Swallow
Financial Planning

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Investment Update December 2021

Welcome to our half-yearly investment bulletin, explaining what is happening to markets and confirming our views going forward. In this bulletin, we have stuck with items of note rather than listing every asset class and region. Our notes on fund selection are available on the website or by request.

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THE YEAR SO FAR

When we review our recommended funds we have a huge amount of information to gather before considering our next move within the asset allocation environment.

We are continuing to develop our research tool provided by Financial Express. Using their database, we can review how our portfolios might have performed in recent times.

	6 months	1 year	3 years
All Assets (AA)	5.73%	15.52%	38.3%
AA X Property	4.91%	14.84%	37.92%
AA X Fixed Interest	5.64%	17.49%	41.89%
MSCI UK All Cap	1.77%	17.80%	14.49%
FTSE 100	2.36%	16.78%	13.23%

Whilst every client has a bespoke set of fund holdings to match their risk profile, we have 3 initial structures. Many clients have let residential and commercial properties so we subsequently exclude them from our asset allocation. Many clients agree with us that long-dated fixed interest funds are all risk and no reward so we exclude these and buy cash bonds where required to reduce volatility. We do recommend short-dated bonds as an alternative to cash, where interest rate changes cause minimal impact.

INFLATION IS ALIVE AND WELL

RPI was at 6% in October (provisional figures) and CPI 4%. In the US, inflation rose to 5.3%. These could be a relatively short term phenomenon as we recover from the Covid pandemic, but inflation may well be with us for more than the predicted months. Our reasons for suggesting this are:

- Demand has been quick to pick up post Covid.
- The supply chain is taking longer than expected to recover.
- Unemployment is very low and there is a shortage of qualified workers.
- There is massive government spending on infrastructure (Green and otherwise).
- Oil prices continue to rise due to lack of OPEC and US Shale production.

JUST WHEN YOU THOUGHT IT WAS SAFE: OMICRON

The Omicron mutation has already caused stock market jitters. Another lockdown will significantly increase volatility in asset values, not least because it will exacerbate the current supply problems the world has.

ASSET ALLOCATION

Bonds

Top quality 10 year bonds are likely to produce .5% which is a negative real return. We continue our zero bond allocation where we can, or else recommend short-dated bonds where cautious investors wish to diversify from cash.

Cash

Where we need to reduce volatility (usually to match a client's risk profile) we are using cash term deposits. These produce nothing but they should not lose anything if we have a market fall. We continue to recommend NS&I for this purpose although Transact offer term bonds where we need cash in platform wrappers.

UK

We have just updated our notes about investment sectors. In this, we explain the size of the UK versus the rest of the world. If we take a mean average of Gross Domestic Product and market capitalisation the UK is about 3.5% of the global pot.

The UK market is fairly valued compared to the rest of the world, however, it has underperformed for a number of years. For the time being we are maintaining a neutral stance. The recent market falls have once again left the UK with a mediocre year compared with other developed countries.

Developed World

In the developed world demand is firing on multiple engines. The outlook for consumer spending appears particularly strong. Households are still sitting on considerable savings that they accumulated during the Covid lockdowns.

Governments have also set in train massive spending plans, not least to facilitate the transition to low carbon technologies. To some extent these will compensate for the fiscal stimulus which is being removed.

As we have seen in the last Budget, the age of austerity seems to be over with ‘tax and spend’ being the order of the day.

The pandemic should be thanked for a quantum shift in the ways businesses work. We now have up to date tech and are much more efficient.

Central banks are unlikely to slam on the brakes as they are not willing to take any risks with the recovery. Strategically, they would much rather be proven wrong for having tightened too late than too early.

In the UK, fiscal stimulus ended in June 2021. The Fed suggest they will cease in June 2022 and the European bank will continue throughout 2022. This suggests interest increases of .65% in the UK, .25% in the US and zero in the EU (JP Morgan).

Interest rates rises will hit growth stocks more than value stocks but they might strengthen the very weak pound.

FACTORS IN FAVOUR

Clients will know that we invest in a number of factor funds to try and improve the performance of our portfolios. The following are some of the most popular at this time.

Value Stock

Value stock is shares which have an inherent value which is high in relation to their stock market price. Value stock has not done well in recent years, meaning that right now value stock averages at around 42% of growth stock valuations. Going back to 1975, value has always outperformed growth over the next five years when value has traded at less than 60% of the growth valuation (past performance etc).

We have increased our exposure to value stock in this review.

Minimum Volatility

We still like minimum volatility stock as a means of reducing the volatility of our portfolios. This index invests mainly in large US household names such as Nestle, Johnson and Johnson and Pepsi. These companies tend to provide stable returns in all environments.

If, as we suspect, inflation continues to rise we know that quality companies can increase their prices and retain their client base.

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REGIONS OF INTEREST

Far East & Emerging Markets

We continue our bias to Far East and emerging market funds. Emerging markets had a torrid time during Covid but they are showing signs of early recovery and we expect them to do well out of a normalisation post Covid.

The Chinese economy has contributed between 1/3 and ½ of global growth in the last 5 years. The stock market has produced between 6% and 9% p.a. The move to a more centrally controlled economy and the “common prosperity” planning suggests returns of perhaps 3% p.a. going forward. Remember, there are no checks and balances so arbitrary changes of radical effect are at the whim of the communist party.

Mid Caps May Offer Better Value

Large company equity valuations are reaching peaks not seen since the 1999 / 2000 dot.com boom. This would suggest that the mid cap sector, which has not performed nearly so well, may offer better value.

LONGER TERM THEMES

We tend to invest with an eye on the next 5 to 10 years. Looking further out:

Ageing: Today, 8.5% of people are aged 65 and over. By 2050, 17% of the world’s population will be over 65. Healthcare and social property funds offer access to these changes.

Climate Change: Our lives will be shaped both by how well we can reduce the adverse effects of climate change and by the extent to which we can adapt to what we cannot mitigate. Our SRI/ESG funds are heavily into this area.

Automation: Work forces in developed countries are falling. Technology costs are falling as well. Moore’s law is alive and predicted to continue for another 10 years at least (every 2 years computer chip performance will roughly double). We have invested into automation and robotics to try and benefit from this trend.

Increased & Changing Consumption: Standards of living in emerging markets will converge with those in developed markets. Consumer interests are changing to fitness, health and wellness. This should favour emerging markets.

By thinking fundamentally about the future, we believe we can make long term investment choices which will enhance our returns for many years to come.

ENVIRONMENTAL, SOCIAL & CORPORATE GOVERNANCE

Whilst we dislike “fad” investing, ESG is now mentioned on the promotional contact for nearly every fund manager. We do, of course, offer the option to clients to choose Socially Responsible Investments (SRIs) as an alternative to our traditional range of funds, however, we can see a time where every fund will offer the ESG option to the index chosen.

The issue with ESG and SRI is that they remain subjective choices for the fund manager/group. As Fidelity explain, “a classic conundrum would be a copper mine, as copper is ultimately a green metal because it’s critical to electric vehicles and new energy sources - it plays a vital role in reducing companies’ carbon footprints. However, lots of the copper mines exhibit all the ESG difficulties associated with generic mining companies”.

In this fund review, we have again increased the percentage of SRI funds within our SRI template.

COMMERCIAL PROPERTY

Commercial property prices have dropped significantly. Some funds have weathered the storm well (e.g. L&G), whilst others have thrown in the towel (Aviva). Lease terms have dropped from the traditional 10 years plus to say 5 years with a 2-3 year break clause. This makes property far more affected by short-term economic disruption.

With the relaxation of Covid rules, we have been spending a lot of time catching up with clients and when I am in London I am struck by the continued massive development going on. It is difficult to see the market for commercial offices in particular, although anecdotal feedback is that most offices are running shift patterns to typically allow staff 2 days at home a week with different teams coming in each day. It may well be that the future office will allow more space per employee (not least to reduce infection risk) but it is hard to believe that the office environment in 5 years’ time will require the same space as pre-pandemic.

Our allocation remains at around 10% for commercial property whilst we wait for the fallout to settle down and normal service to be resumed.

CURRENCIES

The pound remains relatively weak and will continue to be so until/unless we start to see some rise in interest rates. If the market has a setback, the Dollar and gold will benefit.

MARKET OUTLOOK

Omicron illustrates how fragile markets are. For the more nervous (or short term) investors now would be a good time to increase cash, however, for the rest of us the longer term outlook favours assets which can rise with inflation.