Harwood
Wealth Management Group Ltd

Quarterly Update

Q3 2021

IMPORTANT INFORMATION

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CONTENTS

INTRODUCTION

Capital markets by and large continued their strong run in the last three months with very few registering negative returns – of the major single country equity markets, the Hang Seng (Hong Kong) and the Nikkei 225 (Japan) posted red numbers, although collectively, Asia, and Emerging Markets (which has a predominant allocation towards Asia) delivered poor returns. We're sure you've heard of the saying of "lies, damned lies and statistics", and "a week is a long time in politics". Investment markets are a combination of both! For example, although the Hang Seng Index is down almost 9% in the most recent three months, it was down more than 10% in July alone. Another example – using an index following US smaller cap value stocks – as measured by Russell – has been one of the poorest performing indices over the last 1 and 3 months, and even accounting for this is one of the best performing over 12 and 36 months…. It really goes to show that trying to guess the short-term movements of the stock market is a fool's errand.

At the other end of the performance league table, the highly unpredictable and volatile Brazilian market was one of the strongest performers (up roughly 8%), but impressive returns were recorded from the US (S&P500) the UK Small Cap (as measured by FTSE), France (FTSE) and the world as a whole (MSCI).

Most fixed income indexes delivered returns in the black too, albeit at much more muted levels of return, but this isn't surprising considering the level of interest rates across the globe and this is where the quandary of capital markets exist. Governments and Central Banks of the world have taken to "printing money" over the last 15 months to smooth the financial issues caused by the coronavirus pandemic. Never in history have we seen such a huge shock to the global economy and never in history have we seen such a globally coordinated response from the policy makers to reduce the impact. The world is now awash with debt, and at the moment – arguably – the servicing of the debt is manageable. Interest rates are at, or next to zero (or actually negative in the Eurozone and Japan). A related metric which has until recently also been at a low level is inflation, but recent indications suggest the rate is growing, and growing fast. Take the UK for example, the rate was 0.70% in February and the July print came in at 2.50%. If inflation rises, interest rates usually need to rise to offset this. Will governments be able to issue more bonds at higher rates and still be able to service the increased debt?

Inflation is a “year-on-year” number so shocks and surprises can drastically affect the monthly figure. Events that happened a year ago can positively or negatively impact inflation and if you cast your mind back, the world was in a very different place compared to today. But, with inflation numbers in the US and UK coming in higher than expected the capital markets are at the moment discussing whether the present inflation is sustainable or transitory – i.e., is this high level of inflation here to stay? It doesn’t help when the price of oil – a major component of the inflation basket - as measured by Bloomberg - is one of the best performing “asset classes” up almost 15% over the most recent three months and up over 60% during the last twelve months.

It is fairly safe to suggest the world has changed quite dramatically from a capital markets and economic perspective since the beginning of last year and there are still a lot of unanswered questions surrounding the long-term outcome of the current health crisis in which the world finds itself.

There are always risks associated with making an investment in any asset class, and investing should be considered with a longer-term mind-set. The strong returns witnessed in the last quarter, and in the last 12 months are unlikely to repeat in the next quarter or next year, but there will be opportunities and a diversified portfolio should assist in maximising risk adjusted returns.

Sector Analysis

Top Performing **30/04/2021 - 30/07/2021**		**Top Performing** **YTD 2020 (30/07/2021)**	
UK Index Linked Gilts	9.70%	UK Smaller Companies	22.33%
Property Other	6.97%	North America	15.49%
European Smaller Companies	6.03%	European Smaller Companies	15.31%
UK Smaller Companies	4.91%	Property Other	14.96%
Europe Excluding UK	4.68%	UK All Companies	13.06%
Worst Performing **30/04/2021 - 30/07/2021**		**Worst Performing** **YTD 2020 (30/07/2021)**	
China/Greater China	-11.12%	China/Greater China	-10.10%
Asia Pacific Excluding Japan	-5.11%	UK Gilts	-3.08%
Global Emerging Markets	-3.76%	Asia Pacific Including Japan	-2.44%
North American Smaller Companies	-2.97%	Japan	-1.27%
Asia Pacific Including Japan	-2.69%	Global Emerging Markets Bond	-1.05%

Data from FE fundinfo 2021, dates as above.

FIXED INCOME

Sterling Bonds

The global reopening is now on track and market attention has moved to the strength of the recovery, outlook on inflation and the timing of asset purchase reduction by central banks. Against the backdrop of a robust rebound in economic activity, corporate bonds registered positive returns over the last quarter.

In June the US Federal Open Market Committee (FOMC) put in two post-pandemic rate hikes through their median “dot plot” for 2023 in contrast to earlier expectations of the first hike in 2024. In the aftermath we had a big yield curve flattening in US Treasuries, with shorter end of the curve rising and longer end of the curve falling, both by about 20 bps. This led to a rally in the US bond market.

Currently, the US leads in recovery from the pandemic and that is where the biggest surge in inflation is coming from (core inflation that excludes volatile fuel and food prices rose by over 4% in June). Towards the end of the quarter the supply shortages started to moderate and prices for used cars and lumber have since stabilised.

As it stands, despite rising inflation indicators, 10-year yields dipped below 1.5% in the first week of July. This could mean that the bond market believes that Fed Chair Jay Powell will hold off on interest rate increases and the worry over sustainably high inflation cooled later in the quarter. Another view put forward is that economic growth is not going to be as strong as first expected, given that Covid cases are rising in a number of parts of the world.

The Fed’s plan is to start the liquidity withdrawal programme in the second half of next year. It will need to tread cautiously as that will impact the sentiment of the market and its willingness to take risks. The Fed has broadened its influence and no longer just buys government bonds, but corporate credit as well, it will not want to spook the markets by withdrawing that backstop too quickly.

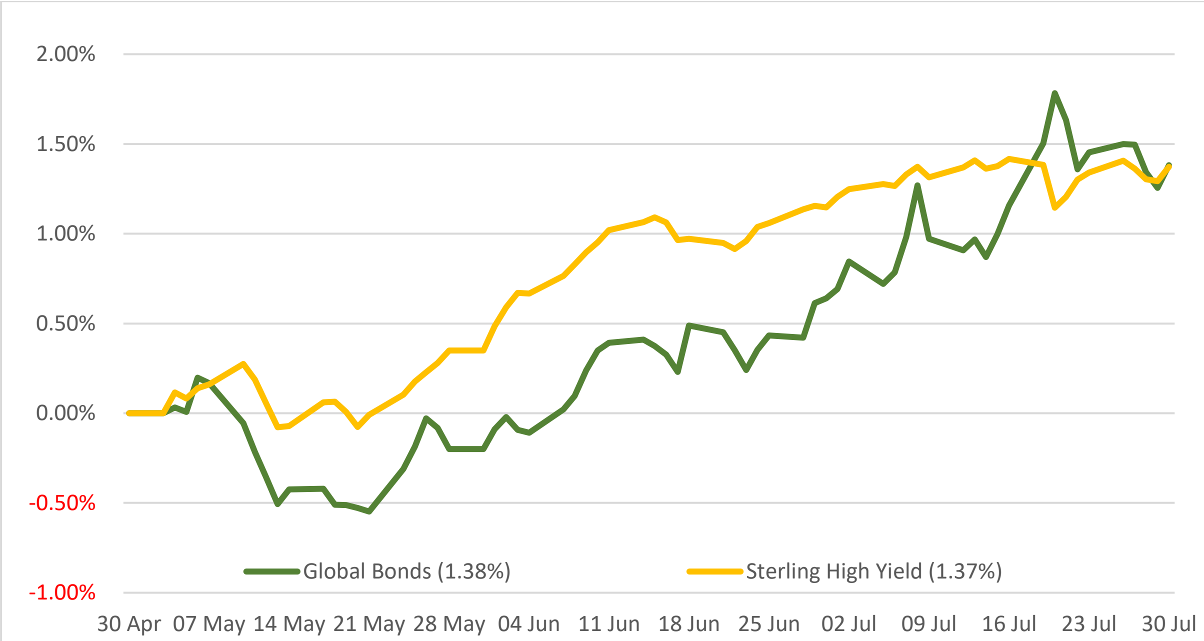
Elsewhere, the shift in the European Central Bank’s (ECB) monetary policy approach should translate into greater market confidence, holding in spreads on sovereign bonds. However, at its last meeting the Bank has made no changes to rates. Essentially, the value of money on deposit will decrease with time due to negative interest rates – forcing savers to take "risk" with their capital. Similarly, the Bank of England (BoE) too has left interest rates unchanged, just above 0%. The problem with very low interest rates is that it leads to a "liquidity trap". When interest rates are at or near 0%, monetary policy becomes ineffective with a much reduced ability to stimulate growth.

The Covid pandemic caused a huge rise in debt – sovereign, corporate and personal. Debt usually rises during recession, although it is clear this was not an ordinary recession. Governments increased spending in order to protect households and businesses. But, increased debt implies concerns about the stability of the financial system. The amount accumulated is enormous and arguably cannot easily be inflated away, given that the cost of servicing this debt will eventually increase as interest rates rise. In order for governments to get the situation back in order and let economies rebuild, they might need to keep interest rate below the level of growth (similar to what happened post the Second World War) and this is known as financial repression.

High yield bonds have lower credit quality than investment grade ratings and a higher chance of default. Many high-yield bond issuers are oil companies and the oil price rose by c12% during the quarter thus improving their balance sheet and reducing the risk of financial problems.

The highest quality, investment grade bonds recovered well from the decline in the first quarter and remains in high demand. High yield can withstand rising yields better than investment grade credit as it has a much bigger income cushion and shorter duration. The high yield market on the whole provides a yield of just below 4%, which is close to an all-time low; credit spreads continued to grind tighter, and default rates are not expected to go up any time soon. Both Sterling high yield credit and investment grade registered a positive return a little over 1% and 2% respectively.

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

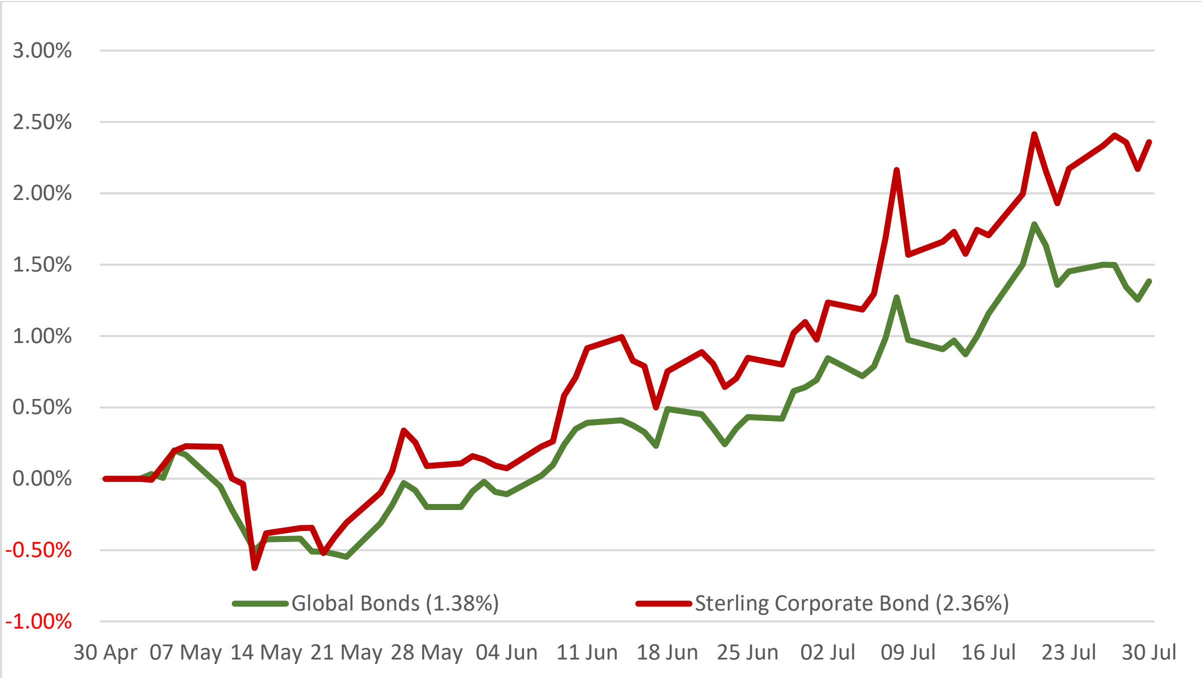


30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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

31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

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

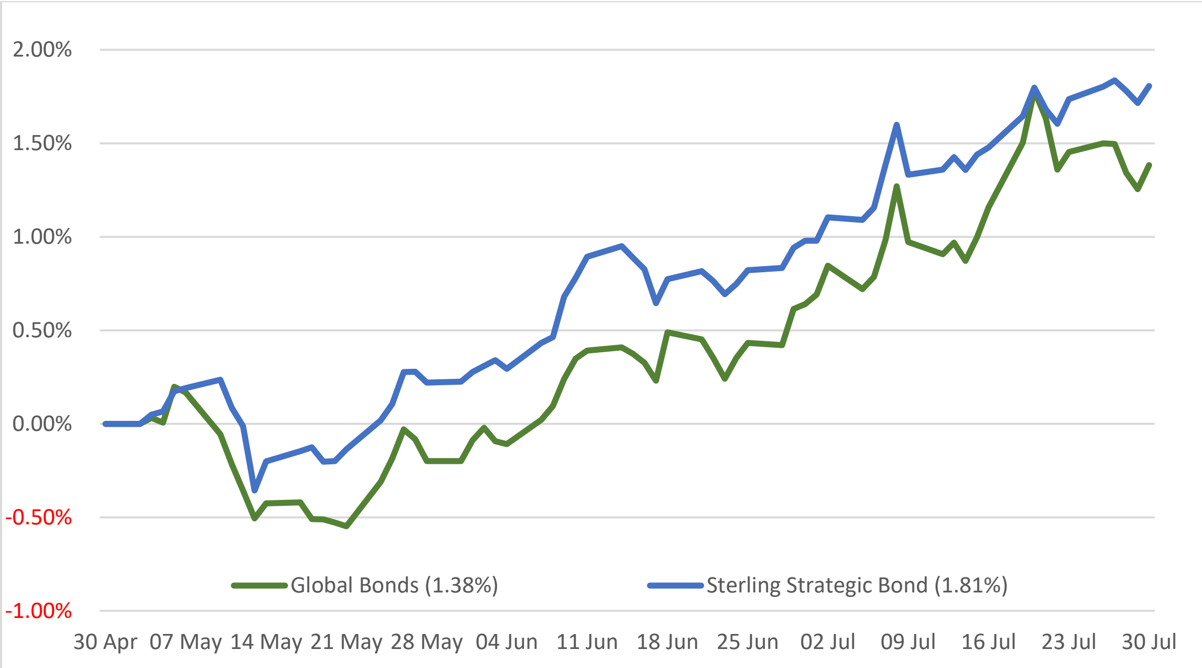


30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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

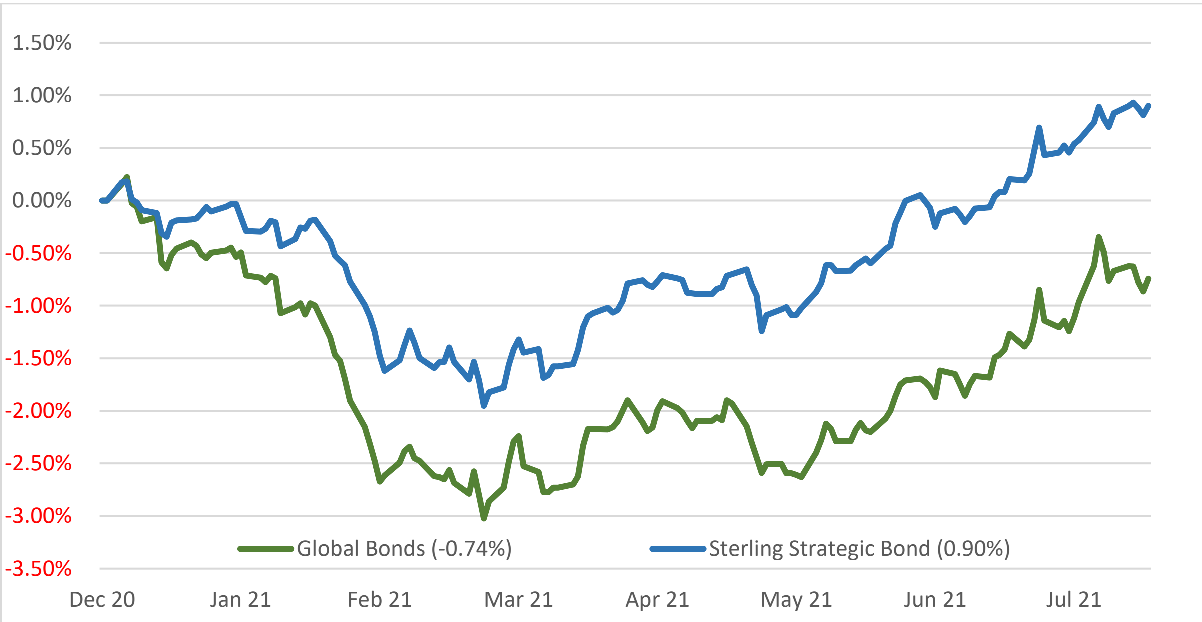
31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

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



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

Global Bonds

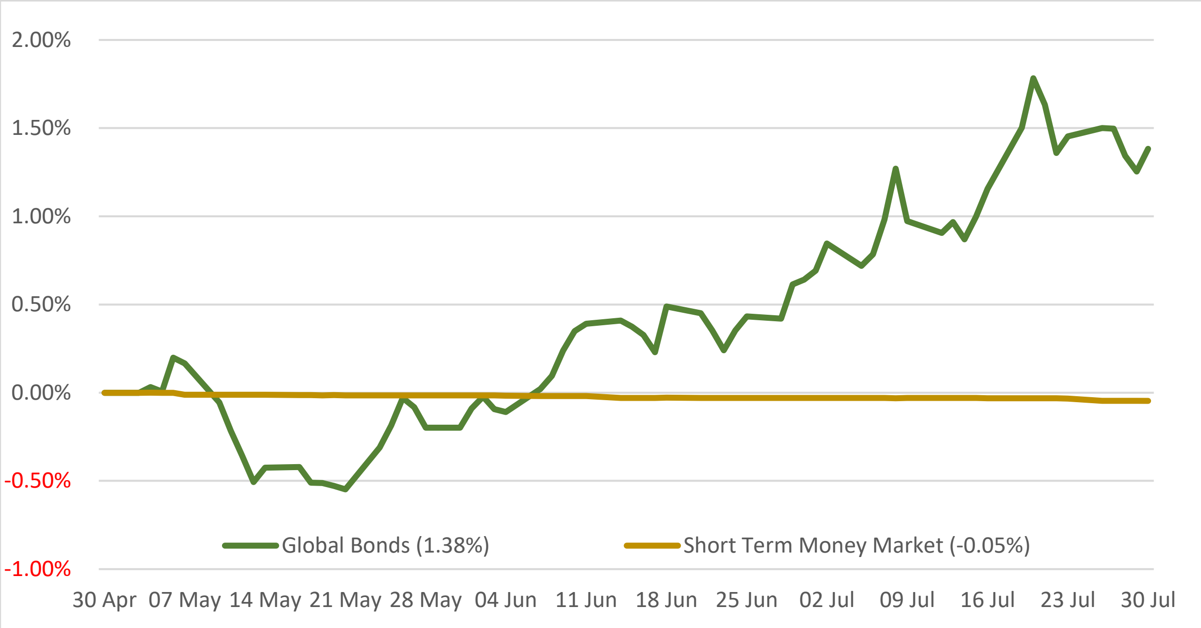
Despite having had a very difficult start to the year on higher short term inflation concerns, global bond markets regained their poise and were calmer during the last three months, posting modest positive returns. It appears that bond markets believe that the strong growth and high inflation environment will be transitory and believe that we are in secular stagnation and rates will remain low. Yields on the US ten-year government bonds fell despite the Fed hinting that rate rises will come slightly sooner than expected, ending the quarter at 1.22% having been at over 1.6% at the start of the period.

June saw the FOMC's (Federal Open Market Committee) announcement of a new median dot plan. This plan is used by the US central bank to signal its outlook for the path of interest rates and, having previously forecast no change to rates in 2023, has now indicated two rate hikes of 25 basis points that year are likely. The impact on ten-year treasuries was immediate on the news, but most of these gains were erased the following day as investors grew in confidence that the Federal Reserve would not let price pressures surge as high as some market participants had feared. US bond markets rallied, drawing comfort from reassuring words from various Fed speakers, including Chair Powell, who noted that the FOMC "will wait for actual evidence of inflation or other imbalances" before moving interest rates higher.

The picture in Europe was a little different, however, with the yield on ten-year German bunds rising during much of the quarter. While European economies have taken different approaches to reopening their economies as vaccination programmes accelerate, business activity in the eurozone surged to its fastest rate in 15 years. The European Central Bank (ECB) expects the region to grow by 4.6% this year, a stronger outlook from its March assessment. However, the ECB is not signalling when it might reduce its pandemic-era stimulus programme and expects inflation to remain below its target in the foreseeable future.

Within fixed income markets, investors searched for yield and inflation hedges against a backdrop of low sovereign bond yields and higher inflation, turning to spread products such as emerging market debt, US investment grade credit, and US and European high yield, as well as inflation-linked bonds. In terms of duration, the US outperformed last quarter as investors appeared to prefer relatively higher Treasury yields to still deeply negative real European core sovereign bond yields. In addition, the issuance of EUR 20 billion of 10-year bonds to fund the European Union's NextGenerationEU recovery package probably also helped to push European core yields slightly higher.

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



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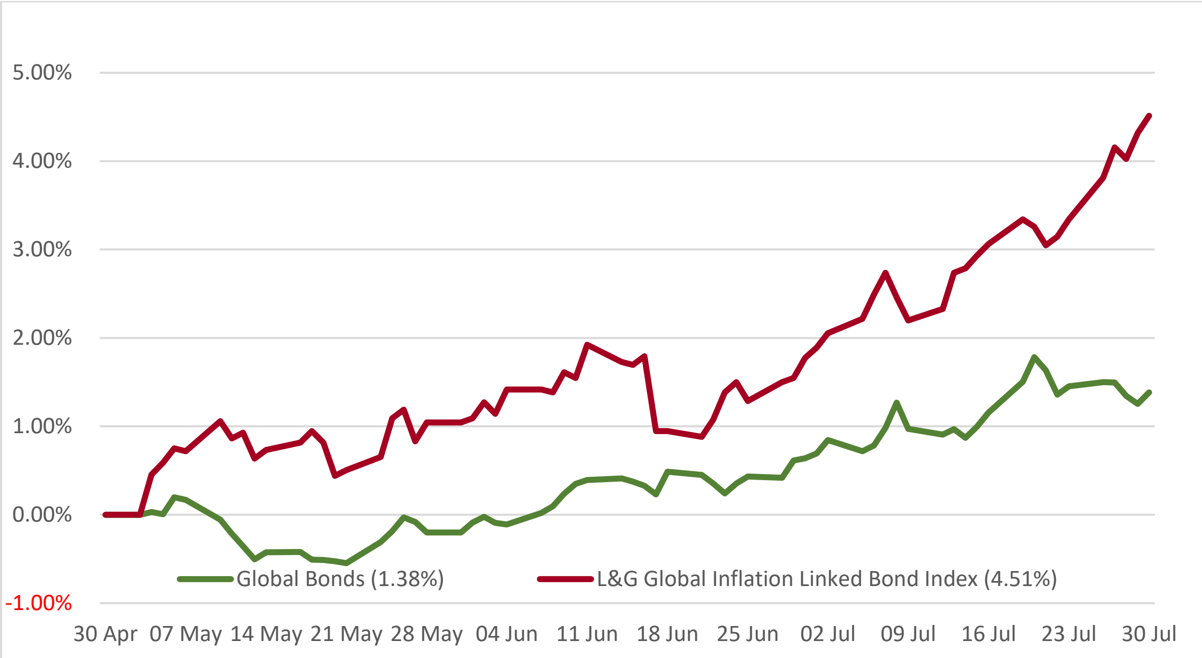
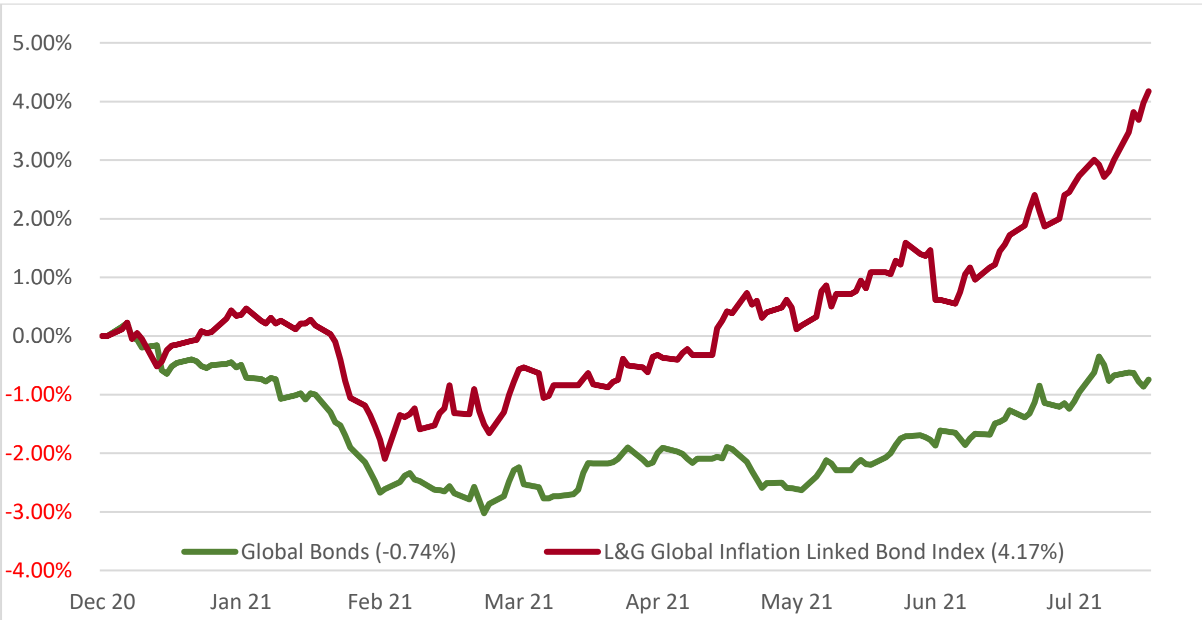
Sector comparison: Global Bonds and Global Inflation Linked Bond Index Proxy – 3 month performance



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

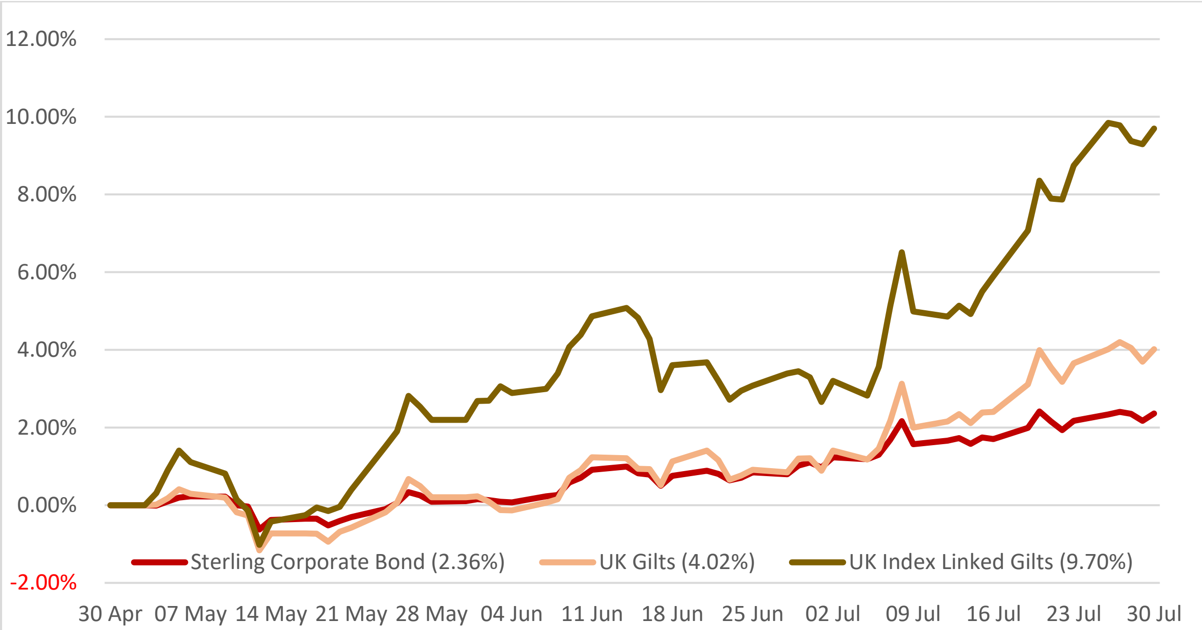
UK Gilts

The Bank of England continues to print money and support the UK economy and the latest forecast suggests £200bn per year until at least 2025 is on the cards, and yet the academic laws of supply and demand seem not to be working at the moment. An increase in supply usually means a decrease in demand and the price finds a new equilibrium – in the case of government debt this can manifest itself in the form of gilt yields readjusting through price changes, and/or changes to Sterling compared to other currencies. But, since the Global Financial Crisis of 2008, academic thinking from an economic perspective has been turned on its head. Demand for gilts is actually high – especially from overseas investors as the UK sovereign debt market is one of the few major markets where the dividend yield remains positive.

Perversely, the yield on the medium and longer-dated paper has actually tightened in the last three months, whereas the short-dated bonds have been flat to slightly upward sloping. This suggests the capital markets are not worried about interest rates moving up anytime soon. This too seems like an odd quirk in market thinking as well. At 2.50%, the present rate of inflation is above the target rate set by the Bank of England (BoE) and usually the BoE uses interest rates to keep inflation under control. This does seem very odd when you see the speed in which the rate of inflation has got to this level. Only a few months ago (March) inflation was 0.70%. This is not a UK only phenomenon though – many Central Banks are suggesting the spike in inflation is transitory and as inflation works on a year-on-year number we have to consider that much of the world was in lockdown a year ago, economies were effectively shut, oil prices were much lower and this will work its way out of the system in the coming months.

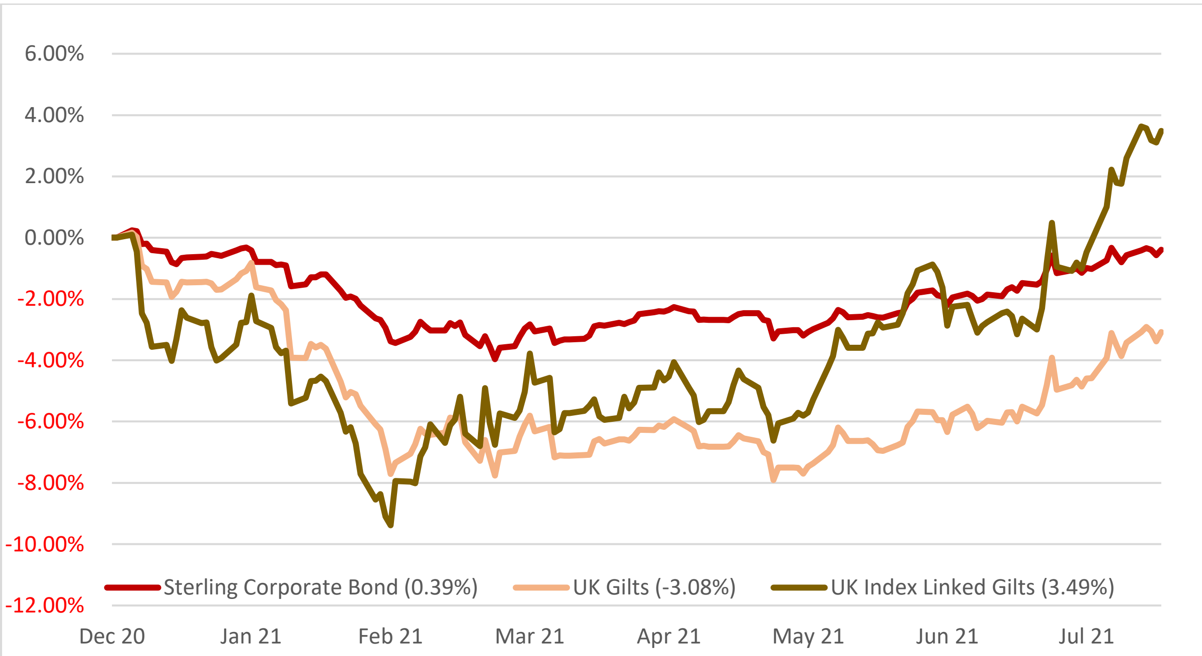
The BoE is willing to let the inflation number "run hot" before having to make a decision on interest rates. The bond markets will be a very good barometer of market sentiment and tend to react before the stock markets. The upcoming 6-12-18 months will be very interesting times in the UK Gilt market and will not be without bouts of volatility.

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



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

DEVELOPED MARKET EQUITIES

UK

UK GDP fell by 1.6% in the first quarter of 2021 which left GDP almost 9% lower than at the end of 2019 after the first three months of the year. However, the growth rate has now been positive for four months in a row, with May's figure coming in at 0.8%. This means that the economy is now only 3% below pre-pandemic levels, but the latest number was both lower than the previous month and also lower than had been expected. This speaks to the challenges the country faces in dealing with the pandemic.

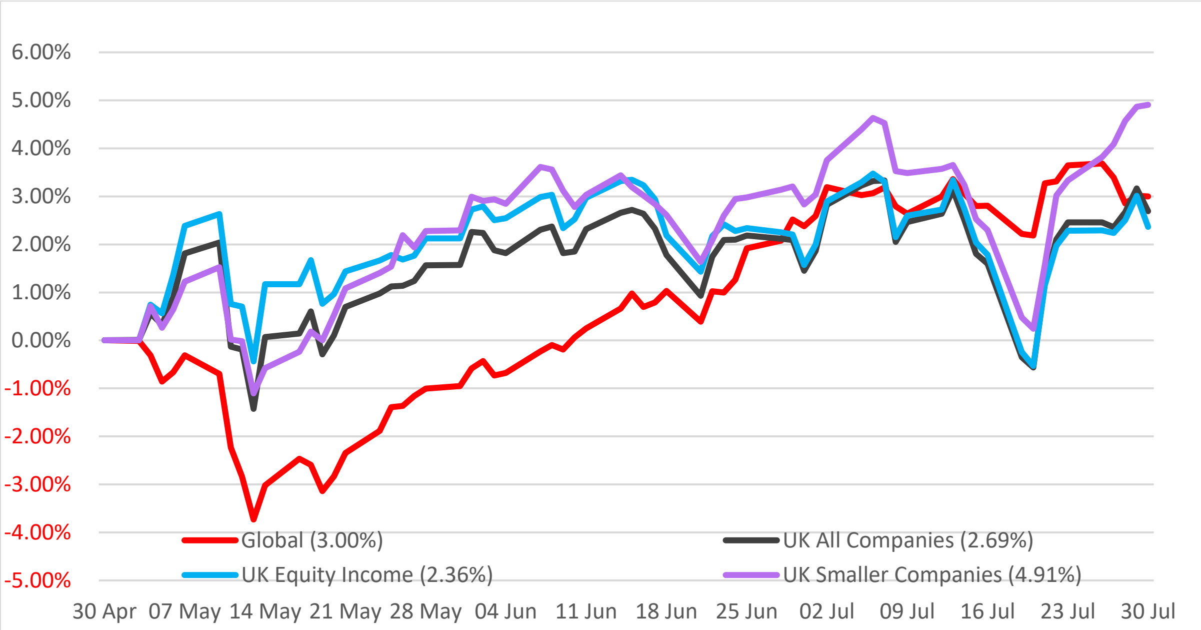
Towards the end of the period, the final step in prime minister Boris Johnson's roadmap was reached and restrictions were lifted in England, with the devolved nations taking similar steps. A week later and Covid infections were back to levels seen in January. With the last vestiges of the lockdown over, the government (and markets) face a nervous wait to see if the vaccine programme is successful in breaking the link between infections and hospitalisations.

The reopening is also likely to lead to an increase in something else: inflation. As increased freedoms led to higher consumer spending and more business activity, CPI for June was 2.5% ahead of the Bank of England's target for the second month in a row, having breached the 2% target for the first time in nearly two years in May. The margin of difference is small, and the bank is currently taking the same approach as the Federal Reserve in the United States, dismissing the spike as transitory, but they will be worried.

Core inflation, which removes things like oil prices (which could hit $100 dollars per barrel before demand peaks according to a report from top traders) that can have an excessive impact on the main rate, has risen from 1.3% to 2.3%, and RPI, the rate behind index-linked gilts, has risen to 3.7%. £460bn of UK government debt (as well as things like rail fares and student loans) is tied to RPI. This means that the UK could face additional payments of around £10bn over the coming years as the rate pushes higher.

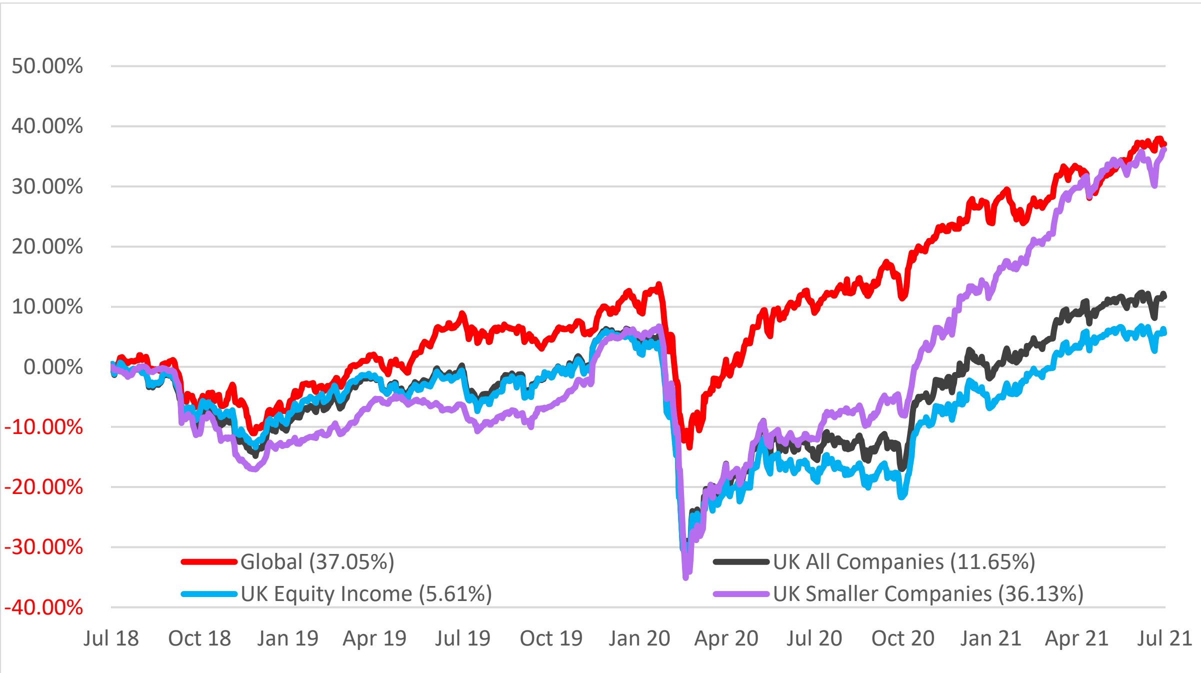
Despite all of this, UK markets appear to offer greater value than many others, such as those in the US, where the recovery started earlier and has been stronger. The question that remains is whether this value will be translated into greater returns over coming months. Where we select active managers in the region, we are looking for them to select those companies which can take advantage of the opportunities that present themselves in a rapidly evolving global economy.

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



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



30/07/2018 – 30/07/2021 Data from FE fundinfo 2021

Europe

European equities posted another quarter of gains as vaccination campaigns were firmly underway and the recovery theme maintained the upper hand in equity markets. Over the last few weeks, Europe's vaccination levels have caught up well. Many European countries loosened restrictions on social and economic activity as infections fell and fears of the new Delta variant subsided.

Last summer the European Central Bank (ECB) created the Pandemic Emergency Purchase Programme (PEPP) to help with the crisis which is currently in action and sits at a staggering €1,850 billion. Alongside this, it announced a sizable bond purchase in March 2020. As of yet, there is no indication that the ECB intends to reduce the PEPP or asset purchases due to muted inflationary pressures. In July, the ECB increased its inflation target to 2% over the medium term, as part of the changes to its monetary framework. This is indicative of its commitment to an accommodative monetary policy for longer. It is expected to translate into greater market confidence, supporting equities through the economic rebound.

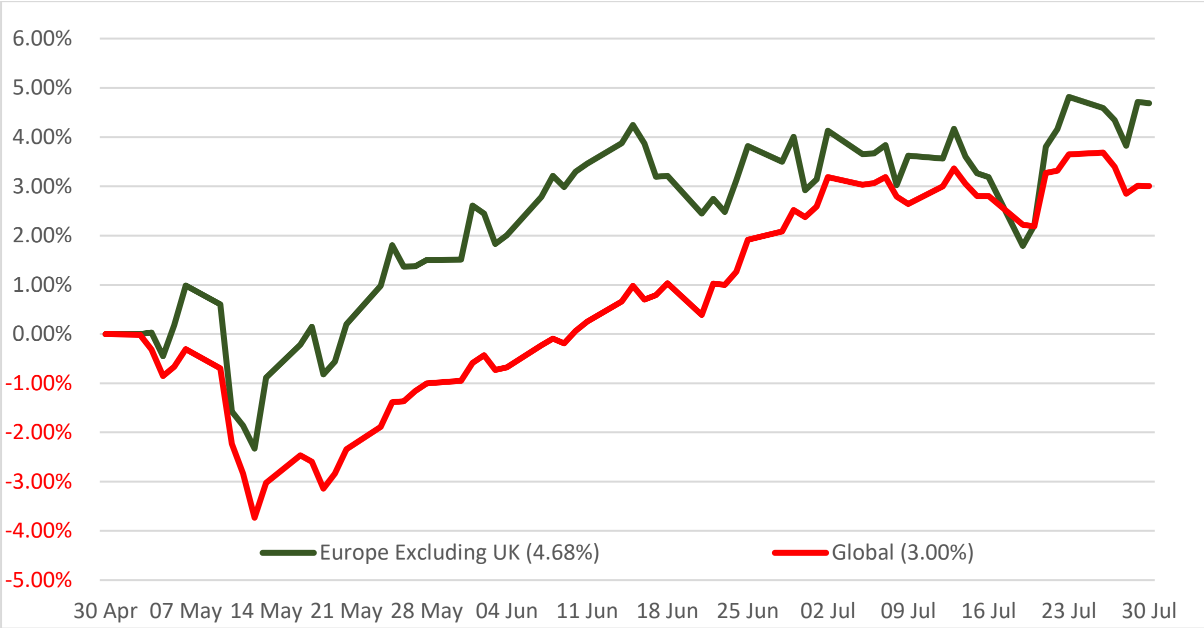
The Eurozone's recovery fund will be very impactful, especially for the Southern regions where growth needs the boost, particularly in case of another poor tourism season. The most sizable grants are going to be 5% and 7% of nominal GDP for Italy and Spain respectively.

After lockdown measures were lifted business investment in Europe is returning which in turn should feed demand and sustain growth. It also takes the edge off inflationary pressures. The start of the quarter saw a very upbeat Purchasing Managers' Index (PMI) number, despite rising commodity prices. Activity in the services sector also rose, suggesting a healthy start to the Eurozone's economy re-opening. Towards the end of the quarter the PMI for the region fell slightly from a record high in June. However, as supply chain conditions improve and re-opening continues, we could see an even stronger third quarter.

The European economy is forecast to grow by 4%-5% in 2021. Germany's exports to China and the US are rising, which benefited its stock market. Likewise, Italy should see export growth too.

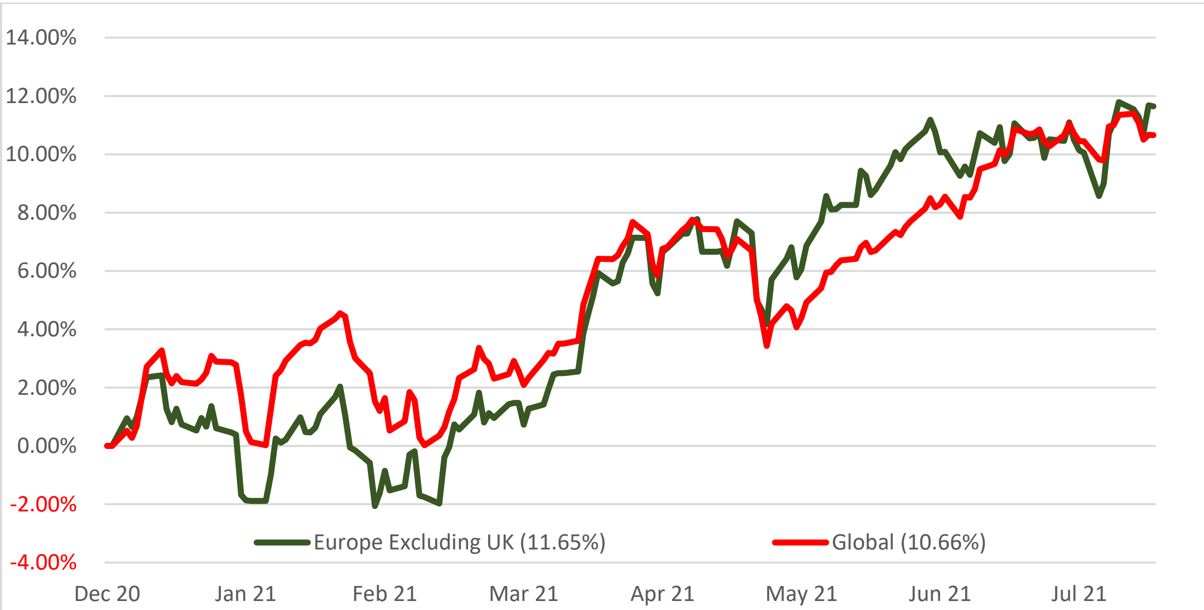
The main European index has a high weighting in cyclical stocks, such as financials. As global growth improves and the yield curve in Europe steepens, financial stocks should benefit, providing a boost to their profitability. Other cyclically sensitive sectors, for instance, industrials, energy and materials should also benefit. The second quarter saw utility and energy sectors lag in performance. Therefore, the rotation into these value companies should continue if the bond yield continues to rise in the second half. The main indices of France and Switzerland have also registered the highest returns of the region – c9%, while Germany has lagged. The Spanish IBEX index ended in negative territory over the last three months.

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



30/04/2020 – 30/07/2021 Data from FE fundinfo 2021

Sector comparison: Global and Europe Excluding UK – YTD performance



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

US

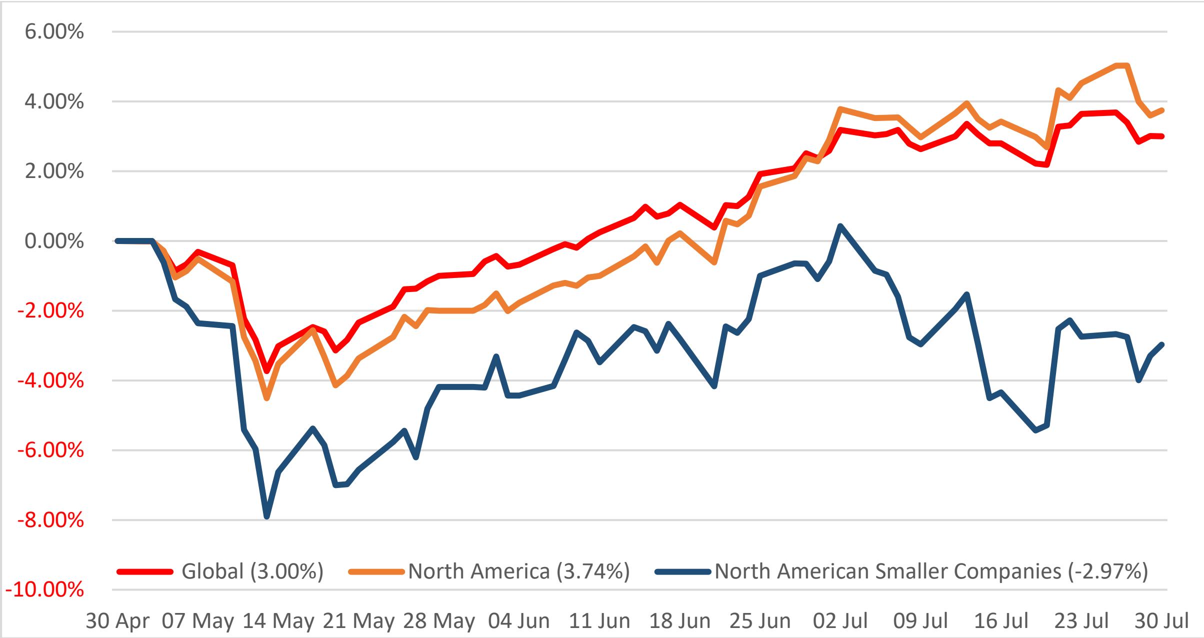
After a weak start to the quarter, the S&P 500 moved higher to finish the period up by over 5%, thanks to a rebound of growth and technology stocks, strong first quarter earnings, and the prospect of more fiscal stimulus as President Biden reached a bipartisan deal to boost infrastructure spending by $600 billion. The NASDAQ index also returned to favour, ending the quarter up by 8%, as both indices continued to hit record highs.

Inflation continued to be a major talking point over the last three months, as the reopening of economies and the quick rebound in activity that has followed has fuelled inflation in some countries. In May, the US consumer price index increased by 5.0% year on year, well above the Fed's target rate, although some of the underlying details suggest that there are temporary factors at play, such as the rise in used car prices. While the Federal Reserve continues to see this inflation increase as transitory, it has become slightly more hawkish, acknowledging that tapering is being discussed with the expectation that it will begin in the first quarter of 2022 being most likely. The median Federal Open Mark Committee (FOMC) participant also now expects two rate hikes sometime in 2023, up from no rate hikes just three months ago. It will be interesting to see how hot the central bank is willing to run the economy.

In terms of economic data, the contribution from sectors that are clearly impacted by the reopening, such as travel and tourism, remained strong, but there were also signs that they were broadening across the economy. The recovery in the labour market picked up pace with 850,000 jobs added in June – the largest monthly gain since last August. The second quarter earnings season also offered reasons for optimism with over half of the S&P 500 companies having reported earnings by the end of July, close to 90% of those reporting had beaten analysts' earnings expectations.

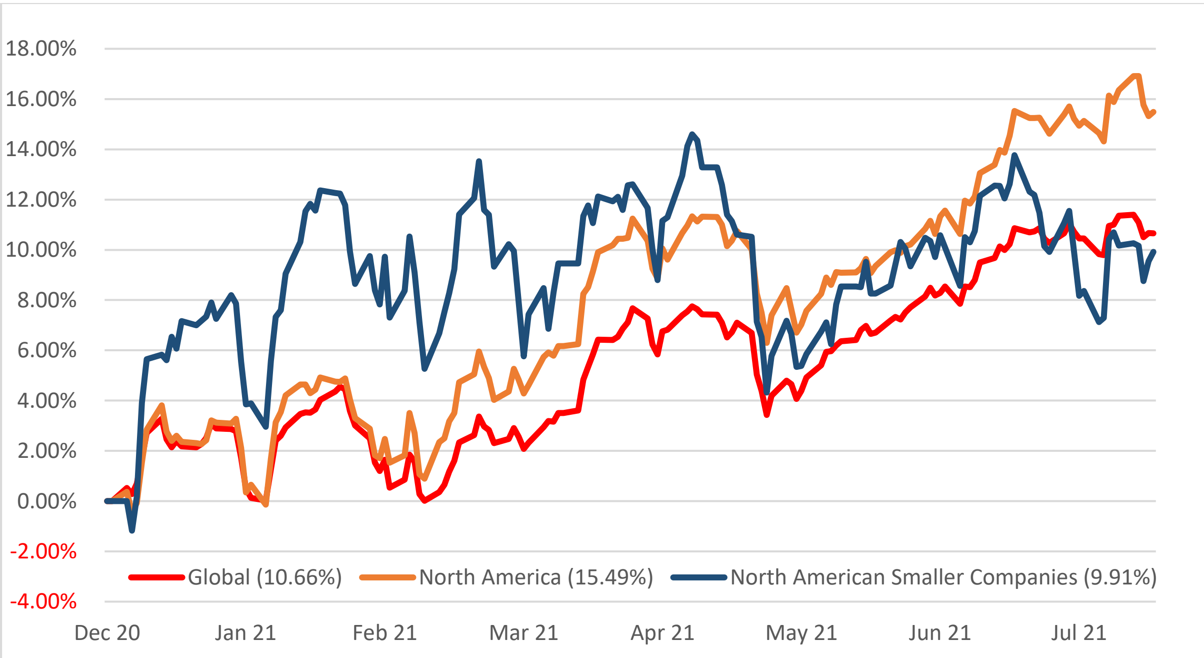
The US Purchasing Managers' Indices (PMIs) for manufacturing and services both beat expectations over the quarter as they rose to their highest levels on record hitting 68.1, with the PMI data being above 50 for twelve months in a row signalling continued economic expansion in the US. The details of the PMIs not only showed that consumer demand remains buoyant but also that businesses are facing rising input costs. Consumer confidence also remained at a 12-month high as US personal spending rose at a steady, modest pace.

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



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

Japan

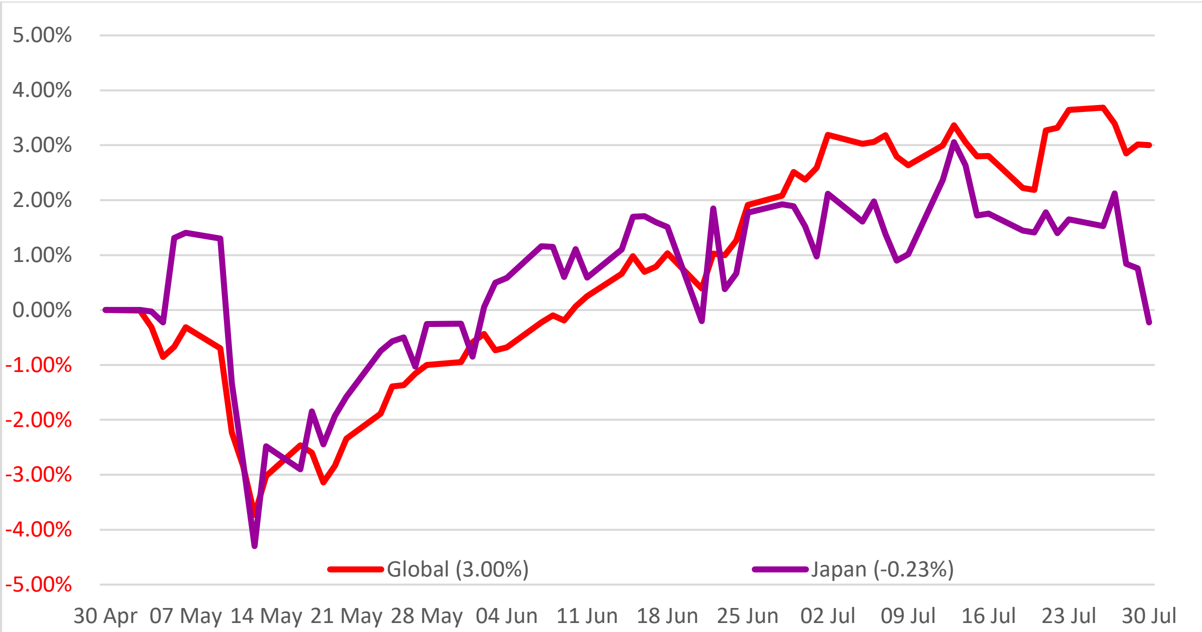
All eyes are on Japan at the moment, although in the main because the Olympics are being held there. Domestically there is a great deal of upset and resentment relating to the fact the games are actually going ahead as the population are not happy with them. Poll upon poll overwhelmingly suggested it was wrong to have them being as we are still in the midst of a global pandemic and in a country where infection numbers are rising and the number of vaccinated residents is falling behind the global average.

There are a number of academic papers looking at historic Olympics which suggest the cost of hosting the games far outnumbers the economic returns, and with the cost of these particular games coming in at something like 10x original estimates, backed up with NO spectators, or increased tourism or leisure and hospitality spend to offset this spend, and this could cost – the estimate for the daily Covid tests just for the athletes, support staff and officials has been mooted at $2bn - but the cost could impact politically – especially as there is an election in October. Prime Minister Suga and his cabinet have seen their popularity plummet and now sees their approval rating sit below 40%. The LDP (Liberal Democratic Party – of which Suga is the President – a Presidency which expires in the forthcoming quarter) will see upheaval before the election due in October. Many market commentators are suggesting Suga's re-election will depend entirely on how well the Japanese Olympians will do in terms of medals – if this is the case then things are not too bad.

From a market perspective, Japan has struggled over the last three months when compared to other Asian Indices. For instance, the main equity index delivered a loss of approaching 5% for the quarter. Although Japan has one of the world's largest economies, it also has one of the world's oldest populations, and with Covid disproportionately affecting the elderly this has not been good for markets. Also, Japan is heavily reliant on importing natural resources and the strong bounce back in the price of oil would have negatively impacted profits and sentiment. On top of that, one of Japan's major exports – cars – is having major supply chain issues (there is a global shortage of semiconductors which means cars cannot be built – or sold – and this issue could take up to 12 months to rectify). Political tensions between Japan and China (the largest economy in the region) are a little strained as well which does not help things.

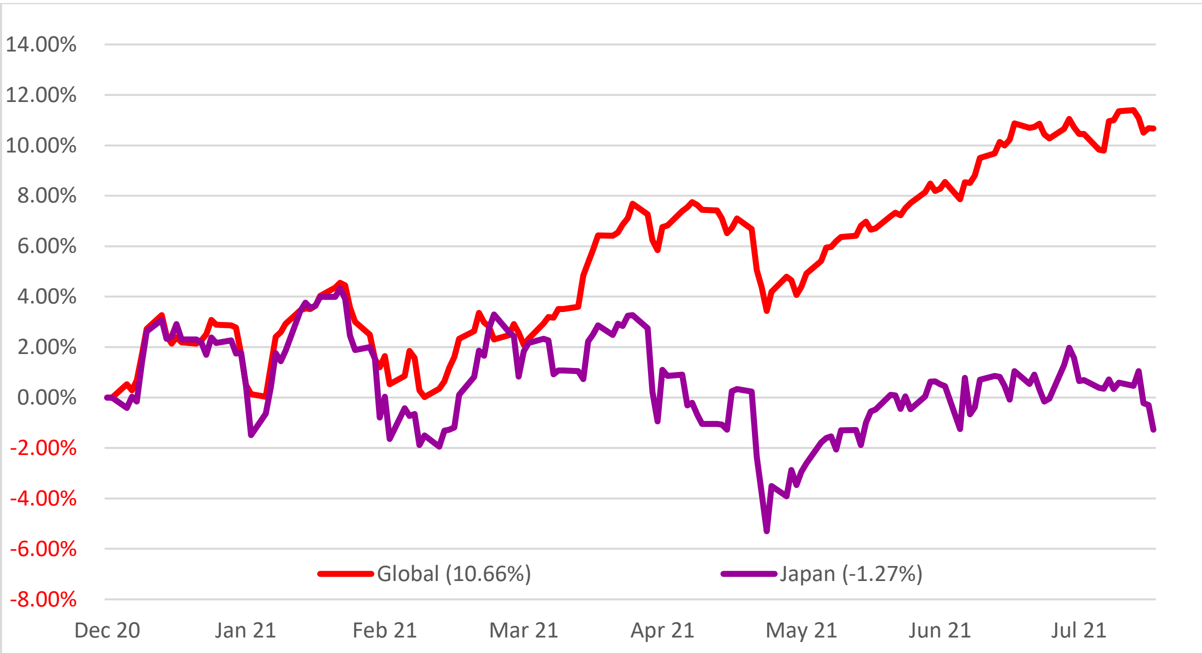
Japan is a global leader in many fields – automation and robotics for instance and could well massively benefit looking forward – especially as minimum wages are rising in the West and if you consider robots don't get ill and can work without holidays or pension contributions and can put in a working week longer than 35 hours, the economics at some stage start to look very attractive.

Sector comparison: Global and Japan – 3 month performance



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

Sector comparison: Global and Japan – YTD performance



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

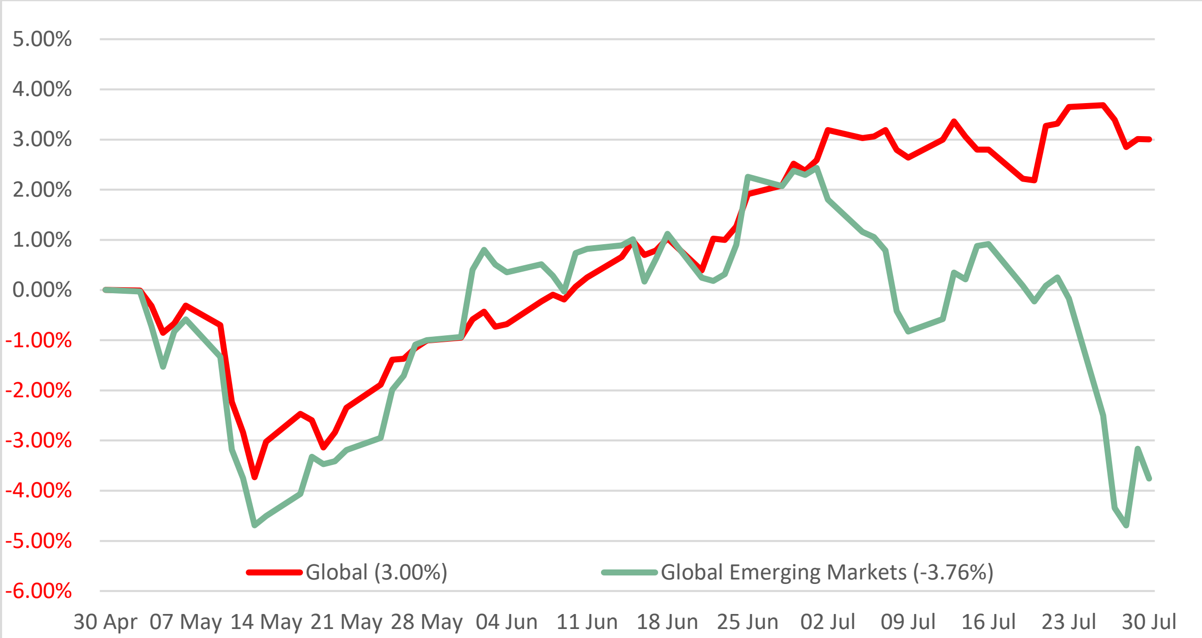
EMERGING MARKETS

This is a very broad sector and on an aggregate view, returns were quite disappointing over the period, however, on an individual country basis there were areas of stronger performance. As has been the case with most emerging economies, the impact of Covid was keenly felt with high rates of infections often coupled with low vaccination rates. Some countries such as Chile and Poland have been able to implement relatively successful programmes, whereas others such as South Africa and the Philippines are well behind with fewer than 5% of the population fully vaccinated.

Outside of the pandemic, the other factors that were prevalent over the quarter and will continue to drive returns over the coming months are the movements in the US dollar and commodity prices. The dollar seems set to remain deflated as a result of the fiscal and monetary stimulus that has been put in place and this should act as a tailwind for the sector. That said, this depends on how long the Federal Reserve is able to resist taper their asset purchases. The impact of rising commodity prices is harder to predict, but for those countries which export more metals and oil than they use, upward movements will been a boon.

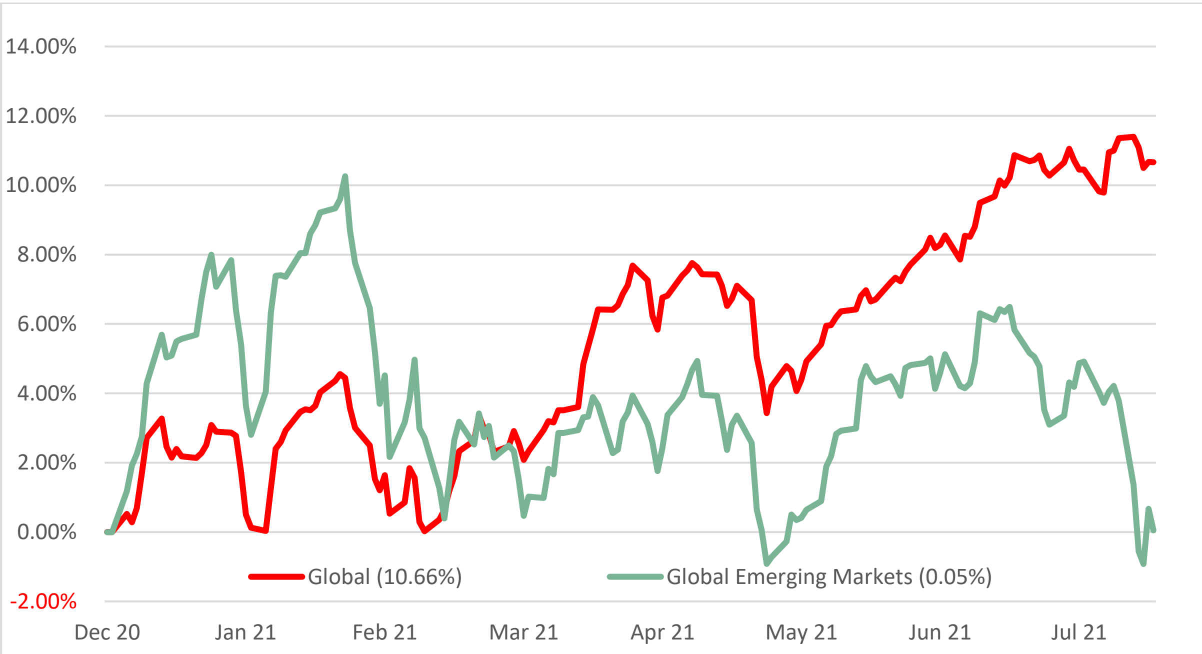
Whilst investing passively into the sector remains a valid approach, recent data suggested that the dispersion between the best and worst stocks was at the highest level for over a decade. This should mean that, where active investing is appropriate, good managers will be able to produce greater outperformance assuming they can identify those stocks which could emerge strongly from the pandemic.

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



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

Sector comparison: Global and Global Emerging Markets – YTD performance



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

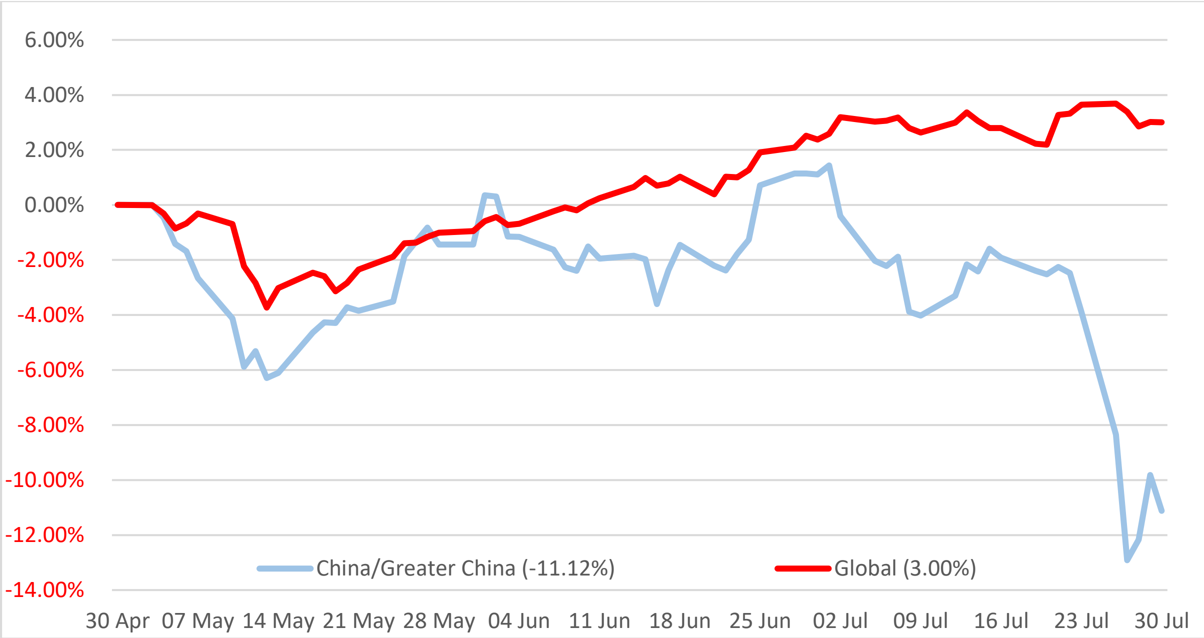
ASIA PACIFIC/CHINA

China’s success at dealing with pandemic has allowed it to rebound strongly the situation in China was also broadly and in the three months to June, GDP rose by 1.3%. This puts the world’s second largest economy on course to hit the 6% annualised rate that the government has targeted, but questions remain about whether more support is required to ensure that the recovery doesn’t stumble. Despite an internal market which is rapidly increasing in size, exports are still critical and new mutations and increasing rates of infections in key regions, compounded by recent floods which have impacted on supply chains, continue to present a potential headwind, with officials warning that the country faces economic uncertainty.

The country is also taking steps to reign in its tech giants which they felt were beginning to exert excess influence over their tightly controlled populace. This culminated (most recently) with a $2.8bn fine for Alibaba which along with Tencent accounts for 30% of the MSCI China Index. The government does not appear to see that penalty as their final word on the matter and the success of the Chinese economy gives them the flexibility to take action where it might have otherwise proved difficult. They have also introduced new rules which prevent Chinese technology companies from listing in the US, which prompted firms to move around $1.4bn worth of launches from New York to Hong Kong.

Unlike China and the broader Asia Pacific region, which struggled over the period as much as anything as a result of news flows coming out of America, India enjoyed more success. Following the first recession for almost 25 years in 2020, the OECD forecast that the country to be the strongest performer amongst the G20 economies in 2021 with GDP growth of as much as 10%. Of course, achieving this outcome relies on their ability to manage the new strains of Covid and in increasing vaccination rates which at below 10% lag behind many other developing markets.

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



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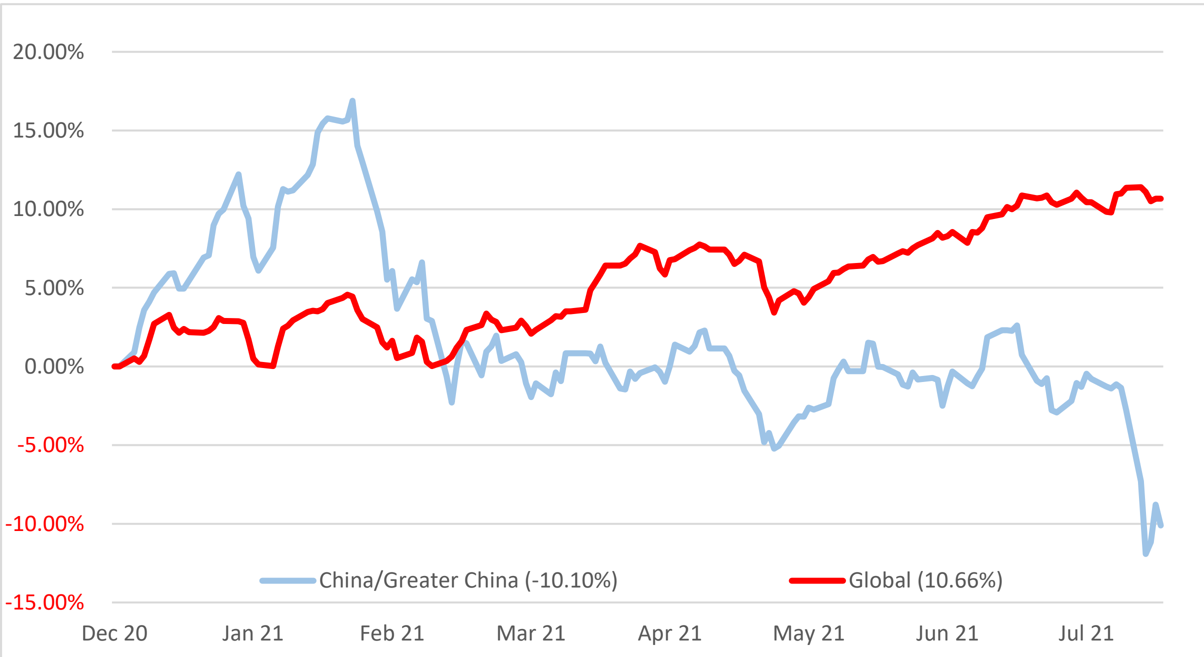
Sector comparison: Global and China/Greater China – YTD performance



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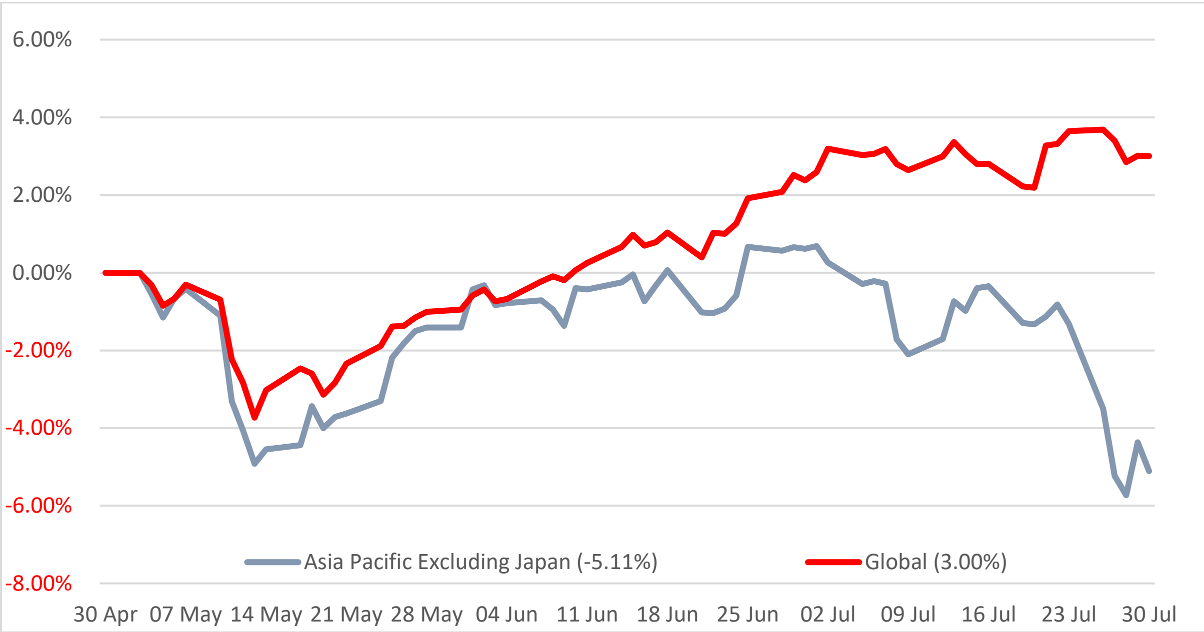
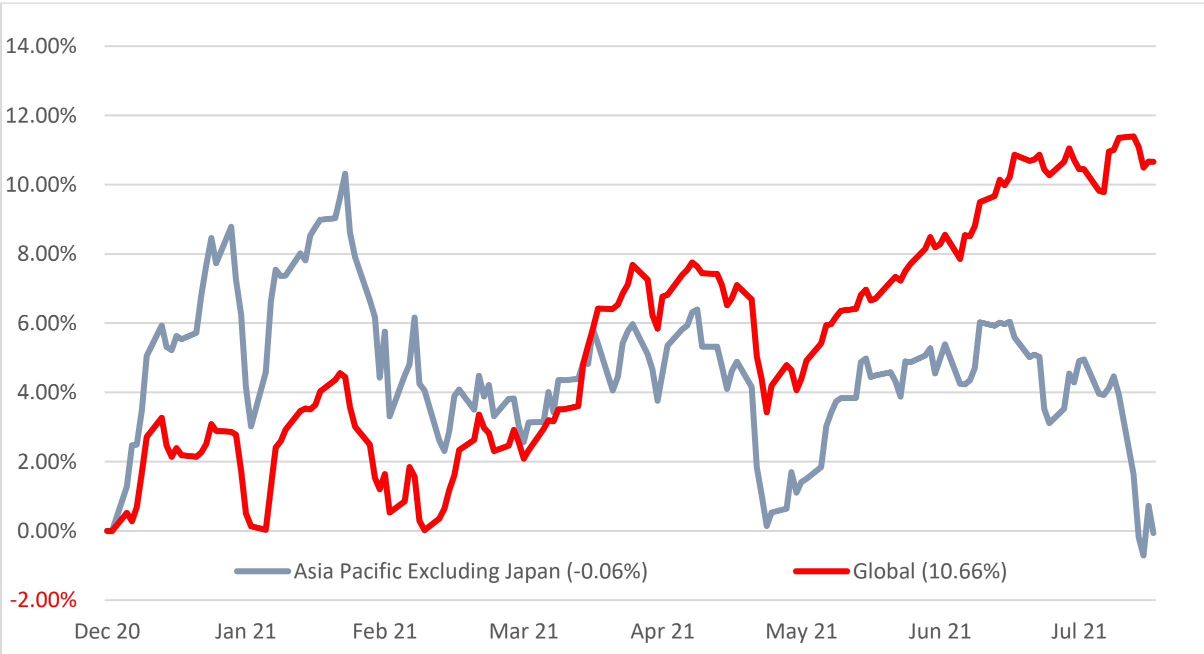
Sector comparison: Global and Asia Pacific Excluding Japan – 3 month performance



30/04/2021 – 30/07/2021 Data from FE fundinfo 2021

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

COMMODITIES

As economies grow, and as emerging market economies mature, so the demand for commodities grows too. It is a volatile asset class, and covers energy (oil and gas), metals (gold, silver, copper, steel) and agriculture (wheat, corn, coffee), each with their own economic cycle.

The gold price was broadly flat over the quarter, despite some volatile moves. During May as investors looked for inflation protection they turned to gold, which saw the price rise by $128 to over $1900/oz at one point. However, the precious metal had a poor June, falling by $135, before regaining some composure in July to finish the quarter at $1817.

Oil on the other hand was having a much better time of it with the brent crude price rising by over $6 per barrel during the quarter to finish at over $75. However, there remained some volatility during this time, largely on the back of OPEC squabbles. We have also seen the rise in the price of oil help big oil majors Royal Dutch Shell and BP recently announce dividend increases and share buybacks as they become more profitable again.

Copper's meteoric rise in the previous twelve months came to a bit of a halt as China attempted to crack down on speculators. However, with copper one of the key commodities for the electrification trend and the market in structural deficit for several years to come the copper price will undoubtedly test new highs again.

ALTERNATIVE STRATEGIES

UK Direct Property

Like a Phoenix from the flames, the UK direct property market sprung into life over the last three months. As the constraints of lockdown were lifted and the desire of many to "return to the office" gathered pace, it became obvious that the wholesale writing off of property as an asset class (which happened last year) became viewed as something that went a bit too far. As opportunistic investors returned, prices started to firm.

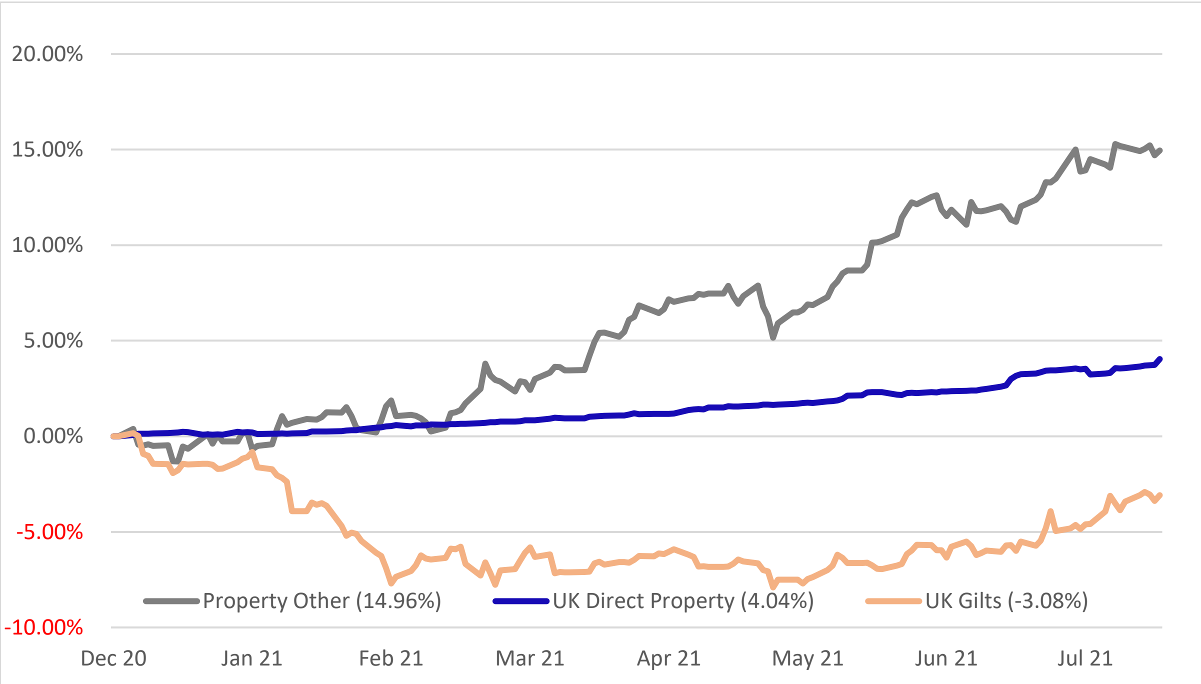
For the last couple of years, the UK property market has been restrained by questions such as "what will happen in a post-Brexit world?" In the last 18 months it has been "will people ever return to work once Covid is no longer an issue" and "what will happen to the high street?" The property market is like any other market – in that it requires buyers and sellers to formulate a price. But, it also needs tenants, and the quality of the tenant, and the length of the lease can impact the price of the property. In a Covid world many landlords and tenants have had to work much more closely than in the past – contracts are changing, lease lengths will become more flexible and in these times of uncertainty there will be volatility.

The governmental protection for landlords is coming to an end – rates holidays and rent deferments are winding down and many landlords are now going to the courts to be paid past due rents. Many (well known) tenants can pay what is owed, but had chosen not to, and legal action has started to bring this to a head. This has caused many issues – in terms of valuing buildings for example, but also in terms of landlords being able to cover their underlying mortgages and so on. Many property companies had to cut their own dividends as they battled to strengthen their balance sheets and this affected the value of the underlying property. Most people invest in property for a stable income….

It seems that apart from the retail and leisure aspect of the property market that most other categories – such as office and industrial are paying full rents again. In the last 12 months many re-negotiations and concessions have taken place and arguably the property market could come out of this stronger. In retail for instance "turnover rents" are being discussed and used as a way for both the tenant and the landlord to work more closely. Many are now paying rents on a monthly basis rather than quarterly too – so as to assist with cash flows.

The property market is not out of the woods and returns have barely moved in the last two years (arguably they have gone backwards if you take the dividends received and the cost of living into account). As many businesses adapt to flexible working there might be a need for less square footage. But, as people return to their place of work they might need more space from colleagues, thus creating an offset. Commentary from the wider market suggests the office of the future will be quite different to the office of the past and there will always be opportunities.

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



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

Cash / Money Markets

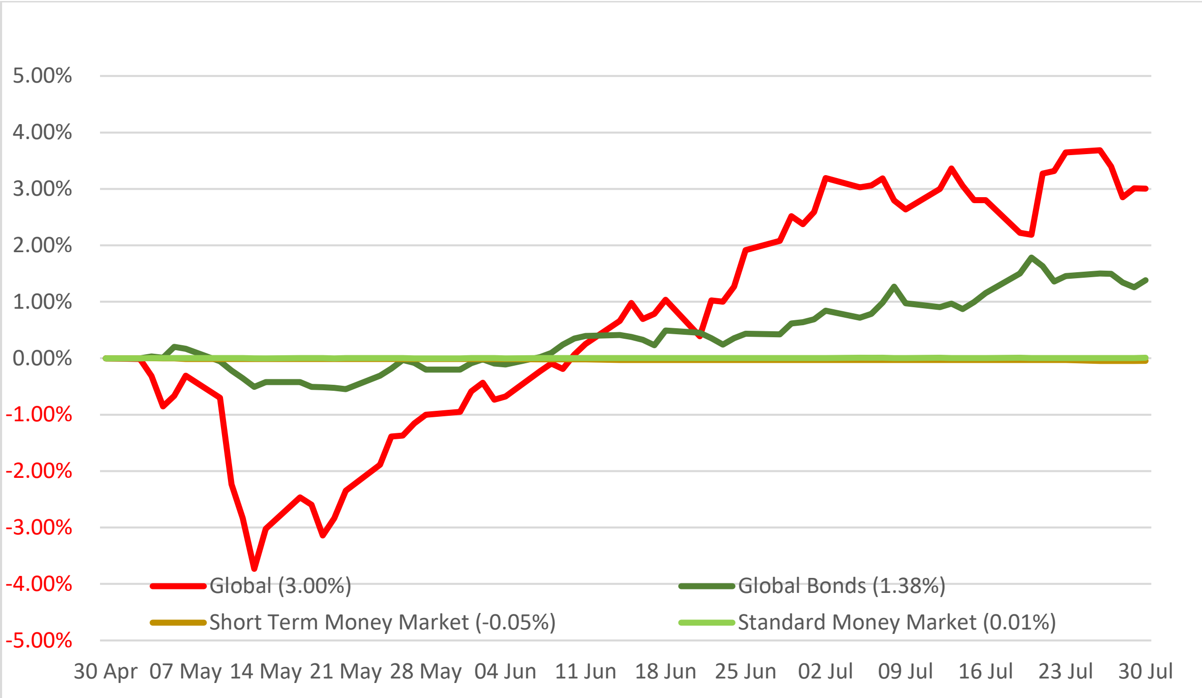
Once again there were no moves by the major economies to adjust their interest rates over the period. However, there was a lot more focus on central bankers in light of recent rises in inflation rates. In America the main inflation rate rose 5.4% in June, half a percent higher than had been forecast and up on the figure from May. The rise was officially the largest since 2008, but excluding this very brief spike which was caused by a massive jump in oil prices, the rise was the largest for 3 decades.

Markets are sensitive to inflation and the corresponding rise in interest rates that usually follow, but after such a sustained period of ultra-low rates, this sensitivity has been magnified. A small increase to rates when the level is near-zero is much more impactful to borrowers than when it is at “normal” levels. The main central banks have been very keen to point out that price rises will be transitory and that they are the completely predictable result of the crash in demand caused by the pandemic.

In order to sooth fears, officials at the Federal Reserve in America have repeatedly indicated that there is little chance of more than a single rate rise before 2023. However, following the latest spike, it emerged that at their latest meeting, the rate setting committee were now looking at a realistic likelihood of two rate rises in 2023, sooner than had been thought, with some members even suggesting that there could be rises next year.

The challenge for the central banks is to prevent their economies from overheating without acting too soon or too fast and damaging the economic recovery. All the while that inflation remains high and interest rates sit at zero or near-zero levels, money markets will continue to be a difficult place to invest with negative real returns. However, with increasing talk of stimulus packages being withdrawn (or tapered), it is important to remember the defensive characteristics of the sector.

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



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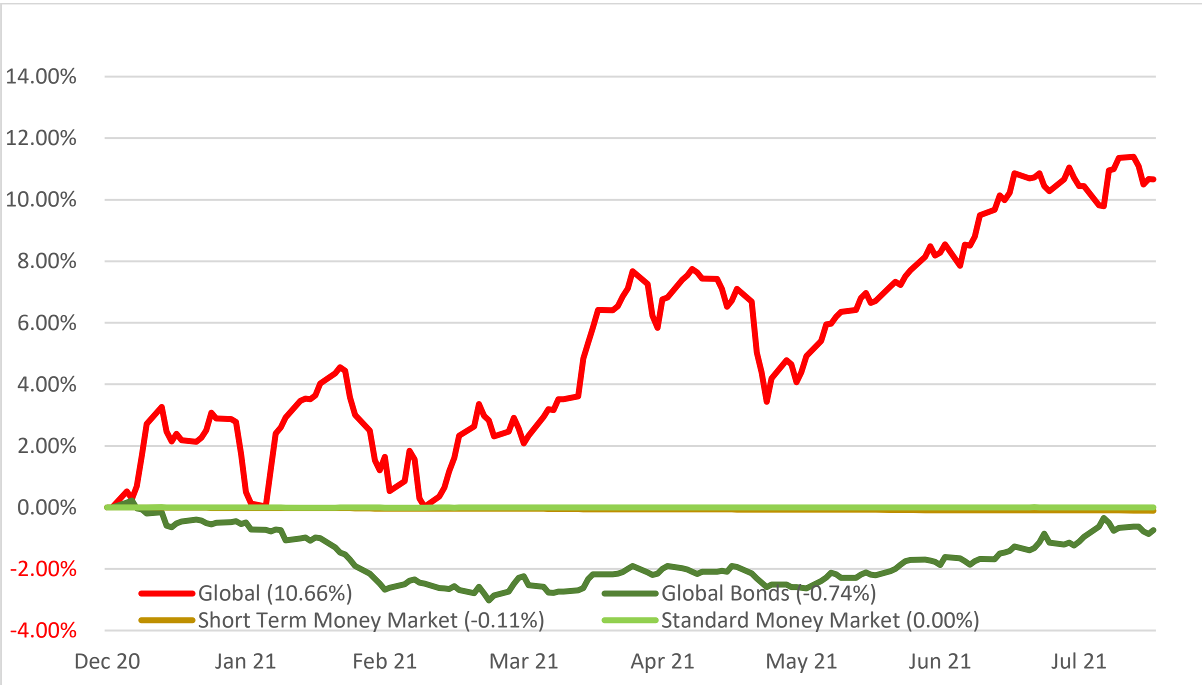
Sector comparison: Global, Short Term Money Market, Global Bonds and Standard Money Market – YTD performance



31/12/2020 – 31/07/2021 Data from FE fundinfo 2021

Infrastructure

The "infrastructure" asset class is quite a complex one. It can be considered from many different angles – there is the traditional physical element such as commercial buildings, roads, rail, ports, bridges, airports, hospitals, prisons, schools, then there is the less tangible elements such as power cables, power stations, pipelines - water, gas oil and there is the burgeoning new "digital" infrastructure – data centres, cell phone towers, television transmitters, fibre-optic cables, solar farms, wind turbines and so on. The asset class is very diverse and therefore not necessarily easy to lump into a single category.

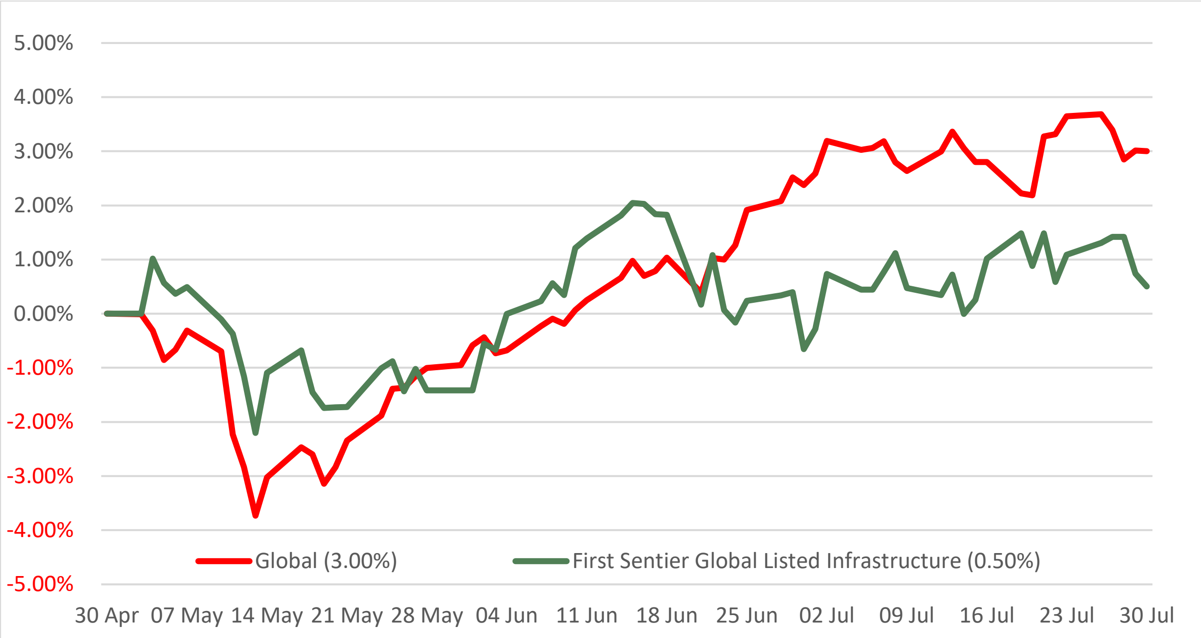
One thing is for certain in the asset class though is there is a series of fantastic tailwinds that over the years ahead there should be great potential for outsized returns. Of course you can invest in mature parts of the infrastructure space such as regulated utilities which will give a nice steady dividend, have prices mandated to inflation and operate in almost monopolistic markets. On the other hand, there are highly explosive growth aspects to infrastructure – just think how much data is being consumed every day – the need for subsea cabling, data centres, 5G masts and the like.

The Covid pandemic saw shopping move online – benefitting a number of aspects of the asset class whilst arguable decimating others. The number of rail journeys (to work for instance) would have collapsed, but the number of deliveries from online retail sources would have sky rocketed.

Most of the Western world operates with incredibly old infrastructure assets – how many roads and bridges are in need of desperate maintenance? How many houses cannot get broadband internet access? How much is needed to be spent on transitioning the world from fossil fuel dependence to renewable sources? How much of the developing world still relies on dirt tracks rather than roads? How many hospitals are needed? How will all of this be paid for?

President Biden has recently introduced a $1trn infrastructure bill, the European Green deal will cost €1trn too. There is a large amount of money heading towards the asset class from both governmental and private funding. It could be argued that infrastructure investing is environmentally friendly and part of the drive to reduce carbon across the world. Given time it is likely to become one of the major drivers of global growth, and although not all aspects of infrastructure will benefit in the same manner, the diversification opportunities of the asset class have the potential to spread risk in a blended portfolio.

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



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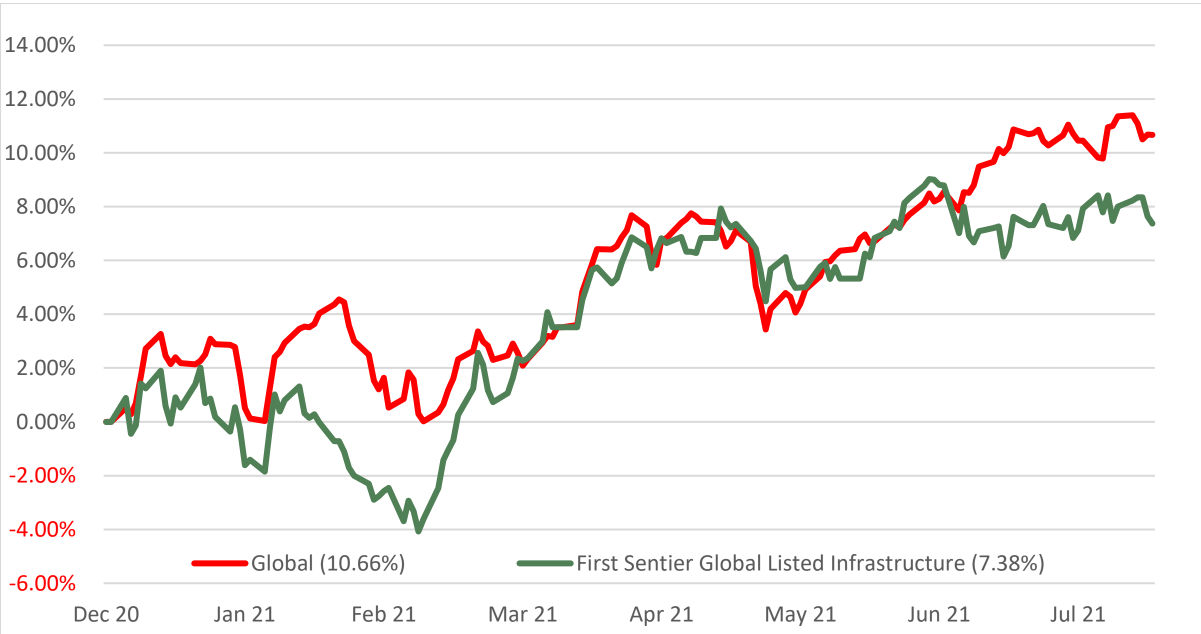
Sector comparison: Infrastructure Index Proxy and Global – YTD performance



31/12/2020 – 30/07/2021 Data from FE fundinfo 2021

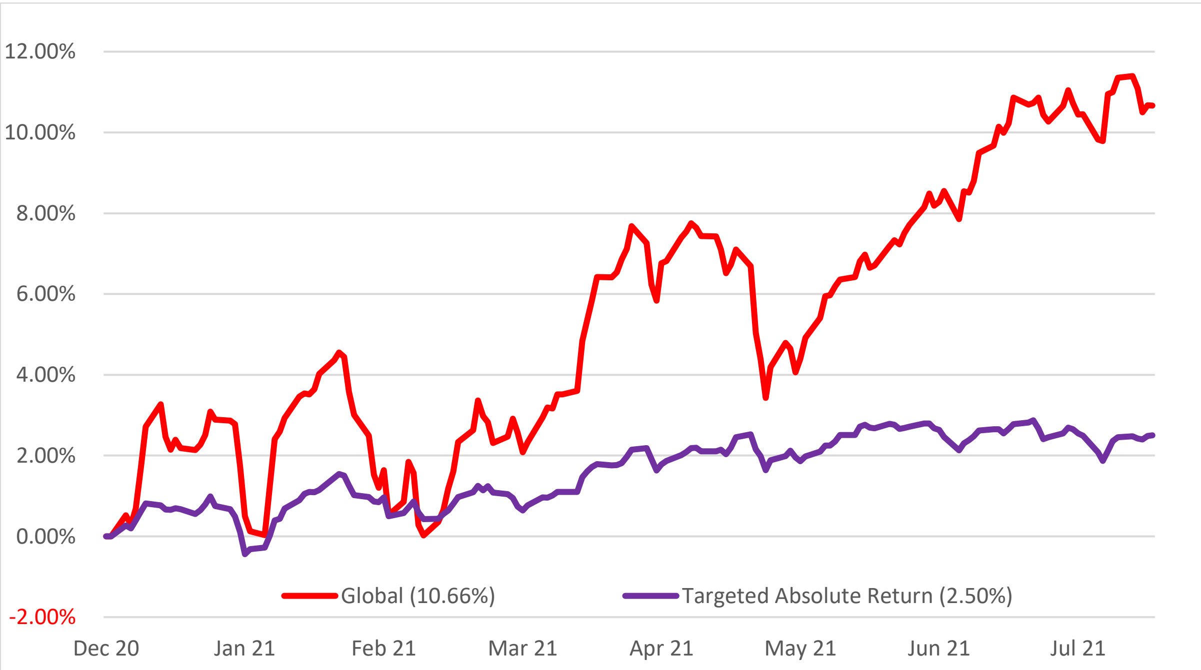
Targeted Total Return

The Targeted Absolute Return sector includes an array of different funds that deploy a variety of strategies, including fixed income securities, equities, property, derivatives, commodities, short selling and other techniques, that are not typical for traditional equity and fixed income funds. Therefore, the dispersion of returns between the sector constituents over different periods can be significant.

Funds in this sector generally depend to a lesser degree on the direction of underlying assets and are relatively lowly correlated to traditional fixed income and equity funds, thus providing diversification benefits. In addition, the funds in the sector are able to reduce the risk of portfolio due to lower volatility of the sector compared to global equities for instance.

Over the quarter the performance of the sector was flat and lagged the UK equity and global indices, as well as broad fixed income index that have joined equity indices on their recovery path. It is possible that funds in this sector will be re-visited because of the recent events in the bond markets and developed market government bonds, but selecting the right fund is very important.

Sector comparison: Global and Targeted Absolute Return – YTD performance



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