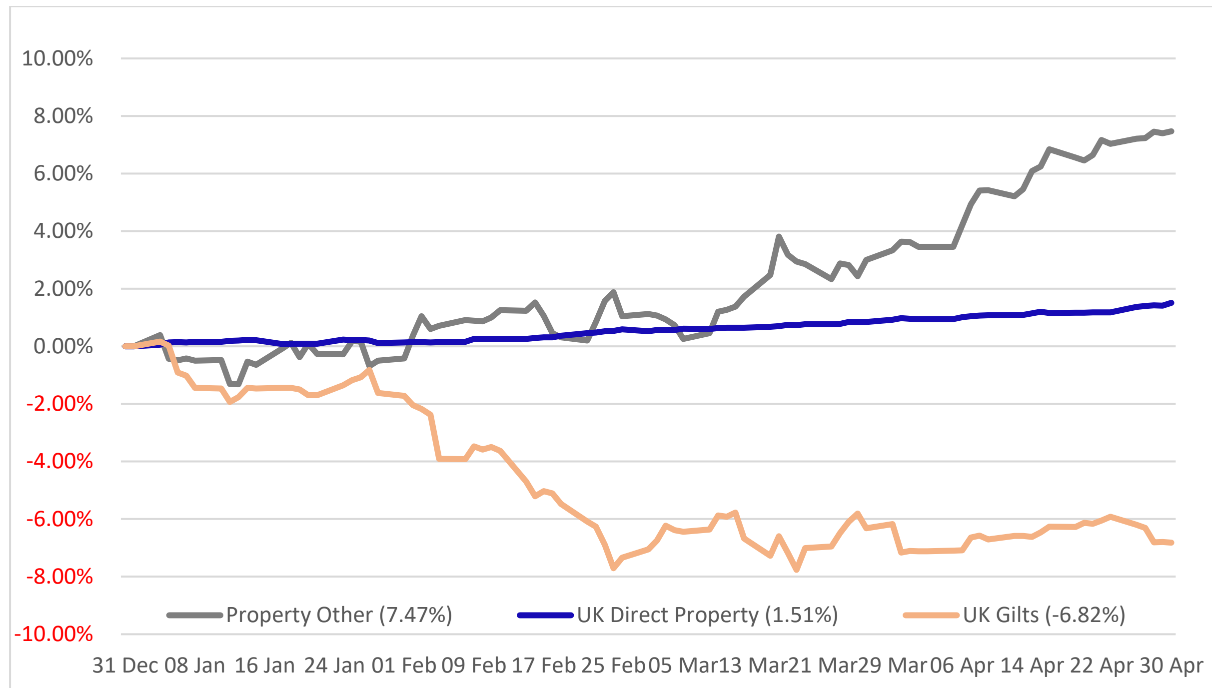
UK Direct Property

The UK Property sector has made positive strides since our last update and most of the funds that had suspended in the wake of the Covid crisis have now reopened. It was a long and slow process to get to this point with managers having to sell properties to release cash to ensure that when they reopened they would be able to absorb all of the withdrawals that had built up over the proceeding months.

Investing in the UK Commercial Property sector remains problematic because of the Financial Conduct Authority's ongoing review. This is looking at issues of liquidity within the sector and could mean that restrictions are placed on how the funds can be used. Where funds are used it is critical to select those with sufficient cash reserves to be able to cover redemptions, and also to be cognisant of the fact that there remains a chance that future suspensions are possible.

Whilst there are obvious issues with areas such as retail, which were heavily impacted by the closure of shops, other subsectors like warehousing and delivery hubs have proved to be much more resilient as a result of the increases to online shopping. Looking forward, fund managers will need to account for the return of shoppers to high streets around the country and adjust their portfolios accordingly.

Sector comparison: Property Other, UK Gilts and UK Direct Property – YTD performance



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Cash / Money Markets

There were no changes to the existing stance of monetary policy by the major central banks of the world in the most recent three-month period with interest rates remaining at ultra-low levels although the Bank of Japan indicated that it would not hesitate to take additional easing if necessary.

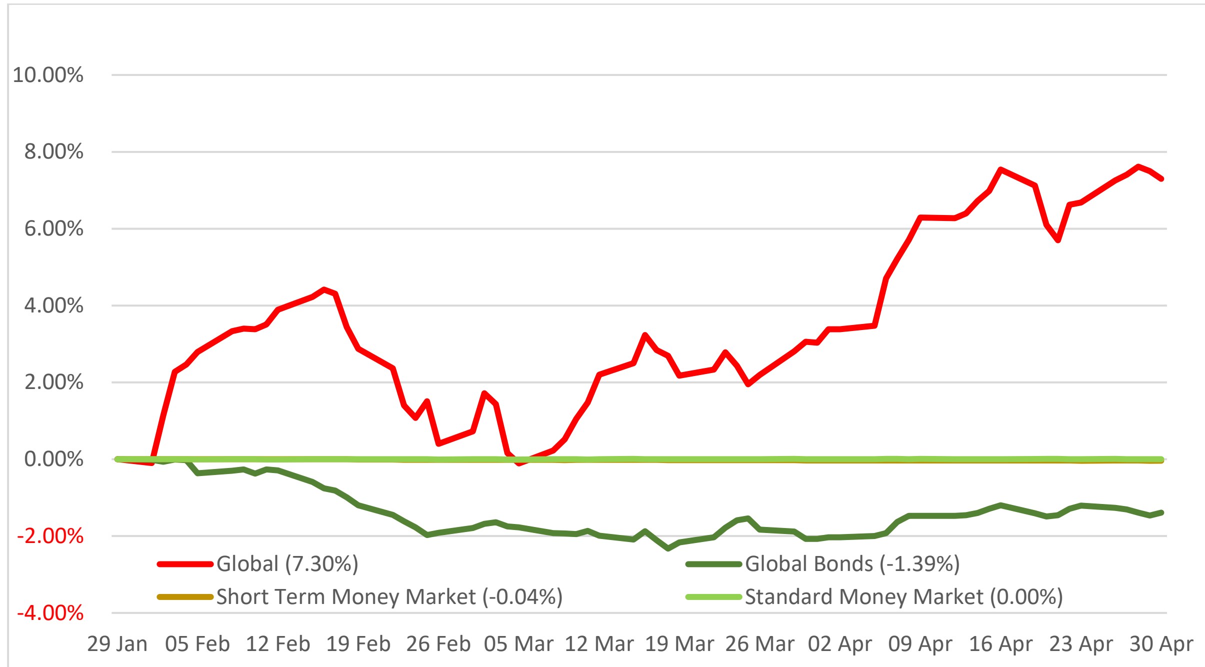
The biggest unknown is how the extraordinary level of fiscal stimulus that was released globally in the last twelve months will affect inflation and growth. Indeed, the outlook around the world remains mixed.

Inflation has edged up over the last few months in the major trading markets of the UK, US and Europe as economic growth registered small positive increments. Unusually, Europe presents a bit of a conundrum as underlying price pressures remain subdued due to significant economic slack and weak demand. In Japan the BoJ has cut its inflation forecast for the current year from earlier predictions.

While vaccine rollouts and the ongoing effects of the Coronavirus continue, big risk to the greatly anticipated reopening of the global economy remain, although we believe the pandemic will not be the primary macro driver going forward. However, the lockdowns around the world continue to put strain to economies, affecting output growth, supply and demand, inflation, consumption, unemployment levels and investment.

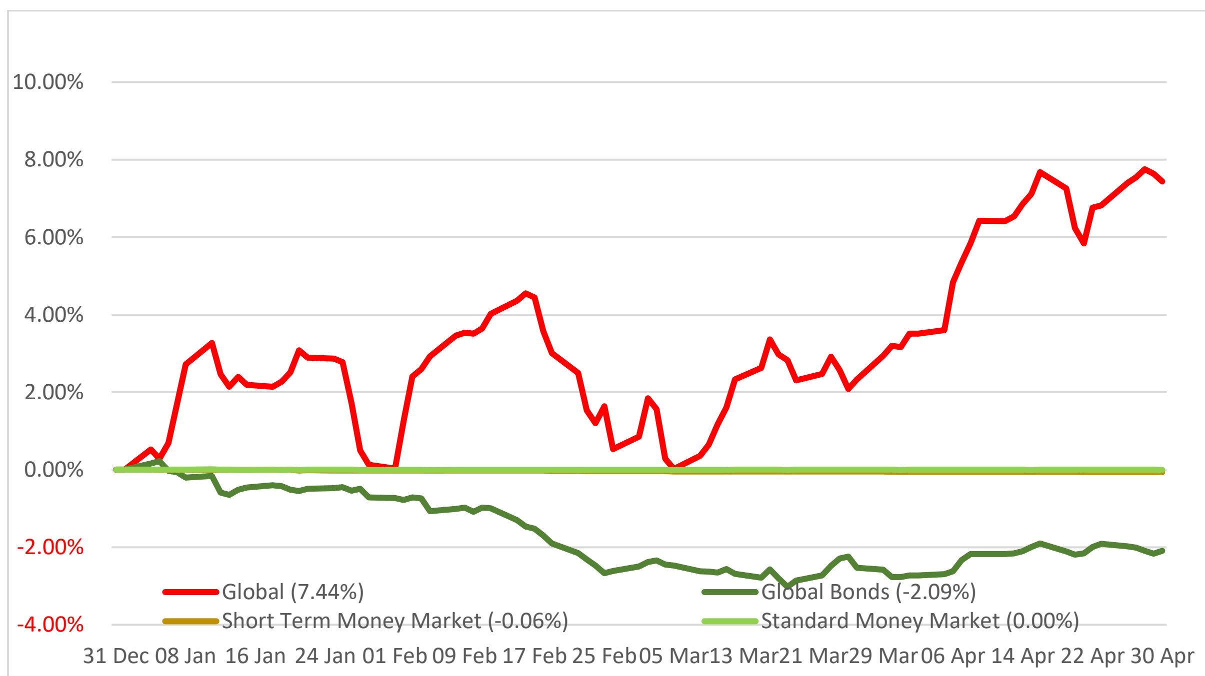
The cash market remains a challenging environment for decent returns. With interest rates at zero or near zero levels across developed markets the opportunity cost of cash is low and the opportunities in cash markets are very limited.

Sector comparison: Global, Short Term Money Market, Global Bonds and Standard Money Market – 3 month performance



31/01/2021 – 30/04/2021 Data from FE fundinfo 2021

Sector comparison: Global, Short Term Money Market, Global Bonds and Standard Money Market – YTD performance



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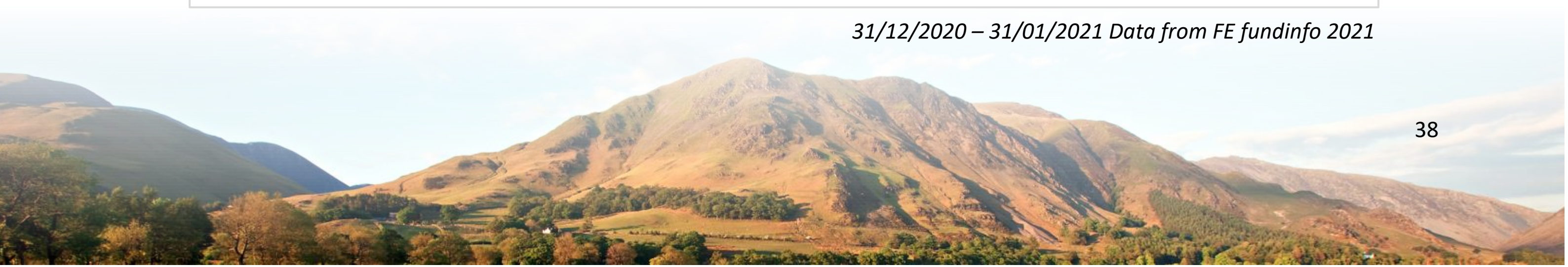


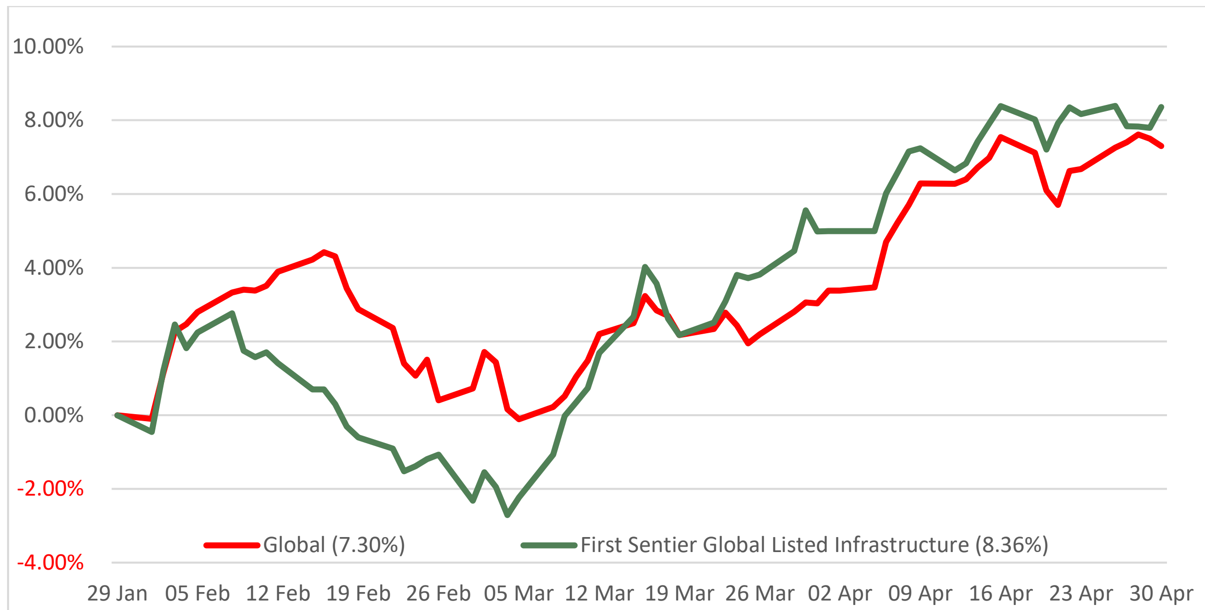
Infrastructure

Investment in this sector is typically made either directly or indirectly into a broad range of global companies involved in the ownership and operation of infrastructure assets, including, for example, electricity, water, gas, telecommunications, airports, roads, railways, seaports and social infrastructure assets.

As this description suggests, the sector is a very broad church and fund performance can vary widely, but broadly speaking the reopening of economies following Covid-related lockdowns was a positive story. The sector was also boosted by President Biden's plans to reignite the US economy which could be supportive for the sector, as well as by commodity price rises which benefitted pipelines.

Looking forward, an improving economic outlook bodes well for the sector, but areas such as airports and related industries seem likely to continue to struggle for some time yet. We also need to be wary about the impact of the potential for bond yields to rise which would be a headwind.

Sector comparison: Infrastructure Index Proxy and Global – 3 month performance



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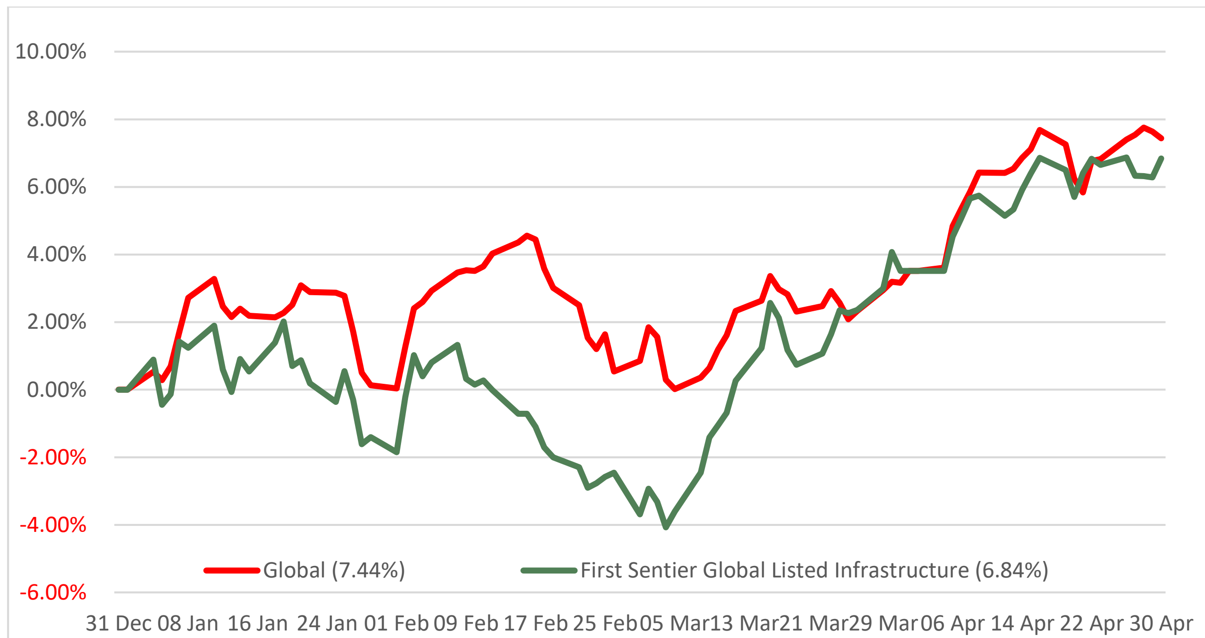
Sector comparison: Infrastructure Index Proxy and Global – YTD performance



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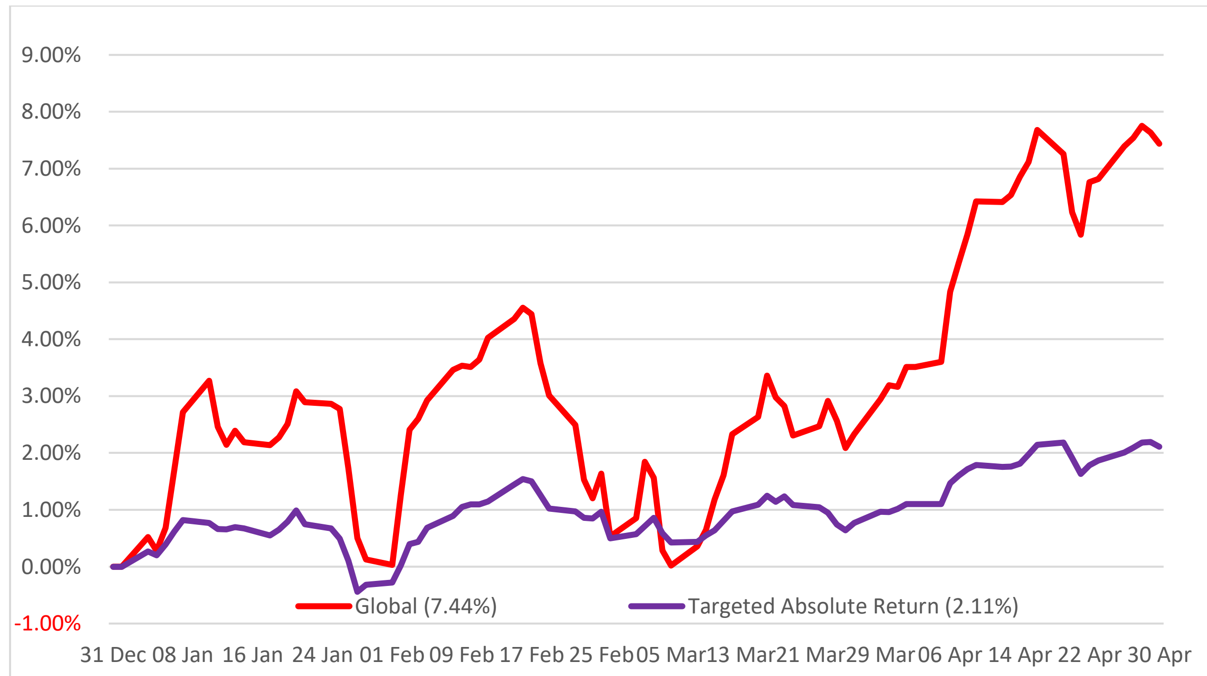
Targeted Total Return

The sector is predominantly used as a diversifier for traditional asset classes held within a portfolio with the aim of providing reduced volatility in times of uncertainty. However, given the diverse nature of the sector by both asset class and investment objectives, and that it has the ability to use non-traditional instruments such as derivatives to either reduce or enhance risk, it was of no surprise to see a diverse range of returns over the quarter by the underlying constituents. Deviation between the best and worst funds over any time period is likely to be large because of these factors.

Overall, the sector rose by 2% over the quarter as the majority of funds returned a small low single digit gain, but it lagged behind both the broader global and UK equity indices which enjoyed a strong period of recovery, however it outperformed fixed income markets which have seen a more volatile quarter.

Sector comparison: Global and Targeted Absolute Return – YTD performance



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