Investment Review

Q2 2021

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Contents

1. Summary

The global economy is in the early stages of a strong expansionary phase, with world GDP growth estimates at 5.8% this year and 4.4% in 2022, above the average of 3.3% per annum for the period 2013-2019[1].

Investors experienced positive stock market returns throughout Q2, adding to the impressive and above expectation numbers year to date.

- Yet again North American shares led the way with the S&P 500 index rising 8.3% in the quarter.
- UK shares climbed 5.6% with company valuations attractive.
- Government and corporate bond values stabilise after the swift Q1 sell-off.
- Inflation concerns are widespread but consensus is that price pressures are transitory.
- Record in-flows from UK investors into shares, especially to 'responsible' investments.

Governments and central banks continue to provide economic stimulus to ensure a full recovery from the pandemic downturn and to grease the wheels until full freedoms are possible. There are concerns that inflation will become ingrained, which it might well do a little further out, but for the moment markets are betting that inflation will fall back to an acceptable level allowing interest rates to stay lower for even longer.

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- This investment commentary review contains information and opinion on current economic and political positions and does not constitute advice.
- The information is provided in good faith and is believed to be accurate, but as some data is provided by third parties this can not be guaranteed.
- Past returns should not be seen as predictors of future returns.

[1] OECD Economic Outlook, Vol 2021 Issue 1

2. Market Performance (Year to Date)

Asset Class	Index	Q2 2021	Year to Date
North America Shares	S&P 500	8.3%	13.8%
World Shares	FTSE World ex UK	7.6%	12.0%
European Shares	Euro STOXX 50	5.7%	11.3%
UK Shares	FTSE All Share	5.6%	11.1%
Emerging Market Shares	MSCI Emerging Markets	4.9%	6.3%
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	3.9%	5.7%
Gold	S&P GSCI Gold Spot	3.0%	-7.9%
UK Commercial Property	FE UK Property Proxy	2.9%	4.7%
Corporate Bonds	Bloomberg Barclays Sterling Aggregate Corporate	2.0%	-2.8%
UK Gilts	Bloomberg Barclays Sterling Gilts	1.8%	-5.8%
Japanese Shares	TSE TOPIX	-0.9%	0.1%

Performance Data: FE Analytics in GBP to 30/6/2021

UK Shares

UK shares have continued to recover climbing 5.6% during Q2 and 11.1% year to date. The small to medium sized company FTSE 250 index has made a new all time high, whilst the larger company FTSE 100 index remains 8% below its pre-pandemic peak at the quarter end. UK listed companies are attracting attention from overseas private equity firms with supermarket player Morrisons the latest company subject to a takeover.

Whilst economic growth has been rapid of late it is likely that this will slow due to caution around social contact impacting business activities, notwithstanding the passing of 'Freedom Day'.

Global Shares

The North American economy has improved strongly following the pandemic downturn. It is expected that official data later this month will confirm that Q4 2019 GDP levels will have been restored. Fiscal support equivalent to 8% of GDP has been announced by the Biden administration since December 2020, which provides a huge tailwind for the economy.

The better market performers over the quarter have been those developed countries where vaccination rates have been high, with the exception of Japan where it is estimated that just 7% of the population have been vaccinated leaving it relatively susceptible to further spread and economic restriction. Japan's TOPIX index was one of the few negative performers in Q2.

Fixed Interest

The fixed interest market has behaved contrary to most expectations after a difficult Q1, with prices rising and yields falling, though gilts remain -5.8% and corporate bonds -2.8% so far this year. We highlighted in our Q1 review that whilst the asset class had fallen sharply due to renewed inflationary fears, it was unlikely that further sharp falls would be seen. We took this view because heavily indebted governments are unlikely to want to see borrowing costs rise at this time and will act to prevent any significant increase.

2. Market Performance (Year to Date) cont.

Property

The stamp duty holiday extension has continued to support residential sale prices. The ONS suggests average house prices have risen 10% over the 12 months to May[2]. This is a similar rate of growth as was experienced in the housing boom in late 2007, which eventually gave way to double digit declines. London continues to be the region of lowest annual growth at 5.2%.

The majority of commercial property funds are now open for trading having been halted for a number of months. Funds with exposure to quality industrial and non-discretionary retail, as opposed to shopping centres and offices, have seen capital values rise. There remains much uncertainty about specific parts of the market.

Alternative

Digital cryptocurrencies are an unregulated and extremely speculative asset class and not one we consider as part of our advised strategies. They have however caught the eye of some retail and institutional investors over the past couple of years, partly we suggest, from a fear of missing out. Over the past 12 months the most recognisable cryptocurrency, Bitcoin, has risen 115% to a high of $63,346 in mid-April, only to fall 43% through to the quarter end[3]. Such extreme volatility, as well as liquidity concerns and potential regulatory clamp down make cryptocurrencies feel insecure as an investment and certainly not for the faint hearted.

[2] ons.gov.uk/economy/inflationandpriceindices/bulletins/housepriceindex/may2021

[3] Coinbase.com

3. Inflationary Pressures

The most topical issue in markets currently is the ongoing debate regarding inflation. Many of us have felt to some degree the difficulty in sourcing goods and services due to the supply constraints resulting from the pandemic. As economies have begun to open up this has ignited demand for many raw materials and supply has simply not been able to keep up to balance growing pricing pressures.

This is beginning to show up in consumer price inflation indices with CPI to June in North America rising 5.4%[4] and in the UK 2.4%[5] year on year. Most central banks, including the Bank of England, believe this inflationary increase to be short lived or transitory and that as economies are fully re-opened market pricing will find an equilibrium again.

We have sympathy for this view believing that unemployment will have to fall sharply to see sustained inflationary pressure and for the moment that feels distant. Indeed, the bond market is suggesting the same outcome by not offering higher yields to compensate investors for the added inflation risk.

Central banks have stated that they will tolerate a certain degree of inflation, even if above target, so the transitory narrative allows them to keep interest rates lower for even longer.

[4] bls.gov/cpi

[5] ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/june2021

4. Responsible Investing

There has been a significant shift of focus over the past couple of years from both institutional and retail investors towards investment funds that allocate money responsibly/sustainably. Approximately 50% of the over £6bn net inflows into shares in Q2 found its way to such funds[6].

What does responsible investing mean in the asset management industry? It is actually a catch-all term for a number of different investment strategies:

- Excluding certain industries and companies that do harm
- Supporting 'best in class' companies in an effort to raise overall industry performance
- Investing in companies that target positive solutions
- Impact investing seeking evidence of non-financial success

If an investor is asked if they wish to invest responsibly it is probable the vast majority would agree they would, but you can see that there are different degrees to which an investor may decide to invest responsibly, determined by individual preferences.

This therefore raises questions as to how best to express an individual's ethical preference. Take the oil and gas sector as an example: do investors avoid the sector altogether whilst knowing they may remain reliant on this energy source for years to come? Do they invest in the best in class company most heavily investing within renewable sources and raising overall industry standards? Do they fund a start-up technology company aiming to innovatively capture carbon whilst risking capital loss? It is not as simple as it may first appear.

However, most investors will have heard of the Environmental, Social and Governance ('ESG') factors of investing, which are an accepted measure of determining how responsible a company is. The problem with using ESG inputs as a bridge for expressing responsible investment preferences is the lack of an industry framework and consistency on what constitutes a company's ESG score. For example, the Dow Jones Sustainability Index in North America includes Phillip Morris, which produces an addictive and harmful product selling 700bn cigarettes a year, yet scores well on other metrics and therefore has a high ESG score[7].

Fund managers use ESG as inputs into their investment process to measure to what extent companies are managing their risk and impact in each area. It is fair to say there is now a general acceptance that funds must consider ESG or risk losing investor support and therefore be bad for business, and that company management must do the same or risk losing funding opportunities.

[6] calastone.com/ffijul21

[7] Stanford Social Innovation Review (July 2021), 'The World may be better off without ESG investing'

4. Responsible Investing cont.

Integrating ESG as an added factor of investment selection or undertaking responsible investment does bring about additional risks in the form of concentration to geographies, industries and companies. Furthermore, the sheer volume of money that has flowed into companies that are currently ahead on their ESG credentials could mean valuations have become excessive.

Investors interested in responsible investing as a primary objective need to accept that the costs of investment are higher for funds labelled as responsible, perhaps given the extra resources required for analysis or, cynically, that the present demand is providing fund managers with pricing power. As the industry moves forward and ESG standards and integration improve across the board costs will probably fall as more, if not all, funds move into the space.

FPC has deep due diligence on the investment funds we choose for clients. This process involves an assessment of the degree to which ESG is considered by our fund managers and the direction of travel being taken towards integration. However, we recognise that some clients may prefer to support funds that hold themselves out as specifically targeting a responsible outcome and as such we will be making a responsible strategy available shortly and discussing preferences with clients. Watch this space.

5. Introducing Tricio Investment Advisers

We would like to introduce our clients to a further enhancement to the FPC investment process as we appoint Tricio Investment Advisers to support the work of our investment committee.

Tricio comprises three investment consultants John Calverley, James Chu and Gerry Celaya, all of whom have worked together for many years. Tricio is an independent advisory firm that will assist FPC in providing strategic guidance for long-term asset allocation, portfolio construction and thematic investment whilst also providing outside challenge and audit of our investment process.

For a number of years our investment committee has been fortunate to have the valued input of economist Peter Stanyer, who has provided the economic and strategic thinking that has become the bedrock of FPC's investment principles. Peter did in fact introduce us to Tricio and comments:

"John Calverley and I go back many years to our university days and we have followed each other's careers to date. John is recognised as one of Britain's leading business economists and he has vast experience and understanding of UK and global markets. I have the highest respect for his abilities and believe that he and his firm will be an asset to FPC moving forward".

Whilst Peter is taking a less active role going forward he will remain both a resource upon which we can draw and a valued friend and we thank him for sharing all of his knowledge and expertise over the years.

6. Looking Forward

The rapid economic recovery we have seen has been strongly reflected in world stock markets. That is not to say it is directly the cause of the increase in values as there are other factors in play, but generally company valuations follow earnings over time and for some sectors we are seeing record profits for shareholders.

Bringing the numbers back down to earth for a moment, the year to date performance across markets is well in excess of historic norms and should not be expected to repeat through to the year end. There is clearly growing concern the pandemic will not be going away perhaps as fast as would have been hoped post the vaccination roll out.

As a result, we would not be surprised to see increased market volatility emerging but believe that we are in the early stages of a new economic expansion, supported by enormous government spending that is likely to favour projects leading to a more sustainable future. Investors will likely continue to accept and target risk assets because they have the means through increased savings, motivation because of low returns elsewhere, and confidence to do so because of the strong economic expansion.

Mike Lea
FPC Investment Director

Invest With Confidence

At the heart of what we do is a simple goal – to help you achieve and maintain financial independence, provide for those who rely on you and live life well.

We do that by providing the financial planning and investment advice you need to secure your future.

We recognise that investors with similar risk profiles may have very different objectives, tax positions and personal circumstances so we adopt a bespoke approach in each case. There are no 'off the shelf' solutions.

We focus on choosing the right blend of assets, managing risk, and minimising tax and costs. Our investment philosophy is founded on a number of key principles which have served our clients well for more than 30 years:

- Differentiate savings from investment
- Understand and manage risk
- Get the "investment recipe" right
- Avoid market timing
- Fear inflation
- Manage tax and costs
- Process is paramount

We believe you win by not losing and this core principle lies at the heart of our investment approach. To find out more, get in touch.

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