INVESTMENT UPDATE & OUTLOOK

QUARTER 2, 2021

PPM WEALTH

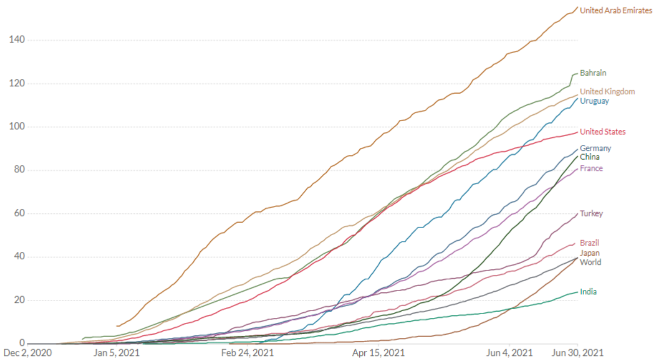
Global Markets & Economy Update

A successful vaccine roll-out and major economies reopening has boosted equity assets in the first half of this year. Whilst COVID-19 variation strain headlines continue to dominate the news, market volatility has diminished somewhat but other risks have appeared.

With most of the population now vaccinated at least once, the re-opening story in full flow and some travel allowable the global economy has regained the ability to rebase and look forward to the new normal.

COVID-19 vaccine doses administered per 100 people
As of 30 June 2021

(Source: Our World in Data)

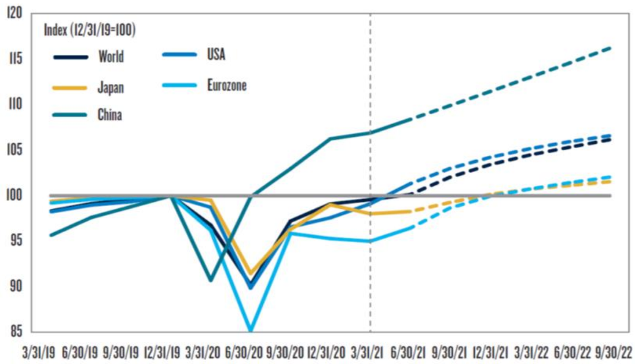


COVID-19 can now be better managed meaning less hospitalisations and lockdowns easing, as countries have now adapted to limit infections and are better prepared. As COVID strains emerge – such as the Delta variant, this will undoubtedly add to some market anxiety, but the health and economic effect should be less impactful compared to last year. In this new norm secular growth trends such as, logistics, e-commerce and working from home / flexi working have accelerated demand for cloud computing and Internet of Things (IoT) – hence the outperformance in tech.

Thus far in the first half of 2021 the rebound has been strong, yet uneven across regions as vaccination rollout speeds varied. The US and Europe, given stricter measures, have managed to navigate through lockdown and lift pandemic related restrictions quicker. In Asia it has been slower, due to vaccination delays and severity of outbreaks, resulting in a stalled recovery due to the emergence of more concentrated cases (currently the Delta variant has spread quickly to India, Nepal, Brazil, and South America). As vaccine supply chain concerns and accessibility start to ease, we do envisage that these regions will bounce back strongly as the US and Europe have done.

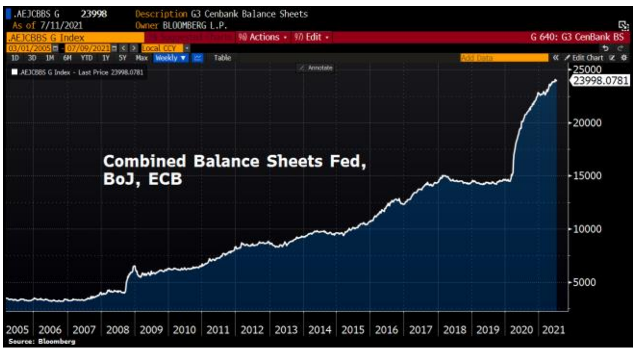
GDP Growth (Consensus Forecast) - As of 10 June 2021

(Source: OECD, Bloomberg)

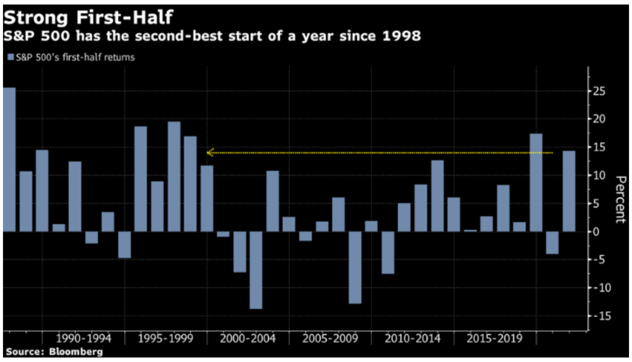


Given this, metrics for growth, inflation and easing back of fiscal support will be the focus in H2 for Central Banks. The economic and market outlook for Q3 will be led by how quickly the vaccinations can be fully implemented and the subsequent full reopening whist watching the rise in inflation.

The economic rebound has been also well supported by a huge influx of monetary and fiscal stimulus that has allowed many economies and corporates to navigate through these unprecedented times. Now as the worst seems to have passed, inflation concerns, rate rises and easing of government support become the focal point into Q3 to show how much of this growth can be sustained.



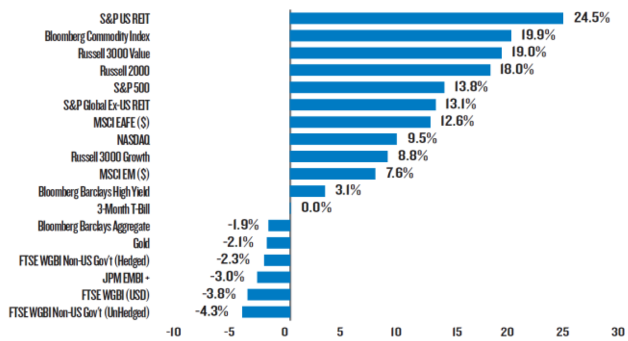
Greater scrutiny will be on the economic health as things return to some form of normality and the outlook dynamics change. A supportive economic environment has enabled companies to release strong corporate earnings again in this quarter. Q2 earnings have yet again beaten expectations with some sectors also guiding higher towards the year end with earnings growth near +19%. In addition, positive earnings, PMI data has also remained strong, led by both manufacturing and services prints moving higher. This can be attributed to healthy backlogs, low inventories, and a pickup in export orders. This leads to positive forecasts for Q3 and into year-end.



As was evidenced in Q1 the global equity performance between regions has yet again been somewhat varied. Economic growth in Q2 has been strong, with the rebound thus far significant. China led the way in terms of economic recovery, the US followed shortly after, but EM and Europe have to some extent, lagged in Q2. This evidences the different phases of the economic recovery which in turn will dictate the direction of forward looking monetary and fiscal policy decision making. This in turn bring the key concern in the current environment – inflation. As the recovery takes shape into Q3, policy makers need to decide whether and when to ease back on stimulus or sit and wait.

2021 YTD Returns – As of June 15 2021

(Source: FactSet)



US

US indices reached new highs led by substantial investor inflows during Q2 as the economy recovered and earnings beat expectations. Some argue that valuations are somewhat elevated at this juncture, perhaps true for some large caps but the Small & Mid (relative to large) caps should perform strongly led by greater domestic spending and consumer trends (in an inflationary environment home builders, transportation, miners, and consumer discretionary in less labour-intensive areas tend to outperform).

Corporate profits for the S&P are pricing in +37% for 2021 (start of the year was 23% and 26% in April). Earnings surprises to the upside have continued and are on trend to continue this throughout H2. Inflation, even if it is temporary, tends to favour value names, bringing again the rotation debate.

Europe

Earnings have been solid, with EPS growth of 83% – significantly above consensus – led by an increase in exports due to a pickup in global economic activity and an accommodative policy by the ECB, which said that its Pandemic Emergency Purchase Programme (PEPP) would last until March 2022.

On a relative valuation basis, European equities remain cheaper than the US, but the gap should narrow. Strong household balance sheets should help consumption and generate opportunities in the consumer discretionary sector (e.g., consumer goods, travel, and retail). Overall, with a higher exposure to cyclical and value names, and bund yields in negative territory, European equity markets remain attractive. However, over 2021, we are likely to see a mixed picture across the region which is positive for active stock picking.

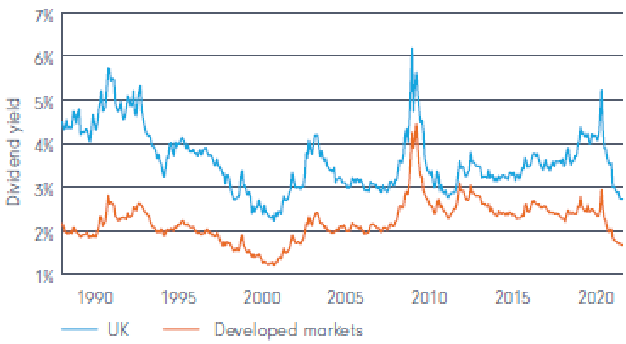
UK

The UK economy has bounced back strongly, and equity markets saw increased investor flows for the first time in months. This optimism can be attributed mainly towards dividends reinstatement, rise in £, recovery in commodities, M&A (Mergers & Acquisitions) and PE (Private Equity) activity which signalled strong confidence as cheap valuations have attracted overseas investors.

UK Equities are currently trading at attractive valuations compared to global peers (lowest Price/Earnings in 20 years) while delivering the highest global dividend yield. Despite this broad optimism, we are aware that unsolved Brexit issues (e.g., Irish Sea border and lack of a deal for financial services) and new variants could create volatility.

Dividend Yield UK vs DMs – As of June 30 2021

(Source: Refinitiv, Fidelity)



Japan

Corporate profits have been slow to recover, and Q1 2021 GDP fell 4% on an annualised basis due to the lack of an accelerated vaccine programme and slower reopening.

The Bank of Japan (BoJ) has remained in accommodative mode. Kuroda, current Governor of the BoJ, announced that the central bank will maintain the pandemic-relief measures already set and allow credit conditions to remain supportive.

Japan's economy is likely to recover as the pandemic's impact subsides, with solid export demand underpinning corporate profits and capital expenditure.

Global cyclical revival, weaker JPY expectations, and cheap valuations (forward P/E at 14 versus 16 in Europe and 20 in the US) should help Japanese equity markets recover from the poor performance of the first half of the year.

Emerging Markets (EM) & Asia ex Japan

In Q2, EM equities posted a 5.05% positive return in USD terms with Latin America being the top performing region followed by EMEA and Asia.

In terms of recovery from the pandemic, we are seeing a polarised trend with some countries having the COVID-19 rate of infection under control (e.g., China, Taiwan, Korea) while others are still suffering due to delays in vaccine roll outs and supply issues (e.g., India and some parts of Latin America).

Rising inflation, derived from a combination of pandemic-related uncertainty, lower supply, and higher energy prices, is pushing an increasing number of EM central banks to tighten monetary policy: Brazil, Russia, Hungary, Czech Republic, and Mexico have already started to hike interest rates. Even if a pickup in inflation signals increased demand and can benefit some stocks, the big concern is that severe inflation hampers the prospect for growth stock.

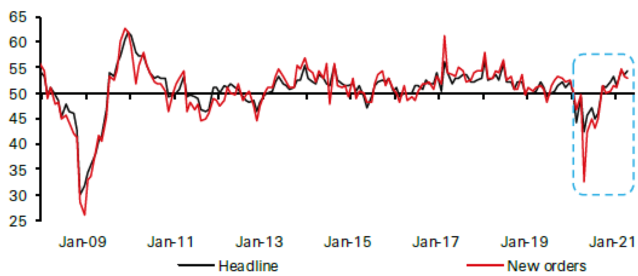
However, rising commodity prices and a potential commodity super-cycle should help exporting EM nations reducing their fiscal and current account deficits. Infrastructure spending of developed markets (US and Europe, in particular) should also increase the demand for raw materials such as steel, cement, copper, cobalt, and lithium and boost EM equities (particularly growth-sensitive stocks, and those that produce goods, rather than services). In contrast, the sharp increase in global food prices seen recently could impact poorer EM countries that rely on imports for staple goods.

In Latin America, there were important political changes towards a leftist direction.

Asian markets have lagged the rest of the world over the last 6 months despite delivering 8% GDP growth YTD. However, the region continues to carry positive growth forecasts propelled by increased domestic-led innovation and rising wealth. In addition, moderate monetary and fiscal policies coupled with undervalued currency dynamic should support Asia equities performance over the coming quarters.

Asia ex-Japan new electronics' orders driven by digitalisation and automation - As of 25 May 2021

(Source: Markit)

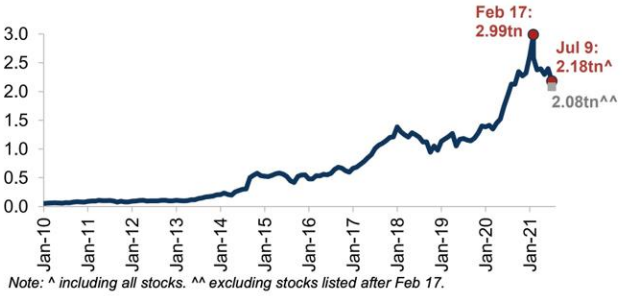


Within China, after the rapid recovery, we do see scope for growth to ease off back to normal levels as the economy rebases back to a more sustainable rate. More stimulus is likely as the economy looks to try and capitalise on the catch-up trade in other regions alongside the intention of the new 5-year road map for China for more inward investment.

Recently, due to data, privacy concerns and tighter regulations in Beijing, led to nearly $1tn of market cap across Chinese indices being wiped off. Concerns have mounted over Chinese firms' ability to list overseas due to national security concerns, this could lead to pressure on the overall Tech sector, growth assumptions and global growth portfolios.

Total listed market cap for Chinese Internet/Tech (USD tn)

(Source: FactSet, MSCI, Bloomberg)



Historically, EM equities have outperformed global stocks during the last four US rate hike cycles and, given the weak recovery thus far, we could see the same. Moreover, a weaker USD is generally beneficial for EM.

Fixed Income

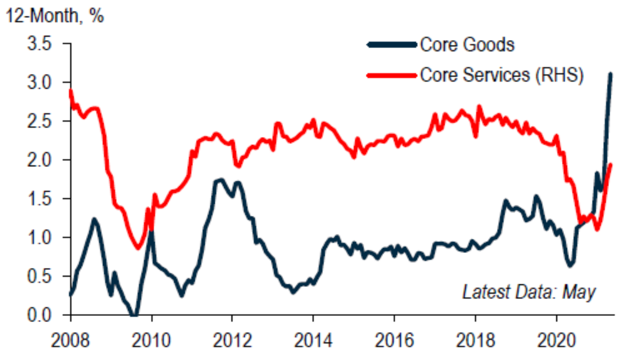
Inflationary concerns represent a large headwind for bonds and for the market, depending on whether they are temporary or not.

The market impact of the Fed's announcement was unusual as the long end of the curve shifted downwards (as the short end went higher) – meaning the market assumes a more hawkish Fed results in lower rates in the long term. With rates remaining low it will move investors further out the risk spectrum – into higher yielding assets.

This is particularly true for European government and corporate bonds which, by yielding negative or very low returns in real terms, have delivered a poor performance in the past quarter. The riskier high yield segment fared better. Even with an accommodative ECB, we are cautious on core European govies as yields may move up in an improved economic environment (considering the Next Generation EU plan) with inflation pressures.

Global Core CPI Inflation

(Source: Haver Analytics)



Inflation

Inflation expectations has been one the most widely covered talking points in Q2 as the market tries to quantify whether it will be temporary. Some of the main reasons for the inflation debate involve the following points:

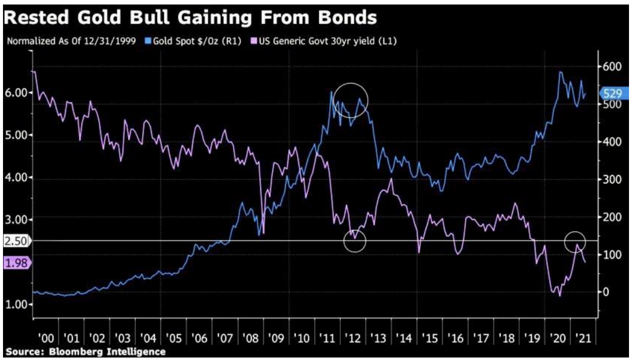
- Will the economy continue to recover ahead of output projections (above trend growth leading to excess demand = rise in production pricing)?
- The swing higher in the labour market and pricing power adding to upside wage pressure.
- The trajectory of interest rates and changes in assumptions which naturally leads to asset class performance variations. Recently some hawkish comments from the Fed reversing dollar weakness (2x rate rises hinted at in 2023) alongside tapering asset purchases.

Commodities

General commodities have performed strongly as economies have re-opened, demand has soared, and inflation expectations have picked up. The Bloomberg Commodities Index has increased 21% YTD (GBP total return) representing the best performing asset class. Within this, the energy segments have risen 45%, agricultural commodities 20%, and industrials metals 16%. Precious metals have delivered a negative return, falling 6.3%.

Even faced with more decarbonisation, the oil price has continued to grind higher in Q2 back to $76 with some strategists suggesting we will revisit $100 this year. OPEC has allowed oil policy to be supportive by closely managing the price during this oil demand recovery.

The Gold price depends on a variety of factors, including safe-haven demand, inflation concerns, USD strength and real interest rates.



Overall, we believe that the huge fiscal stimulus and spending on green infrastructure implemented by governments could create a base for another commodity super-cycle.

ESG

Demand for ESG investments has continued to be strong in Q2 as an increasing number of corporates are showing evidence of becoming more responsible which supported inflows. The growth in both ESG active and passive vehicles has brought greater scrutiny to understand how tangible and credible the narrative banner of ESG actually is. Some scepticism remains as there lies a clear distinction between narrative and actionable change, resulting in some names not being true in nature to achieving ESG thinking but looking to gain from the popularity in this theme.

Investment Outlook

Inflation will remain at the forefront of investment decisions during Q3. We must take this opportunity to decipher between transient and cyclical inflation – only the second is of importance and what the cause and effect on the market will be – and how to position for it. During parts of Q1 & Q2 economic data pointed towards higher inflation data but even so it's not necessarily bad for equity markets (positive for commodities, cyclical assets and small cap equities outperform large cap and growth). Corporates are also better prepared as they have been able to offset higher input costs with higher pricing, coupled with cost savings helping mitigate the impact. We continue to position our portfolios in a strategic and tactical manner, considering shifts in global markets and themes. Climate change, ESG, CSR and renewables asset allocation has continued to benefit from inflows at the expense of historical winners.

The significant investment in green initiatives – Green Deal in the Eurozone, EU stimulus package, Infrastructure deal in the US – will act as a supportive backstop for this space. In turn it will transition into a more sustainable economy, with greater focus than ever before. This asset class will continue to be at the forefront of corporate and government policy to deliver within the Paris Agreement and net carbon zero targets. What makes this sector particularly interesting is that there is no historical precedent in this theme and is constantly evolving so we are cautious and diligent in our exposure.

We will monitor closely the November 2021 UN Climate Change Conference of Parties (COP26) which will likely produce a series of policy, regulation, and investment announcements, and create winners and losers within portfolios.

Overall, we expect GDP growth to remain above trend into the second half of this year, even if we are faced with short term setbacks with the full reopening. The economic outlook will be dictated by main factors such as inflation, COVID-19 variant strains, changes in fiscal and monetary easing and how quickly the new normal is in full flow.

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