# BERENBERG INVESTMENT REVIEW QUARTER 2 2021

*Foreword*

Dear Reader/client,

Half way through 2021 and the pandemic – certainly in the UK – seems to have entered a new phase. The delta strain is causing new cases to rise considerably, but not hospitalisations. How policy makers deal with this remains to be seen, but at the moment it seems that re-opening of our economies will continue as planned.

Economic sentiment has rebounded sharply and equities have continued their long rally. Underneath the hood there have been sharp variations between the value and growth styles indicating it is not all plain sailing.

Faster economic growth expectations have brought with them increased concerns about higher inflation and tighter monetary policy. We continue to believe that such concerns should ease in time. Nonetheless as the Covid recovery matures, we need to be mindful of the risk that either growth disappoints or central banks may be pressed quickly into action.

Our growth style has held up well despite the rally in value stocks – we pick stocks which have structural growth drivers and can pass through price increases. Whilst maintaining our positive outlook, our strategists and portfolio managers are bringing some caution to portfolio positioning.

We hope you enjoy reading about this in further detail and wish you some relaxing time over the summer.

**Richard Brass**
*Head of Wealth & Asset Management, UK*

## SECTIONS


- Overview and Q2 Asset Performance
- Normality comes into view
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## *Q2 asset performance*

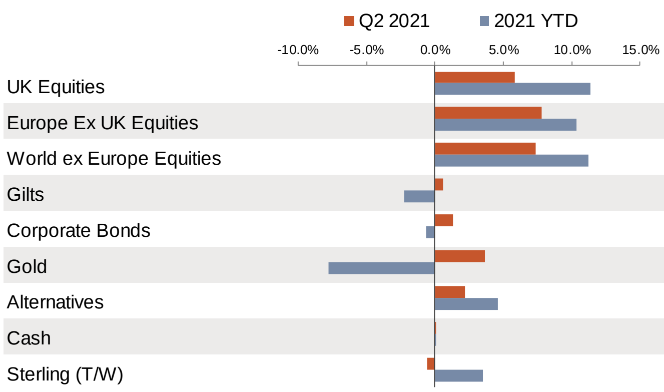
As vaccination programmes progressed, especially in Europe, equities experienced a strong quarter. However, unlike Q1, Q2 saw falling bond yields as inflation expectations were tempered.

On a regional basis the US outperformed as falling yields lent a support to the growth style, which is more represented in US sector composition. Europe also performed well however with the UK lagging slightly. Emerging markets lagged as the USD bounced and tighter monetary policy and increasing regulation weighed on Chinese equities.

Yield movements were hard to read. The US conventional 10 year bond yield declined from the start of the quarter as ultimately did real yields, led by falling inflation break-even rates. One way to read this is increasing confidence that central banks will not allow inflation to rise significantly on a persistent basis. As the quarter came to a close the Federal Reserve acknowledged it is considering tapering its asset purchases, which markets read as a 'hawkish surprise'. Nevertheless, real yields fell as a result. Another reading suggests a lack of confidence in the economic growth outlook.

Gilts and sterling corporate bonds were marginally positive. Gold performed well given the environment, but suffered toward the end of the quarter when the US dollar rose.

**Chart 1: Multi-asset performance (Q2 2021 and YTD)**




Source: Bloomberg Finance L.P.
Total Return in Sterling to Close of Business 30/06/2021

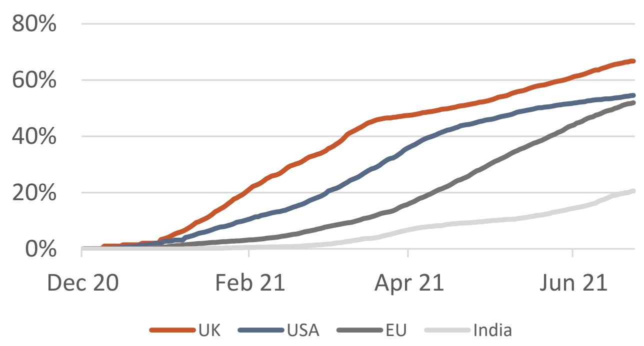
## *Normality comes into view*

The continued rollout of the Covid-19 vaccines saw economies in most of the developed world begin the process of unlocking pockets of the economy that had been shut off to prevent further spread of the virus. In regions which saw rapid deployment of the vaccines, namely Israel and the UK, vaccination rates have already exceeded 60%. European Union nations, which were a significant laggard towards the end of the first quarter, have seen significant acceleration in their schemes with the share of people having received their first vaccine in the area now crossing the 50% mark.

Despite more contagious variants of the virus spreading across different regions leading to a new increase in cases, nations with high vaccination rates are seeing a muted increase in hospitalisation and mortality rates. So long as this trend continues, this would allow governments to continue with their reopening plans and allow the economic recovery to continue as the world returns to normality.

Developing nations that have lagged their developed counterparts on the vaccine front have seen a particularly large spike in cases, which has put a strain on the healthcare systems in the regions given the lack of dampening effect on medical needs seen in highly vaccinated regions. India saw a large spike in cases over the second quarter, which led to the federal government taking control of the programme offering vaccinations to all adults by the end of June. Following a meeting of the G7 countries, it was announced that 1 billion vaccines would be donated to developing nations to help address the current ongoing shortfalls.

**Chart 2: Total population to receive at least one vaccine**




Source: Our World In Data Period: 12/12/2020 – 30/06/2021

## *Inflation takes the headlines*

As economies transition to a full reopening, economic activity continues to gather pace. This has led to a significant pickup in economic growth, albeit against soft comparisons from the largely locked down world last year. However, with an abundance of stimulus coupled with the reopening of the floodgates for economic activity, concerns of the impact of the magnitude and duration of the inflation that would follow began to emerge.

In the UK, at the end of the second quarter outgoing Chief Economist of the Bank of England Andy Haldane said he sees inflation in the UK for 2021 close to 4%, which is almost 1% higher than the value that the Bank of England itself estimated earlier in the quarter. Andy Haldane however seemed to be the sole hawk at the bank, as he cast the sole vote for scaling back monetary stimulus, with the other eight members voting to maintain the £875bn bond purchasing programme. There was no disagreement on the base rate, as all members voted in favour of maintaining the rate at 0.1%.

## *Portfolio Review*

After mildly positive returns for equity focused strategies in Q1, portfolio returns in Q2 were much stronger in absolute terms. Despite the rise in bond yields and inflation expectations, even bond focused strategies in sterling made positive returns.

In relative terms we again outperformed our benchmarks – and by a healthy margin (>2%) – in equity focused mandates. Relative outperformance was assisted by a small overweight to equities and an underweight to bonds. However, the primary driver was security selection, which was positive in all equity regions. This trend was continued in June.

During the quarter we gradually reduced our overweight to equities, which remains with less conviction. This was mainly achieved through a reduction in European equities and a trimming of our position in Latin America. We also switched some of our selections by introducing Worldline and topping up Croda. This was funded through a sale of Unilever and further profit taking in ASML as well as BE Semiconductors.

## *Outlook*

Looking out to 2022 and perhaps further, the economic outlook remains strong. There is plenty of slack for the global economy to grow into and although the inflation picture has certainly changed we do not expect it to become a material problem. Central banks have a delicate balancing act between maintaining inflation fighting credibility whilst not normalising policy so fast as to derail the recovery.

In the shorter term, we are experiencing a very rapid recovery from the pandemic lockdowns, which as yet are not over. Business confidence has soared and GDP growth has come roaring back, especially in the US, but increasingly so elsewhere as well. It is increasingly likely that from hereon in, growth disappointments become more probable and that certainly the pace of growth improvement must slow. Nevertheless, GDP growth will remain strong.

The strength of the recovery has reinvigorated inflation, such that investors are increasingly wary of inflation dynamics. Presently, inflation is being boosted by year-on-year effects and supply disruptions as we emerge from the pandemic. These effects should fade as we approach 2022, however this does not end the inflation debate. There is concern that inflation may prove more sticky than in the recent past, and that many of the factors which have driven inflation lower over the last few decades (such as rapidly increasing labour supply) are now beginning to reverse.

Against this backdrop, monetary policy has grown in import. In the latter part of the quarter the Federal Reserve admitted it was discussing slowing its asset purchase programme and increased its 2 year view of where interest rates might be. Paradoxically, bond yields fell as inflation expectations ebbed. The story of Q1 had been a rise in inflation expectations and real yields.

For equity investors these gyrations cause issues in style rotation. Whilst the 1Q was very supportive for cyclical value, the 2Q has proven less so and looking forward we expect this picture to remain muddied.

Although our growth style has found this environment more difficult, our focus on companies which can pass through price increases has limited the impact of changing inflation expectations. Naturally this increases our confidence in our selections which remain heavily growth and quality oriented even though our view of equities in the short term has become more tempered in view of the uncertainty the summer will bring.

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