Strategy & Outlook MARKET UPDATE

June 2021

Equities were weak in the first half of the month as the spectre of inflation loomed large over financial markets but although much has been written about "sell in May and go away" that thesis has not worked well over the past 20 years. The declines early in the month were driven by tech/growth with value outperforming, though as noted below much of this reversed as the month progressed.

Economic data (and market volatility) this month was all about inflation. The US CPI report for April showed an acceleration in inflation to +4.2% year-on-year and +3.0% for the core inflation reading. Base effects played a large part in this given the decline in inflation numbers this time last year, but the month-on-month increase in core inflation at +0.9% was also higher than expected. Delving into the specifics of the report, transportation accounted for more than half of the monthly increase, driven by used car prices, which rose by 10% and contributed 0.3% of the 0.9% monthly increase in core CPI. Airfares were up 10.2%, hotels, motels were up 8.8% - so a lot of reopening trades were seen in the report. The unusual characteristics of the economic rebound likely means more volatility in the months ahead as the reopening meets supply chain bottlenecks, but as reopening effects subside so too should inflation.

Total employment in the US remains 10mln below the pre-Covid level. The mantra from central banks is that this is a transitory blip in inflation, and not something to be overly concerned about. ECB President Lagarde reiterated the dovish stance of the ECB and even though the FOMC minutes did mention potential tapering discussions over the summer, bond yields ended the month more or less where they began. Indeed, as the month progressed, the price action and market narrative seemed increasingly at odds, with the financial press and sell side reports doom-mongering about inflation worsening yet US 5-year inflation expectations as measured by the bond market subsiding to where they were 2 months ago. Margins for large US companies are at all-time highs, global economic surprise indicators are rolling into negative territory, value has given back half its gains relative to growth from the early part of the month, whilst lumber and iron ore are approximately 20% off their highs of early May.

Corporate commentary continues to be overwhelmingly bullish. Deere and Home Depot both echoed themes of strong demand environments and the ability to pass on cost pressures. A quote from the Analog Devices CEO sums up the ongoing situation in semiconductors: "the economic recovery has materialized faster and stronger than initially anticipated…..reflecting the insatiable demand for our products". The long-term implications for the sector were highlighted by AMD, saying customers will have to accept long term contracts. The CEO of Microchip noted that inventories at their distributors, at just 22 days, are the lowest on record, and cannot recall a time when the imbalance between the supply and demand has been more acute. NVIDIA reminded us that "every industry is becoming a technology industry, and accelerating investment in AI infrastructure both through the cloud and on-premises".

The challenges faced by Big Oil were highlighted as US shareholder activist groups managed to successfully enter the boardroom for the first time, gaining board seats at Exxon and forcing climate resolutions at Chevron. In Europe, a Dutch court ruled that Shell has a legal responsibility to cut GHG emissions. The direction of travel towards decarbonisation is increasingly clear and is accelerating.

Positioning and Outlook

Over the last number of months, we have been steadily selling cyclical reopening beneficiaries and adding to great long term secular winners (and some cheap quality) which have severely underperformed over the last number of months. The outlook for equity markets suggests the opportunities exist now in exciting structural growth stories rather than the recovery names, where much of the recovery is already in the price.

We will continue to actively manage our risk and our exposures using all available instruments, asset classes and derivative products available to us for everything from short term tactical trades to long term fundamental holdings. The merits of investing in our actively managed multi asset funds with a proven investment process continue to be evident.

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