Chetwood Investment Management

ESG GLOBAL GROWTH OPPORTUNITIES

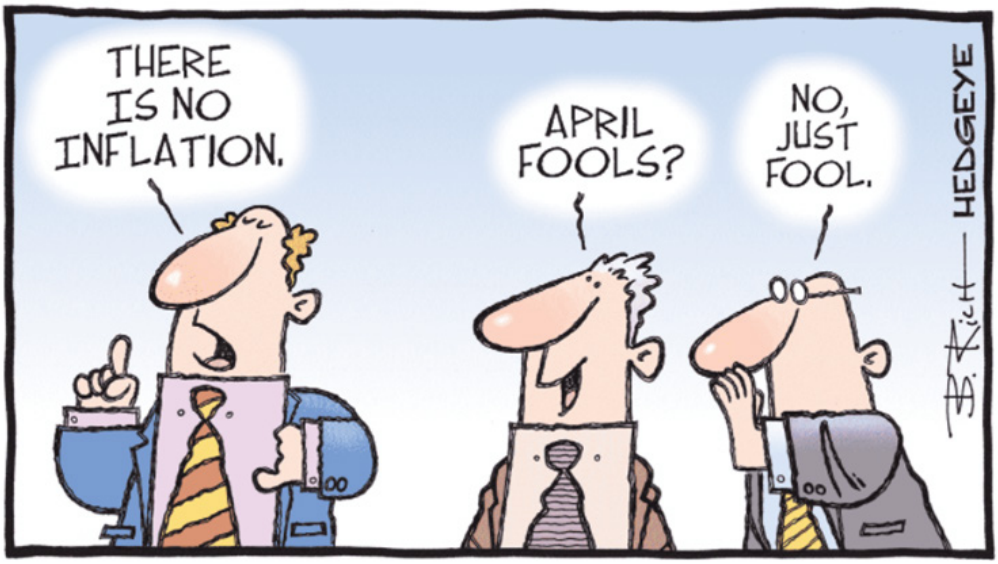
2ND QUARTER 2021 REVIEW

Introduction and Market Overview

As we write this quarterly update to you on the 1st July 2021, UK cases of the Delta variant of COVID have risen four-fold in less than a month to over 30,000 cases a day and Boris Johnson continues to reassure us that Freedom Day will remain the 19th July. I am not sure what will be the case by the time you read this. As news of the global pandemic moves so quickly, in this quarterly review we will instead focus on the global investment environment and summarise the last three months and our views and positioning for the rest of the year. Over the second quarter the key word has been "inflation" and we expect this to be the case for the rest of the summer – with markets deciding between short term transitory inflation or a longer-term spike that may force central banks hands to raise interest rates ahead of time.

At the start of the quarter, we wrote about rising inflation and the effect on bond yields and future interest rates. Basically, if inflation continues to rise and remains high, it puts pressure on central banks to raise interest rates to cool the economy, which in turn causes bond yields to rise and as bond yields rise, there is a reciprocal fall in the bonds capital value. We have seen this in action in the second quarter of the year, where UK Government Gilts were one of the worst performing assets. It was interesting that the nearest parallel to the inflation rise in the second quarter was probably in 2016 when 10 year Treasury Bond yields rose from 1.3% to 2.5% between July and November that year. This coincided with a year in which technology shares experienced a sharp correction, before embarking upon a sustained rally through the 4th Quarter into 2018 as inflation concerns receded.

Over the first two months of the quarter higher oil and commodity prices caused a rapid rise in inflation, then in June we saw significant cost increases caused by a supply / demand imbalance of a gradual reopening of the economy. Although the US Federal Reserve (FED) initially ignored this rise, it has since used inflationary pressures in its updates to forecast its monetary policy and rate guidance speeding up through to 2023.



Counter-intuitively, a higher oil price can lead to a fall in inflation beyond the immediate timescale as, according to John Authers, "higher oil prices act like a tax increase, and tend to dampen consumption - eventually." Let us not overlook the fact that automation has probably taken a step forward due to the pandemic as well and the deflationary effects of technology have probably only been increased by the events of 2020. Ah, but what about the stimulus cheques paid out in the US I hear you cry? Fair enough, there is a likelihood that these may be spent more than saved, but as we mentioned previously, as they are spent, this is likely to be short term spending and therefore only a temporary spike to inflation.

What about demographics? Again, it is hard to make the case for inflation in the longer term when the population is aging. The older generation tends to save more (not inflationary) while the younger generation of the under 40s is spending their money on much different "stuff" than people of older generations did. Much of their spending has moved online and they tend to be cost-conscious.

This short-term inflationary pressure has led us to rejig our portfolios over the last eight months to accommodate more value equities that have performed well in this environment, and we had reduced our technology exposure accordingly. Having said this, this may be a short-term position. For now though, last years stay at home stocks have been replaced by stocks due to benefit from a relaxation in COVID restrictions.

In April, England's chief medical officer, Chris Whitty, warned that the UK will see another surge in COVID-19 cases at some stage. Simple arithmetic demonstrated why. UK Government modelling assumes an overall vaccine take up of 79%. Coupled with effectiveness of 80% to 95%, depending on vaccine and the dosage, this could potentially leave as much as a third of the adult population at risk. It seems optimistic to assume that rising case rates could be confined entirely to the healthy and young. New variants were another risk and the rise of the "Delta" variant in the last two months is proof enough. The vaccination programme has turned the tide, but it is likely we will have to learn to live with this virus.

Investor sentiment currently reflects the good economic news. Interest rates are seen as manageable, and the risk radar is not bleeping very loudly. Bitcoin has been the rollercoaster ride of the last six months, rising by 100%, then falling back down by more than half on the back of Chinese state crackdown on cryptocurrencies. We are often asked if we would hold Bitcoin as an asset in our portfolios. Until we understand more about the violent price fluctuations, it is an "asset" we are happy to leave to one side for now.

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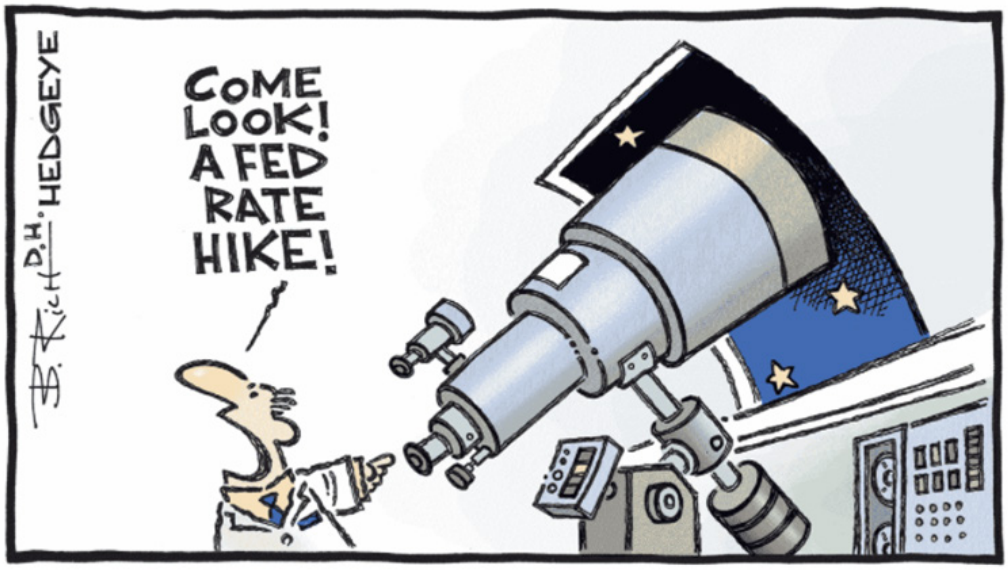
Our recent quarterly review of markets concluded that returns continue to be driven by a positive macro environment as economies gradually release from lockdown and the surge in global money supply has found its way into equities through savings products as returns on cash deposits remain at historic lows. Given valuations across markets, it is difficult to answer the question about what investors should do with their portfolios today and how any spare cash should be invested. The only real answer we can give is to take a longer-term view and engage with active investment reviews. When we consider the positive macro views, the glue that holds it all together is sentiment. Investors have cash, see an ongoing recovery and are bullish. What can burst the bubble? The obvious thing is early rate rises (pre-2023) and sustained higher inflation (the latter probably leading to the former), but that will only manifest itself if a central bank turns decisively hawkish. Related to that, the beginning of a reduction in central banks buying bonds (Tapering) could be a negative signal.



Market timing is tricky. It is hard to hedge against adverse market moves at exactly the right time, because when the actual event will happen is, of course, unknown. We remain positive on markets as Central Banks around the world maintain their policy of keeping interest rates low and focussing on job creation, rather than tackling the growing threat of inflation. Having said this, we have been adding bonds to our portfolios at attractive prices as we are a fan of having some bond duration in portfolios just in case equities should sell off. The correlation between bond and equity returns, over the long-term, is negative after all (i.e., they should perform at different times).

Yes, inflation is creeping in, but this is likely to ease off as supply bottlenecks get ironed out, and prices rising modestly as a result of increased demand is no bad thing. So on balance, we remain committed to the view that we held at the start of the year, that 2021 is likely to be a good year for stock market investment and we hope to deliver strong positive returns for our investors through active management, focussing on the risks we are paid to take and avoiding the ones that do not make sense.

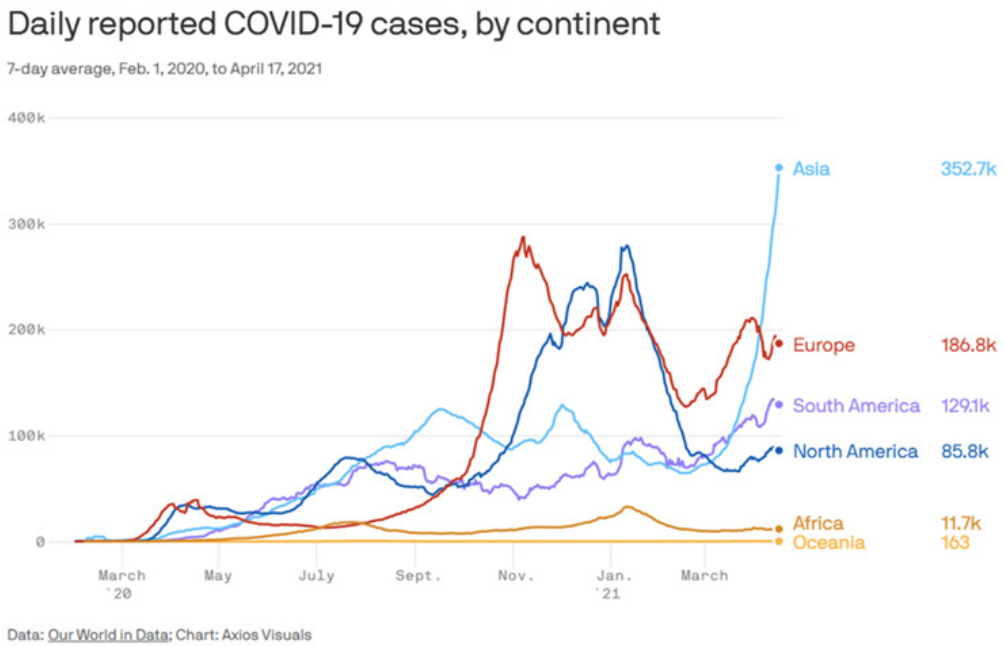
Investors are living with risks that are seen to be manageable while growth and the set-up of our financial system is rewarding capital allocated to risk. As always, we will keep a close eye on any developments and make sensible changes as and when required.

Portfolio Review 2nd Quarter 2021

Global Growth Opportunities ESG

In the early part of the quarter, we introduced a new fund to the portfolio: **Artemis Positive Future Fund**. This is a recently launched fund, but the management team have worked together previously, managing the Aegon Global Sustainable Equity Fund, which produced very strong returns. The fund seeks to invest in companies that have a product or service that has a clear transformative and positive impact, which will help the world transition to a better future. One example of a company they have invested in is Insulet, which has a mission to improve the lives of people with diabetes. Its product gives automated insulin delivery, which provides better outcomes and lower healthcare costs. Another company the fund invests in is Everbridge, whose platform delivers efficient and accurate communication during emergencies. It helped reduce the number of deaths from India's 2019 cyclone to five, compared to 138,000 deaths caused by an equivalent cyclone in 1991. We have been able to access a founder share class of the fund, which has a reduced annual fee of 0.5%.

Later in the quarter we started to move some of our Asian equities that performed so well last year, towards more focussed US Equity exposure. At the start of the year, we had an underweight exposure to US equities, but with their Covid-19 vaccination programme progressing well, strong growth rates expected from their $1.9trn stimulus package and strong pent-up demand, we were comfortable about removing this underweight. We were careful to avoid some of the more richly valued parts of the US market such as stocks like Tesla and Netflix. The situation in Asia was not helped by a slow vaccine rollout and new waves of cases, particularly in India and Japan.



The new waves were forcing large Asian countries, such as China and India, to employ more stringent lockdown measures, whilst much of the rest of the world were relaxing measures as we moved towards the second quarter. We expected this to put further downward pressure on economic growth. The reduction in the allocation to Asian equities was achieved by cutting exposure to the **iShares MSCI EM ESG Enhanced ETF** and **iShares MSCI Japan ESG Enhanced ETF**. Japan had been slow to rollout their vaccination programme and were in the middle of a fourth wave of cases. This contributed to them being forced to ban overseas fans from attending the 2020 Tokyo Olympics, which means their local economy will not receive the usual boost that Olympic host countries enjoy from the many thousands of overseas visitors.

A new fund added to the portfolio was the **Foresight Sustainable Real Estate Fund**. Foresight are specialists in managing funds that invest in listed real asset companies. The fund is actively managed, invests globally, and currently has a c. 50% exposure to North America. All investments must meet their Sustainable Investment Criteria. This means that they will only invest in companies that deliver a net social or environmental benefit, meet the ten principles of the UN Global Compact, and meet one of four pre-defined UN Sustainable Development Goals.

Companies within the real estate sector have historically proven to be very resilient investments during periods when growth moderates, which we expect in the US towards the end of the year but should still provide good participation if equity markets continue appreciating before then. The real estate sector has also historically proven to be a good hedge when inflation is rising and having a direct exposure to real estate also helps to improve the overall diversification of the portfolio.

We also topped up exposure to the existing holding of **Legg Mason ClearBridge US Equity Sustainability Leaders fund**. This actively managed fund invests in US companies. The investment manager's portfolio construction process restricts the companies in the fund's investable universe to accommodate only those companies that are Sustainability Leaders. The investment manager will try to focus on companies that, in their view, offer products and services that have a positive impact on society by doing less harm to people and the planet relative to other companies within the same industry. It also counts Microsoft and Apple as its largest two holdings.

The portfolio has benefitted from a strong performance over the quarter. We feel that we have made important changes during the quarter to diversify your portfolio and bring in some important portfolio protection for the summer.