Stepping Stones

AUTUMN 2021

Introduction

I start by hoping that you have all had a good summer and have been able to perhaps begin to embrace normality as the UK benefits from the reduced lockdown measures. I hope you have had a chance to spend time with loved ones, friends and families and perhaps left our island shores or indeed enjoyed what these shores have to offer.

Covid is still very much on our minds and, whilst we have seen a fast and effective roll out of the UK's vaccination programme, different parts of the world are at different stages of embedding the vaccination programmes which will enable more freedom of movement and global trade.

Our last publication back in the spring, titled Tailwinds had reviewed and assessed the economic data at the time which signified accelerated global growth as markets returned to some sense of normality, and indeed this has been played out over the last 6 months.

The strong growth seen is expected to be supported by corporate earnings but we do not believe that global growth will continue to be as strong and much depends on what continues to be a long road back to normality.

The 'better than expected' economic numbers are beginning to fade and inflation is continuing to rise. There has been a surge in gas and power prices, supply chain issues deepen and geopolitical rumblings are being reported.

Whilst we have seen a rapid return to pre-Covid levels in global markets we are approaching the latter part of the year and into 2022 by treading carefully. There are a number of stepping stones to cross and there is a long way still to go before a return to normality.

Covid-19

It is beginning to feel a lot like Brexit and, whilst the UK now has some of the loosest restrictions, the same cannot be said on global basis. We can continue to praise the roll out of the UK vaccination programme, but the less developed nations have a long way to go. The Delta variant continues to lock down parts of the Asia Pacific region as once again measures are made to reduce the spread.

Eyes are on Israel who were quick to vaccinate a large proportion of their population but are now experiencing a sharp increase in serious cases. Scientists report a prevalence of the more infectious Delta variant and waning vaccine efficiency results in the outbreaks.

Let's hope this is not a future roadmap for the UK and US over the coming weeks as the colder months approach.

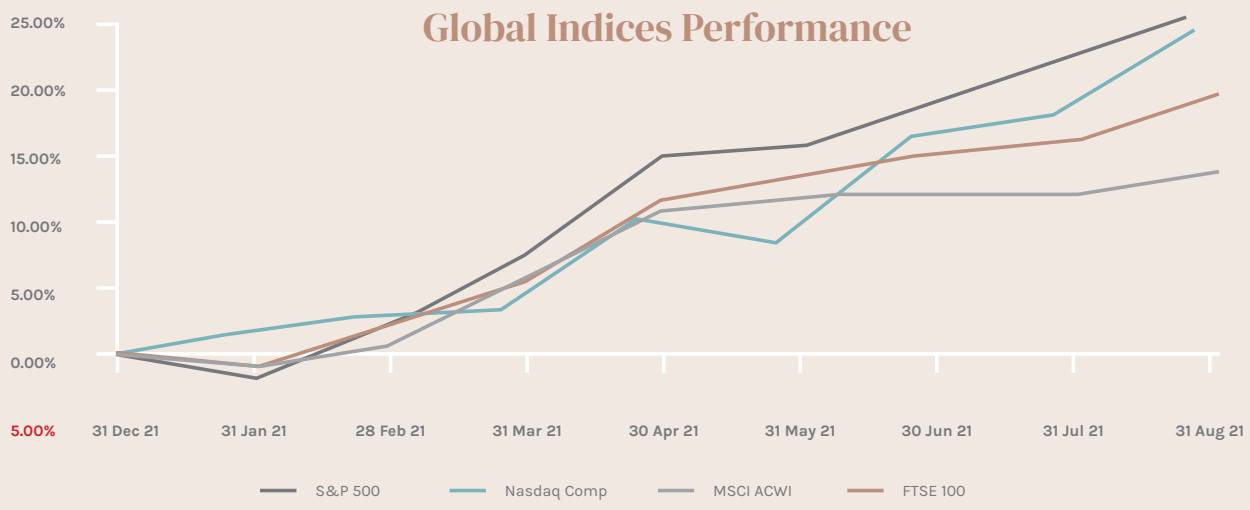
Post pandemic outlooks

A sharp global recovery has taken markets to new highs in the US and the UK has also made up some ground, albeit on a slower scale. Investor optimism has seen large market in-flows, in particular in the sustainable and impact areas of investment. Global growth remains strong, despite the recent slowdown, and the Federal Reserve and European Central Bank are likely to purchase c. $2.25 trillion of assets in the next 12 months, supressing interest rate rises.

Below charts the performance of the S&P 500 (US top 500 companies by market capitalisation), the Nasdaq (US based, heavily weighted in the technology sector), the FTSE 100 (UK main index of top 100 companies) and the MSCI ACWI (a global index of large and mid-caps across developed and developing nations) which demonstrates the levels of recovery over the last 12 months.

We continue to remain cautiously optimistic as we look to the end of the year, but we do expect things to remain 'bumpy' with spikes in volatility.

We will need to use stepping stones to navigate around these choppy waters and carefully evaluate what is causing these ripples in the waters.



Stepping over the ripples

Inflation

Inflation continues to dominate the headlines for 2021 and whilst a little bit of inflation incentivises consumers to spend, the increases in costs of goods and services will drive inflation up and households will feel the squeeze, especially those on lower incomes. Governments and policy makers will work to stop inflation getting out of control and it is going to be a difficult decision as to when to raise interest rates to prevent a stall in economic recovery.

When the rate rises will actually take place in the US and UK is splitting Governments on both sides of the pond and, against the current economic backdrop, central banks will not want to move too quickly and Governments will not want to withdraw fiscal support too quickly either.

Inflation can impact a portfolio in two ways; it is partly to blame for causing bond yields to remain extraordinarily unattractive (especially over the longer term) which in turn is forcing further money into equity markets, pushing equity markets into higher territory. We will benefit from the latter with our equity exposure and will use our bond exposure as a hedge should inflation start to spiral out of control.

China

What started as the Chinese authorities attempting to address the imbalances in poverty and a goal of 'common prosperity' led to what many termed 'China's Lehman moment' as concerns over the solvency and liquidity of China's largest property developer, Evergrande, rattled the markets.

Although this caused some anxiety in global markets there is unlikely to be a contagion effect, this is policy driven and self-inflicted and the Chinese Communist Party is in control of where this goes.

Alongside regulatory crackdowns including a ban on all crypto-related transactions, retail sales are weaker, production is down and 70% of Chinese personal assets are linked to real estate so likely slower growth going forward.

Energy supply crisis

There is no single answer to this and wholesale gas prices have surged by 250% since the beginning of the year, including a 70% rise since August. It's a problem hitting the UK more than mainland Europe, in part due to the larger demand from the UK for fossil fuels.

We have also produced less wind power than usual as calm weather has cut output from the UK's 11,000 wind turbines, which account for more than 20% of electricity generation (Source Blomberg). Other factors include high demand in Asia for liquified natural gas which has meant less than expected has reached Europe. Several gas platforms in the North Sea have also closed for maintenance which had been paused during the pandemic and cables that import electricity from France were damaged last week following a fire.

A perfect storm that will drive inflation to higher levels as the price rises filter down to the consumer.

Stepping over the ripples

Emerging market pressure

With soaring consumer prices across energy, food and daily living, plus lower vaccination rates , EM policy makers are having to increase interest rates way too early in this crisis. This will impact this sector, although we have limited exposure within our portfolios but another 'ripple' to bear in mind.

Geo-political tension

Rising tension between China and Taiwan, diplomatic relationships between the UK and the EU and rise of the Taliban all cause concern. But a pandemic has highlighted and created headlines and changed the tone of geo-politics. Challenges like climate change and tax regimes are building united fronts.

We expect equity markets to continue to rise, albeit not at the levels we have seen year to date. Deceleration in growth momentum is expected for 2022.

However, we need to step with caution and tread carefully across the stepping stones as these events can all send jitters to the market. But this is normal market activity, in a world that has been dominated by Covid-19 and its economic impact. We do see this as a return to normality with other items on the agenda.

Navigating 2022 will not be easy with deceleration in growth and policy and political risk rising but we are well diversified within our portfolios and will tread carefully over the ripples.

Portfolio update

Performance Year to Date

In summary, we are pleased with the performance of the Thematic portfolio range year to date. All three have outperformed the risk adjusted FTSE 100 Index and the MSCI All Companies World Index, the latter of which is designed to represent the performance of large and mid cap stocks across developed and emerging markets.

The risk scores of the portfolios are shown below and it should be noted the FTSE100 has a risk score of 100 and the MSCI ACWI of 80.

	31 August 2021 (Year To date)
Conservative (Risk Score 37)	**6.57%**
FTSE 100	10.20%
FTSE 100 risk adjusted	3.77%
MSCI ACWI	14.70%
MSCI ACWI risk adjusted	5.44%

Moderate (Risk Score 62)	**10.79%**
FTSE 100	10.20%
FTSE 100 risk adjusted	6.32%
MSCI ACWI	14.70%
MSCI ACWI risk adjusted	9.11%

Growth (Risk Score 85)	**12.13%**
FTSE 100	10.20%
FTSE 100 risk adjusted	8.36%
MSCI ACWI	14.70%
MSCI ACWI risk adjusted	12.05%

Theme review

A sharp global recovery has taken markets to new highs in the US and the UK has also made up some ground, albeit on a slower scale. Investor optimism has seen large market in flows, particularly in the sustainable and impact areas of investment. Global growth remains strong, despite the recent slowdown, and the Federal Reserve and European Central Bank are likely to purchase c. $2.25 trillion of assets in the next 12 months suppressing interest rate rises.

Our themes include Digitalisation, Ageing Population and Healthcare, Resource Scarcity, Urbanisation, Changing Economic Power and Sustainability, which we believe represent global megatrends that will enable financial reward over the longer term through structural change shaping the world today.

Technological advancements

We remain firm backers of this theme over the medium to long term as robotics, artificial intelligence and automation drive development and growth opportunity globally and the technology funds have seen considerable returns this year. In addition, the 'world' turned to technology throughout the pandemic from Zoom to shopping and day to day lifestyle habits may have been permanently altered. To quantify the performance in this sector, the Blackrock GF Next Generation Technology fund is up over 45% on a rolling 12-month basis and the Polar Capital Technology fund over 20%. Technology will also benefit enormously both in the short and long term as there is a shift to a carbon neutral footprint for the future.

Healthcare innovation

Schroders have returned 18.66% over the rolling 12 months, and the Fund Manager, John Bowler, who has been at the helm for over 17 years brings a wealth of expertise and experience. John believes that pressure on government healthcare budgets is one of three forces shaping healthcare investing in the coming years. Another is demographics, as the baby boom generation reaches an age when procedures like hip replacements and heart operations are required and the third is new technology. We continue to back this trend and once again note the relationship between technology and other sectors, in this case healthcare innovation.

Resource Scarcity

The UN Climate Change Summit (COP26) takes place this year, bringing together heads of states, climate experts and campaigners all looking to agree on a coordinated route to tackle global climate change. The world has recognised the urgency to move towards a low carbon economy and an increase in energy efficient technologies and alternatives, and this theme is likely to create investment opportunities both in the short term and over the next decade. We continue to back Pictet with their Clean Energy and Water funds.

The Pictet Clean Energy fund concentrates on investable companies within renewable energy, energy efficiency and the technology and infrastructure relating to these fields.

This translates into a direct positive impact on the environment and global health. It is estimated that over 6.5 million people die of air pollution every year and reducing atmospheric aerosol has a direct, measurable impact on health.

The Pictet Water fund invests across all areas of the global water industry, with a particular focus on water supply, water technology and environmental services.

Urbanisation

Our core theme for this trend has been to invest clients' capital in a fund managed via the team at Pictet, the SmartCity fund. Mobility and transportation, infrastructure, real estate, sustainable resources management, as well as enabling technologies and services supporting the development of smart and sustainable cities are all included for investment opportunities.

Changing Economic Power

Baillie Gifford continue to dominate in terms of performance in the Asia Pacific Ex Japan sector. The Pacific fund is the top performing fund over 1, 3 and 5 years and we will continue to back this. There has been a recent change in one of the two lead Fund Managers who has left after 8 years, but management remains in the very capable hands of Roderick Snell who has been at Baillie Gifford since 2010.

Sustainability

We introduced this trend back in 2018 and continue to see positive return alongside positive impact. Sustainable investing often combines with innovative thought leadership and acts as a key driver to long term growth. The strategy aims to meet current needs using sustainable principles alongside innovation.

As the theme has developed, it is possible to see sustainability start to follow key investment trends such as low carbon and technological innovation. Both Janus Henderson and Royal London are key managers in this field and we will continue to back both houses for this trend.

UK Value and Opportunity

The 'opportunity' or small cap stocks have continued to perform extremely well, with the Octopus Micro Cap fund up over 50% on a rolling 12 month basis and the multi cap fund, Gresham House Multi Cap up over 30%.

UK Value, represented by the Troy Trojan Income fund, has lagged behind 'Opportunity' as this fund represents the larger UK growth companies. We expected some lag in terms of performance, but there has still been a performance in excess of over 12%, once again on a rolling 12-month basis.

These funds enable us to diversify our UK exposure from the micro and small company space to the much larger household names.

Return to Yield / Income

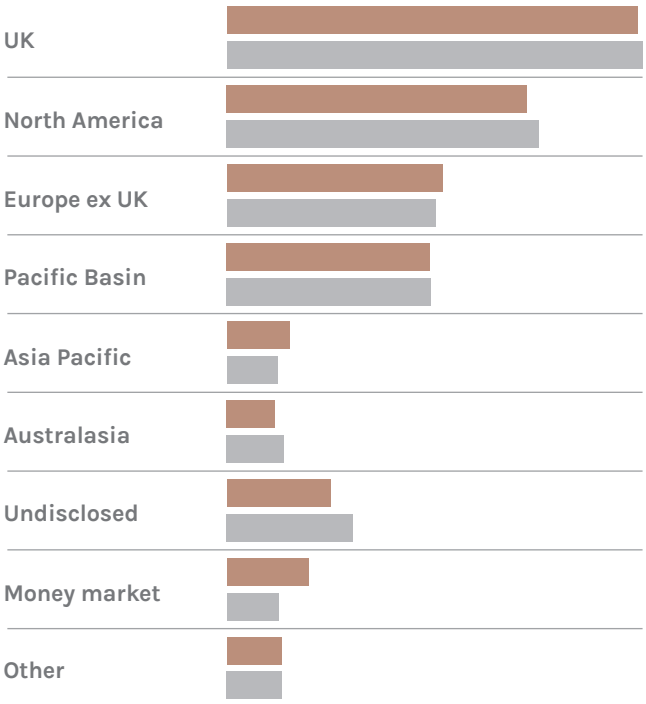
As we reported back in the Spring, we were monitoring the return to a natural income portfolio working alongside investment houses and fund management teams that have long and established track records and strong equity research desks. We have now made a return to Natural Income portfolios with two risk options.

Historically large cap UK companies have paid greater dividends to their shareholders versus their international counterparties. Currently the FTSE 100 has an average dividend yield of c.3.07% with its US comparable, the S&P 500 c.1.3%.

Whilst these figures remain subdued as companies and their bottom lines recover from the effects of Covid-19, the outlook is positive in terms of income generation.

Whilst both portfolios have the largest regional allocation to the UK of c. 28%, we have looked beyond our shores and stepped on global stones in the search for natural income for 2021/2022.

We are expecting dividend payments to rise in the US and Europe as recovery continues. The Asia Pacific region proved more resilient in their dividend payments during Covid and forecasts for this region are positive for the future.



Despite the challenges of the 18 months, the dividend growth story looks likely to recover and we are expecting a rebound in both corporate earnings and dividend payments. This rings true for global equities although ongoing volatility and continuing uncertainty emphasises the need for strong fund manager and house selection.

The portfolios are well diversified and will target a gross yield of 3.75-4.25% respectively.

Natural Income - Conservative

Natural Income - Moderate

The next economy is the sustainable economy

'The old economy was built for the old world', a statement from one of our experienced fund managers in the sustainable investment space. Drastic change is needed to address the environmental, social and governance issues that the world is facing.

The IPCC (The Intergovernmental Panel on Climate Change, who are a credible source of climate science) published a recent report using the strongest language yet that change is needed, and not little steps - it is too late for that.

Giant leaps are required to reduce global temperatures and decrease CO2 before critical 'tipping points' are reached and the earth experiences permanent shifts in its systems of which there is no going back.

The old economy was not built to last and relentlessly sought growth whatever the cost, be it on an environmental or social level. The move to a more sustainable global economy has been supercharged by the pandemic and the old economy is in transition to the sustainable one.

The UN Climate Change summit (COP26) takes place later this year, to review the Paris agreements, and discuss climate change and how countries are planning to tackle it. Since 2015 sustainable investment funds have largely used the UN Sustainable Development Goals (UN SDGs) as a framework for their mandates, but the COP26 with an agenda covering how to secure net zero carbon emissions by mid-century, and keeping 1.5 degrees global warming within reach for example, is likely to see additional remits added to these funds.

Moving to a sustainable economy requires the mobilisation of significant levels of finance and investment. Decarbonisation, electrification, and digitisation lead this transition. Technology especially will be a huge driver in this change and likely contribute to exponential growth prospects. Companies are rising to these challenges and this provides both medium and long term growth prospects for investment.

'Renewable, electric, digital; the Fourth Industrial Revolution' *

We firmly believe that companies embracing these values and aligned with the development of a sustainable global economy and will ultimately see greater growth and demand for their goods and services and ultimately deliver investment return over time.

We see sustainable investment as key in our portfolios and our asset allocation also includes digitisation and electrification. As we watch the fourth industrial revolution unfold and a merge of industrial and technologies economies, we want to benefit both in terms of investment return and positive impact on our planet and its inhabitants.

* Janus Henderson, Head of Sustainable Investment

Summary

We summarised our last Vobis Views with a positive outlook for 2021. So far this has been played out as predicted.

Countries continue to open up. Lives are beginning to return to normality, albeit with arguably some positive changes, and we are all adapting to the post-Covid era. The 'new' normal (a phrase that I prefer not to use) seems to be a recurring message.

Global markets have risen over the course of the year although there are a number of stepping stones to cross. Q4 2021 looks likely to be 'bumpy' but remain in positive territory. Inflation is being closely watched and central banks continue to monitor rising consumer prices and supply chain issues remain. Ongoing volatility and market jitters are expected and we are busy navigating these as we approach 2022.

Regards,

Sarah Lockington

VOBIS VIEWS

Let's talk

ADMIN NO.

01482 780 167

SEND US AN EMAIL

info@vobiset.com

VISIT OUR WEBSITE

www.vobiset.com