INVESTOR INSIGHT

Summer 2021 A look at the markets by RSMR

Welcome

Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

We hope you find this useful.

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GRAYSIDE FINANCIAL SERVICES

The global economy: What's going on?

Investors tough out inflation fears

Although the last quarter was generally positive for risk assets, such as equities, commodities and high-yield bonds, current investor concerns are about whether inflation is about to soar as the economy reopens.

Much depends on which force dominates post pandemic, determining investor confidence: 'structural' shifts in how the economy works with resulting disruption, technological advances higher productivity, which reduce inflation, or economic expansion, wage demands and supply shortages which may increase it.

> “Much depends on which force dominates post pandemic, determining investor confidence.”

Supportive actions by central banks have led to inflation being regarded as a passing phase, gone after economies resume closer-to-normal activity after 18 months of lockdowns.

As confidence has increased in the first half of 2021with the Covid-19 vaccine programme, at least in western, richer nations, global economic growth has significantly improved.

The International Monetary Fund (IMF) upgraded its global growth forecast to 6% in 2021, falling to 4.4% in 2022 in the larger economies, due to government support and vaccine take up.

Recovery is underway. Markets are now backing companies that struggled during the lockdowns, although recent data shows yields falling, surprising many investors. It is not a market for timing entry or focusing on one asset type.

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The asset classes – a quick round-up

EQUITY MARKETS

Equities have performed well with the UK among the strongest, and smaller company returns particularly good, but they are now at a point where the coming months are harder to predict.

Markets have stabilised around narrow values due to relaxations in central bank support and fears of higher corporation taxes in the US and globally.

This has dampened growth expectations amid uncertainty about inflation which, if sharper and longer lasting than expected, will create a bumpy ride for many equity markets.

So far this year, value stocks have benefitted from their sensitivity to an improving economy, but their lead has reduced since April as a cut in bond market yields reflected doubts about the strength of US growth.

Debate also continues about whether economic stimulus and post-pandemic spending will generate stronger growth and push wages and prices higher as labour and goods are in shorter supply.

Concerns about inflation will eventually determine investor confidence but it seems that, for now, the US Federal Reserve (Fed) has convinced investors that it is under control.

FIXED INTEREST

The inflation threat and likelihood of central banks having to increase interest rates faster than initially expected dominated the first part of the last quarter.

This initially triggered higher returns but, by the end of June, the Fed had convinced investors that inflation would rise, and then fall as the economy stabilises.

Rate rises are predicted by 2023 but this hasn't appeared to affect concerns about future inflation and there have been several weeks of relative calm as investors accept rates will be stable for the time being.

This apparent complacency brings risks of sustained price increases, which could disrupt consumer spending and stoke inflation.

Higher yield markets and emerging market debt have been in favour although there have been limited returns on capital.

Most fixed interest investors recognise that the market lacks direction due to the pandemic and mounting inflationary pressures, creating global economic uncertainty. There is general agreement that consumer prices inflation will be bumpy this year.

Bond market values remain hard to judge with yields stable but likely to fluctuate. For most investors they provide some stability against risk assets and their value in a portfolio should not be underestimated.

PROPERTY

The second quarter saw improvements in investor confidence as economies reopened but certain sectors are still in difficulties including traditional retail and leisure.

Many commercial property changes created by the pandemic remain. Some may be temporary, but others will be longer term due to shifts in how this sector functions.

Any retail recovery looks longer term with possible changes in property use, or multi-occupancy, becoming popular. Rental income data is stronger than expected but remains very poor in sectors including retail and leisure.

Major changes, such as home working, may be temporary, although many large institutions are offering more flexible office attendance after seeing better productivity from home working.

Some property sectors have seen signs of improvements, but these will take time to feed through to investment opportunities.

Investors are likely to remain focused on well-located retail space with secure and long-term income streams, anchored by high-quality tenants.

The office market remains subdued, with limited leasing, reflecting slower decision making by potential occupiers, although this is improving. It is an expected symptom of economic weakness and forced home working.

Many direct property investors' approach will remain as much about how easily investments can be turned into cash, market access, and timescales as about the scope it offers.

Although direct property offers little marked movement, it should not be ignored but the practicalities must be central to any investment decision.

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Global round-up

- The IMF upgraded its world economic growth outlook to 6% in 2021 falling to 4.4% in 2022.
- US growth looks likely to beat forecasts with Q2 expectations close to 9% and above 6% for the whole year.
- The broadest economic measure of European markets has raced ahead by 15% in euro terms since the end of 2020.
- According to the Office for National Statistics (ONS), UK headline GDP figures were 8.7% lower in Q1 than in the same period in 2020.
- China is recovering best from the pandemic. Even last year it grew by more than 2% with 8%+ growth expected this year.
- Japan's yen-denominated merchandise exports soared 49.6% annually in May, after April's 38% jump.
- The Central Bank of Indonesia kept rates unchanged at an all-time low in June.
- A Global Economic Prospects survey suggests 94% of high-income countries will regain pre-recession Gross Domestic Product (GDP) per head within two years.
- The US Consumer Prices Index (CPI) reached 5% in the 12 months to the end of May following a 4.2% increase in April..

"Japan's yen-denominated merchandise exports soared 49.6% annually in May, after April's 38% jump."

> “We can look forward more positively to the next 12 months, but Covid-19 and its various mutations will result in bumps along the road”

So, what’s next?

Markets have raced ahead of global economic recovery, looking beyond second or third Covid-19 lockdowns, believing that vaccines will lead to economic recovery.

This is clear when comparing developed countries to emerging economies where, apart from North Asia, growth rates are trailing behind.

Markets continue to focus on recovery in the second half of 2021 and 2022 and beyond, unperturbed by potential taxation shifts.

By US standards, the Biden administration is advocating a significant wealth re-distribution from companies and high earners to those with the greatest tendency to spend. Developed country governments and central banks now all favour higher wages for the lower paid.

Historically, investors would expect value-based strategies to do well during accelerating economic growth, and while this happened in the final months of 2020 and early in 2021, it doesn’t explain why value underperformed when economic growth and profitability forecasts improved in the second quarter.

Forecasting has always been uncertain, and the most prudent course for investors is a balanced approach to portfolio construction.

So far this year economies have improved and, even in areas such as South Asia, where coronavirus remains rampant, valuations suggest exposure to consumer markets for long-term investors are likely to be profitable.

Overall, equity markets seem likely to be supported by a continuing economic recovery and measures to stimulate growth.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our ‘R’ fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don’t limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a ‘snapshot’ of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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