BERENBERG INVESTMENT REVIEW QUARTER 3 2021

Foreword

For non-London readers, it may be of interest to observe that the city has started to resemble life pre Covid. Let us make a tenuous link from this to the market environment. Post summer, financial markets doubled down on their economic assessment of life post Covid. We have an ever-louder discussion on inflation and interest rates as debates about the "shortage economy" ensue. This could be attributable to the post pandemic recovery but maybe this is too simplistic.

As governments look forward, we are seeing a return of domestic politics and international brinkmanship - US debt ceiling, Polexit, China/Taiwan for examples; could this be back to normal or evidence of a rise in protectionism? Climate change efforts have also taken central stage, with sustainability credentials becoming a point of differentiation amongst companies and countries. We look forward to seeing the output and actions from COP 26[1] in November.

For long term investors, the uncertainties may be contextualised and we remain positive in our outlook. As my colleagues outline, in the short term we are experiencing an "air pocket" of turbulence which is rarely comfortable but should pass and bring new opportunities.

We are delighted to have achieved the three year milestone for GBP multi-asset with strong performance. Alongside this our equity coverage from our Investment Bank is on track to exceed 1,200 companies worldwide and we continue to see fascinating ideas for our advisory business.

With, maybe, normal service resuming post-pandemic, we are looking forward to seeing many of you in person. Certainly, London is more welcoming.

Yours sincerely,

Richard Brass
Head of Wealth & Asset Management, UK

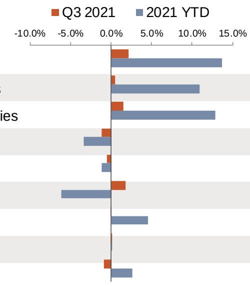
SECTIONS

- Q3 market review
- Chinese regulatory crackdown and debt worries
- Tapering at the tip of the Fed's tongue
- Post-Covid normality comes into view
- Portfolio performance
- Outlook

[1] 26th United Nations 'Conference of the Parties', an annual climate change conference taking place in Glasgow 2021

Overview

Chart 1: Multi-asset performance (Q3 2021 and YTD)



	12 Month Performance Over Last 5 Years				
	30/09/21 - 30/09/20	30/09/20 - 30/09/19	30/09/19 - 30/09/18	30/09/18 - 30/09/17	30/09/17 - 30/09/16
UK Equities	25.8%	-19.8%	2.8%	5.8%	11.0%
Europe Ex UK Equities	20.8%	-0.7%	6.2%	1.3%	21.4%
World ex Europe Equities	22.3%	7.6%	8.1%	15.6%	13.9%
Gilts	-3.3%	1.7%	6.6%	-0.3%	-1.7%
Corporate Bonds	1.7%	3.7%	8.3%	0.3%	2.4%
Gold	-10.6%	21.9%	31.2%	-4.4%	-5.8%
Alternatives	9.8%	-2.6%	-0.1%	0.0%	4.8%
Cash	0.0%	0.4%	0.7%	0.5%	0.3%
Sterling (T/W)	4.6%	1.2%	-1.7%	-0.1%	0.8%

Source: Bloomberg Finance L.P. Please see data source on page 4
Total Return in Sterling to Close of Business 30/09/2021

Q3 asset performance

Over the quarter equities still managed a decent and positive return despite a very difficult close to September. Gold, curiously also managed a positive return in an environment not conducive for it. Bonds, as might be expected, did not.

The quarter started pretty much as it ended, with fears that growth was slowing and inflation accelerating. The fear for growth though was sparked by jitters over Covid-19 outbreaks, whereas the quarter ended with global supply shortages, 'brown-outs' in China and labour shortages. Concerns for higher inflation and what it may mean for monetary policy stalked markets throughout the quarter and remained as we entered October.

Of particular concern is how rapidly the US central bank will slow asset purchases (referred to as 'tapering') and whether this accelerates the first and subsequent interest rate increases.

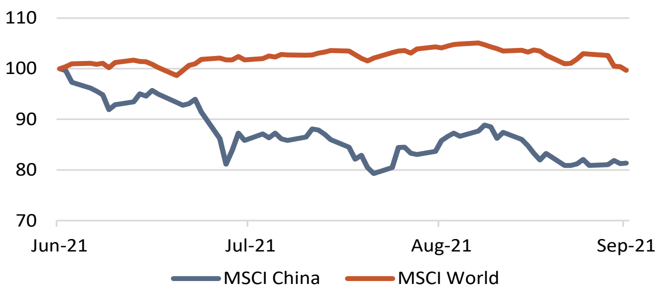
Finally, the elephant in the room made its presence known. For many years China has been building up debt – often resulting in serious capital misallocation, particularly in the real estate market. Evergrande, a huge real estate developer with reportedly titanic $300bn debts, was given instructions by its financial regulator to avoid default on an $83m coupon due in late September. As the quarter ended, another real estate developer – Fantasia – defaulted on a coupon payment. Whilst most believe that China has the wherewithal to cope with rising defaults, the fear is that this is the tip of the iceberg.

Chinese regulatory crackdown and debt worries

What began in 2020 with the suspension of the Ant Group IPO, an affiliate of Chinese e-commerce conglomerate Alibaba, gathered momentum over the course of the third quarter as Chinese policymakers flexed their regulatory muscle once more. In the crosshairs now is the EduTech sector, which faced pressures as for-profit school tutoring was banned. Adding to this pressure was the introduction of new rules stating that under-18s could only play video games for 3 hours per week, which hit technology names in particular video games developers significantly. Uncertainty surrounding future policy crackdowns and the associated contagion spelled a weak quarter for the equity regions as markets speculated which sector would be next under fire.

Debt levels of Chinese property developers were also of concern as the world's most indebted real estate developer, Evergrande - with over $300bn worth of liabilities – missed a coupon payment on one of its offshore bonds. Given that the liabilities of the property developer equate to c.2% of China's total GDP, alarm bells were rung in the mind of investors and bonds issued by heavily indebted large Chinese property developers sold off. The central bank in the region sought to stabilise the situation by urging banks to cooperate with local governments to protect Chinese consumer interests. It remains to be seen whether the missed coupon payments will be salvaged, as the 30 day grace period for payment ends in late October.

Chart 2: Third quarter performance of Chinese and World Equities (Indexed at 100 in USD)



Source: Bloomberg, MSCI Period: 30/06/2021 – 30/09/2021

12 Month Performance Over Last 5 Years

	09/20-09/21	09/19-09/20	09/18-09/19	09/17-09/18	09/16-09/17
MSCI World	27.0%	8.6%	-0.2%	9.2%	15.9%
MSCI China	-8.6%	31.3%	-5.9%	-4.0%	30.4%

Source: Bloomberg, MSCI

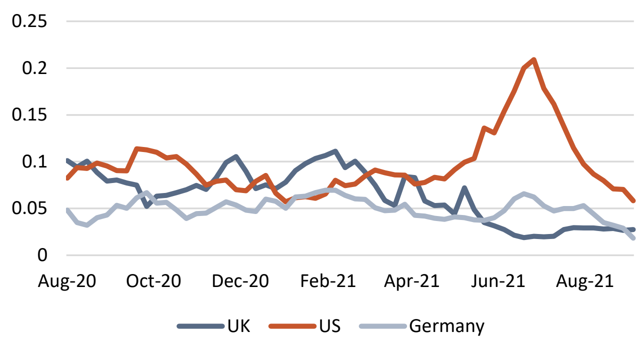
Post Covid-19 normality comes into view

Although the third quarter saw a continued spread of the delta variant of Covid-19, some solace could be found in regions that possessed a high rate of vaccination, where hospital admissions were not keeping pace with the increase in infections. Government policy with regards to national or regional lockdowns has largely been driven by the need to ensure that medical services can accommodate the increase in demand for treatment rather than the absolute number of new infections, which could indicate so long as authorities see a stabilisation in the hospital rate, the need for future lockdown measures should be limited.

Data over the quarter from some early vaccination rollout nations such as Israel and the United Kingdom suggests antibody resistance wanes 6 months following the vaccine. This prompted nations to initiate plans for the rollout of a third jab to stay ahead of the curve in terms of limiting serious cases of Covid-19. As we approach the winter months, it is likely that other nations, particularly European, that lagged the initial rollout of vaccinations will follow suit.

Fiscal policy normalisation has started to come to the forefront for a post lockdown environment, with the ending of the Furlough scheme in the United Kingdom. In tandem with unwinding Covid-19 support measures will inevitably come tighter fiscal policy in the form of tax increases across the globe, as nations seek to balance the additional deficit accrued through providing ultra-loose financing in order to limit the economic impact of the pandemic.

Chart 3: Number of weekly hospital admissions per new Covid-19 case



Source: Our World In Data, Berenberg Calculations
Period: 30/06/2019 – 30/06/2020

Tapering at the tip of the Fed's tongue

The first signs of a hawkish tilt from the Fed came from its September meeting as it indicated it would likely start reducing its bond purchasing programme in November. Although the date is not set in stone, the central bank aims to completely unwind its purchasing programme before it takes any action on rates, which will likely end around the middle of 2022.

Although rates remain near zero for now, half of Fed officials have now signalled they are ready to raise interest rates next year. This tilt from US Federal Open Market Committee members follows the central bank notching up its inflation expectations for the year to 4.2%, which is notably above the long-term target of 2% that the bank set as its long-term objective.

Previously, the Fed indicated that they would now target average inflation over a period of time and would allow for it to run above their 2% target temporarily before they enact significant changes in monetary policy. Therefore, this hawkish tilt can be read as some members feeling that the inflation rate is running a bit hot despite this broader target, although the core view of the bank remains that this inflationary period is transitory.

Portfolio Review

Despite perturbed markets, many of which ended the quarter where they began, our strategies delivered positive performance. In addition, each outperformed their respective benchmarks; for low risk portfolios our lower sensitivity to rising yields and higher exposure to credit drove performance, whereas in equity focused mandates credit and UK stock selection were the primary drivers. September was another matter – the rapid rise in yields – due to a mix of rising interest rate and inflation expectations – was anathema to our style and resulted in sharp underperformance.

Outlook

After a rapid post-pandemic recovery, the global economy has hit an air pocket. Whilst demand remains strong, supply side constraints have emerged from several sources. In China, chief amongst these is energy supply, in the UK labour, and globally microchips. These will take some time to resolve but, in the meantime, have caused inflation pressures to rise – and perhaps remain stickier - and growth to slow from its heady rate rather more quickly than markets anticipated.

Notwithstanding these issues, prospects for the global economy remain good. Underlying demand is strong and should move into the driving seat once the supply side issues are resolved. Households have significant excess savings built up from being unable to buy services, and many goods, during the pandemic lockdowns. Meanwhile, companies need to rebuild their inventories and many have delayed investment over the last 18 months. Finally, although the tide is beginning to turn, fiscal and monetary policies remain very supportive and will be for at least a few years.

In the longer term, our economists believe the supply capacity of the economy could be boosted by faster diffusion of new technologies which many companies have been forced to adopt during lockdown. In addition, any remaining labour shortages could encourage investment into labour – saving technologies.

If inflation does prove to be more sustained than expected, this needn't be a bad thing for companies with pricing power assuming two things hold true – the first is that the impetus for higher and/or sustained inflation is demand led and not the result of continued supply side issues; the second is that inflation does not get to the point where central banks feel the need to increase interest rates more rapidly to get ahead of the curve.

We are confident we are positioned well for such an environment as our stock selections focus on companies with strong, competitive advantages and thus can deal with moderate costs increases and interest rate increases, provided these are not too fast. From an asset allocation perspective, we are overweight in equities with a focus on quality growth and small caps. We are naturally underweight bonds and have recently adopted a position in industrial metals to take advantage of the likelihood for rising commodity prices.

BERENBERG INVESTMENT REVIEW QUARTER 3 2021

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Data Sources

UK Equities	MSCI UK Net Total Return Local Index
Europe Ex UK Equities	MSCI Daily Net Total Return Europe Ex UK Euro
World ex Europe Equities	MSCI ACWI ex Europe Net Total Return USD Index
Gilts	IBOXX GBP GILT TR 5-7
Corporate Bonds	IBOXX GBP CRP TR 5-7
Gold	Gold USD Unhedged
Alternatives	Hedge Fund Research HFRU Hedge Fund Composite GBP Index
Cash	ICE LIBOR GBP 1 Month
Sterling (T/W)	UK GBP Broad Index 2005=100 Trade Weighted

Important Information

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