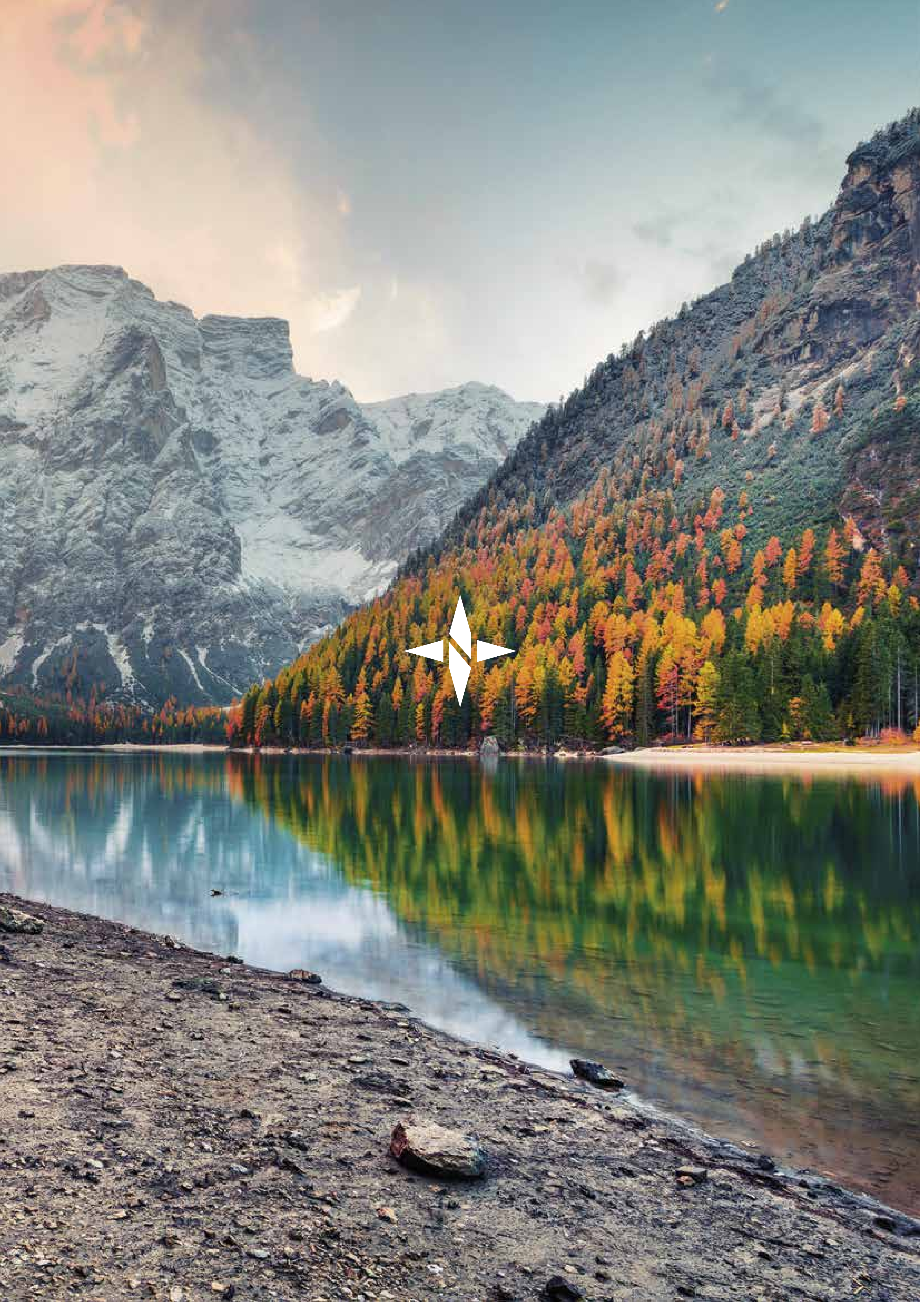
NORTH CAPITAL
MANAGEMENT

October 2021

Market overview and outlook



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Introduction

October 2021

Brian O'Connor Chief Executive Officer
Angus Jack Head of Clients

We write to you from our office desks, which is in itself somewhat of a novelty. We decided that working from the office on a Tuesday, Wednesday and Thursday was a sensible first step and have been delighted by the resultant energy and vibrancy created simply from being able to work closely and collaborate with one's colleagues easily again.

Microsoft reported recently that between February 2020 to February 2021 there was over 40 billion more emails than in the previous 12 months. It is little wonder that new work from home workers have reported feeling overworked and over saturated with information bombarding them at all hours from relatively new 'working' stimuli such as instant messaging and video conferences as well as increased email flow. Microsoft's own analysis of the data concluded that flexible working is here to stay and although high productivity is masking an exhausted workforce, more encouragingly, 'talent is everywhere in a hybrid work world'.

We would very much agree with these conclusions based on our own observations and would add that a further challenge lies with providing adequate training and development to colleagues and in particular new team members. Extending Microsoft's view that talent is everywhere, we are delighted to announce that alongside our return to the office we have four new joiners. Firstly, Connor Davidson, an engineering graduate, joins us to support the investment teams' research capabilities. He has recent been awarded a distinction in his post-graduate degree in Finance. Maggie Zane joins us to help manage the office and Hamish Macpherson and Gillian Murray have joined the advisory team. Hamish, a Geology graduate with a distinction from his MSc in Economics, previously worked in a client services role for a digital platform business whilst Gillian is a highly experienced and well regarded investment adviser who has joined us from Adam & Co. The photograph also includes Andrew Spence who joined earlier in the year and heads up our discretionary management proposition, and has recently been appointed Chief Investment Officer.

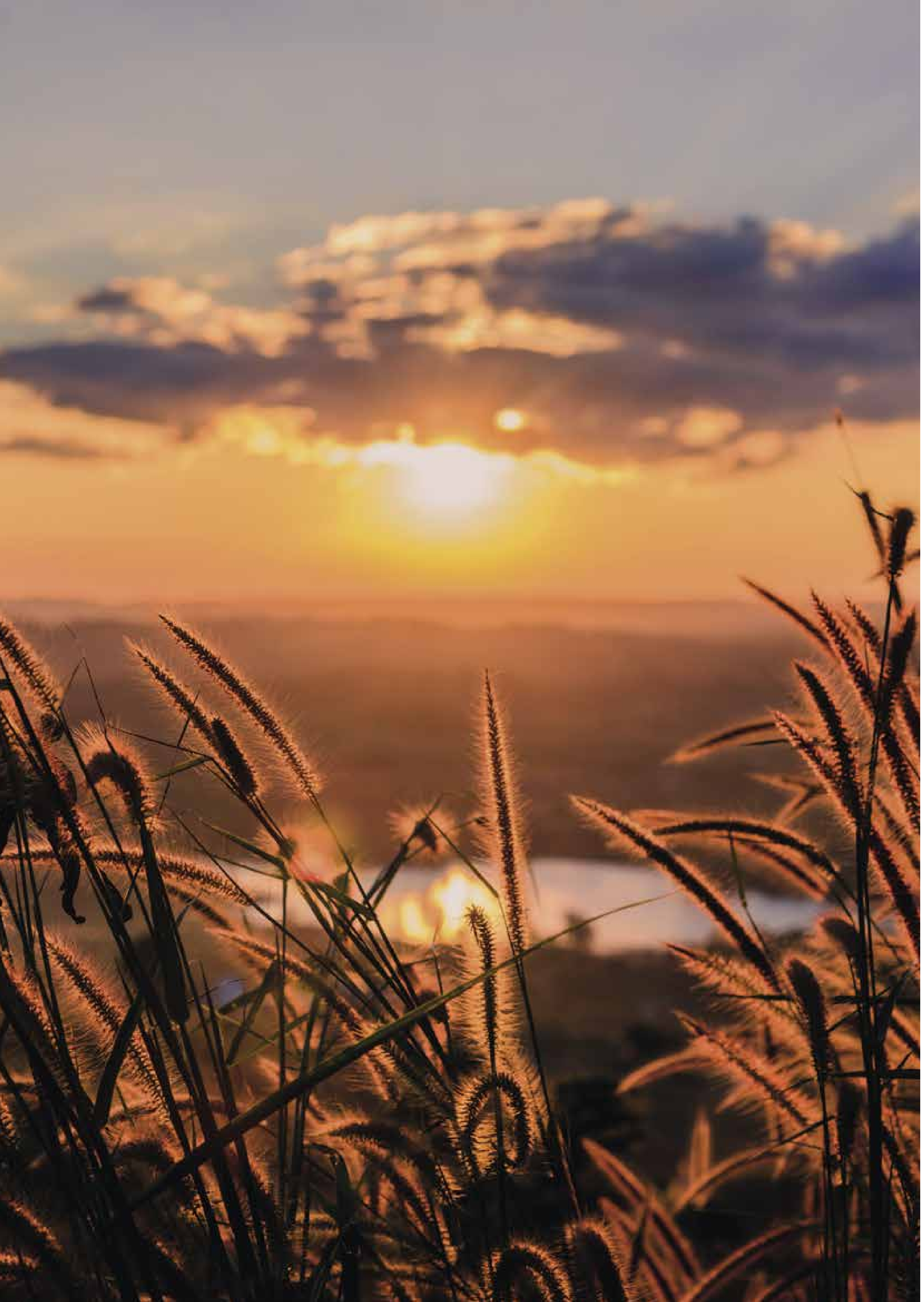
In this edition we have chosen to focus on two areas - the first being portfolio and the second is pensions.

Whilst growth in asset prices have and will continue to be supported by earnings growth, it is our view that equities will outperform bonds over the next 12 months. As a result it would not be a surprise to see some heightened volatility as we transition into a period with monetary policy tightening and rising inflation (transitory or not) being part of the macro landscape. We therefore discuss some investments that allow equity market participation but with lower volatility. The second spotlight has arisen in part because of the increasing number of conversations we have had regarding clients' own pensions. Writing about pensions is always a challenge, as it is a complex area, but we have tried to use plain English as best we can, to highlight the key characteristics and some questions you may wish to think about.

Left to right: Hamish, Gillian, Andrew, Maggie, Connor.

We very much look forward to introducing you to Gillian, Connor, Hamish and Maggie at the earliest opportunity and if you are passing 58 North Castle Street, please feel free to pop in. The doors are open.

Angus Jack



Highlights

Four new team members join North Capital as we return to the office

Many major economies return to pre-pandemic levels of growth

Global stock markets continue to perform well

Government bond prices fall as investors fear a spike in post-pandemic inflation

UK level of employment back at pre-pandemic high plus 1.2m job vacancies

This Callan table shows performance for various asset classes (colour coded) across multiple time frames.

10 YEARS	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD
Developed Equities 257.65%	Oil 16.84%	EM Equities 16.99%	Developed Equities 28.87%	Developed Equities 9.81%	UK Property 4.33%	Oil 25.37%	EM Equities 30.55%	UK Property 1.18%	Oil 35.57%	Gold 20.95%	Oil 60.86%
EM Equities 129.35%	Gold 9.63%	Developed Equities 15.71%	UK Property 8.07%	UK Property 7.2%	Hedge Funds 2.68%	EM Equities 9.69%	Developed Equities 18.48%	GBP Cash 0.72%	Developed Equities 27.34%	EM Equities 19.12%	Developed Equities 14.85%
UK Property 49.96%	Government Bonds 6.33%	Corporate Bonds 11.21%	Hedge Funds 7.26%	EM Equities 5.17%	Developed Equities 2.08%	Developed Equities 9%	Oil 14.25%	Government Bonds -0.38%	EM Equities 18.05%	Developed Equities 13.48%	UK Property 7.02%
Corporate Bonds 47.56%	Corporate Bonds 4.32%	Oil 7.64%	Oil 7.22%	Corporate Bonds 3.15%	GBP Cash 0.57%	Gold 7.75%	Gold 12.79%	Hedge Funds -2.73%	Gold 18.03%	Corporate Bonds 10.37%	Hedge Funds 3%
Hedge Funds 33.86%	UK Property 0.98%	Gold 6.08%	EM Equities 3.44%	Hedge Funds 2.73%	Government Bonds -3.29%	UK Property 4.43%	Corporate Bonds 9.09%	Gold -2.81%	Corporate Bonds 11.51%	Government Bonds 9.5%	EM Equities 0.73%
Government Bonds 10.83%	GBP Cash 0.86%	Hedge Funds 4.4%	GBP Cash 0.51%	GBP Cash 0.54%	Corporate Bonds -3.56%	Corporate Bonds 4.27%	Government Bonds 7.29%	Corporate Bonds -3.57%	Government Bonds 5.59%	UK Property 6.99%	GBP Cash 0.05%
GBP Cash 5.61%	Hedge Funds -0.69%	Government Bonds 1.83%	Corporate Bonds 0.35%	Government Bonds -0.79%	EM Equities -5.76%	Government Bonds 1.65%	Hedge Funds 3.25%	Developed Equities -7.38%	Hedge Funds 4.7%	Hedge Funds 2.85%	Corporate Bonds -2.44%
Gold -0.76%	Developed Equities -5.49%	GBP Cash 0.85%	Government Bonds -4.3%	Gold -1.75%	Gold -10.88%	Hedge Funds 1.06%	UK Property 1.84%	EM Equities -10.07%	UK Property 1.44%	GBP Cash 0.29%	Government Bonds -5.67%
Oil -35.19%	EM Equities -12.74%	UK Property -0.96%	Gold -28.65%	Oil -47.62%	Oil -45.57%	GBP Cash 0.5%	GBP Cash 0.36%	Oil -14.89%	GBP Cash 0.81%	Oil -31.55%	Gold -7.92%

Returns are reported in local currency, sorted in descending order for each column. Unless stated otherwise, each asset class is global in scope - see Disclaimer for full details. EM refers to Emerging Markets and UK property is residential property. Source: Lipper. Date: 30 Sep 2021.

Spotlight:
Portfolio protection whilst maintaining equity exposure

Andrew Spence Chief Investment Officer

As global equities continued to hit new highs over the summer, investors are understandably becoming nervous about what lies ahead. Preserving capital forms part of growing capital, and if one can avoid significant drawdowns, as part of a long-term growth plan, so much the better. However, calling market peaks and troughs is notoriously hard, so we would never advocate trying to time entry and exit points. That said, there are ways in which investors can still maintain exposure to equities whilst taking a little less risk. Strategies include favouring fund managers that have a defensive style of management; passive funds that screen for lower volatility stocks; or engineering a return from the market through a structured product. Here we will discuss a few of these strategies.

Defensive fund management

A portion of fund managers believe that a portfolio that suffers fewer and less destructive drawdown will be in a better position to compound returns over the long run. These managers will tend to invest in quality businesses with the following characteristics:

- **Strong pricing power:** Essential products and services.
- **Stable franchise:** Sticky customer relationships; high switching costs; few/no rivals.
- **Barriers to entry:** Unique intellectual property (IP); cost advantages; high regulatory hurdles.

This will likely lead to businesses that have stable and recurring revenues, predictable growth and high free cash flow (a measure of profitability). An example fund that invests in this way is the Troy Trojan Income Fund. The fund invests in predominantly UK equities. Stocks within the fund, which exhibit many of the above characteristics, include: Unilever, Croda, Experian and Intertek. Over the long-term, the fund has provided solid compounding returns to investors and importantly cushioned drawdowns during periods of significant market stress (e.g. COVID stock market fall in 2020, and the financial crisis in 2008).

You might think this is an eminently sensible approach to have for much of your equity investments, but it can mean forgoing strong long-term returns, as investors tend to miss out on high growth companies as well as those companies that present good, shorter term, value for investment.

Lower volatility stocks

In a similar vein, if you are looking for companies to help reduce risk in your portfolio, screening for low volatility might help you in your quest. Factor investing, which screens for specific types of stocks, such as quality, value and low volatility has become a popular investment approach in recent years.

The low volatility factor has consistently shown to deliver equity market like returns, but at lower levels of volatility than a basket of stocks.

What we see from the data, is that during good times – when equity markets are very buoyant and volatility is low – investors in low volatility stocks still participate in much of the upside. The real value of this investment approach comes in the downside protection that has been shown historically, where screening for low volatility stocks has seen investors suffer far less significant falls during periods of market stress. Accessing this style of investing is predominantly done through a passive (factor driven) approach, through funds such as the iShares MSCI World Minimum Volatility ETF.

Structured products

Structured products have been available to investors for the last couple of decades under various guises. Essentially, they are investment products, typically sold through banks, that seek to provide a more defined return profile, than investing directly in equities. For example, if an investor had a view that equity returns were going to be relatively flat over the next 3-5 years, a product could be created to generate a return of 6-7% per annum in such an environment. Alongside this, investors can receive a degree of capital protection (up to a 40% fall in the index). Whilst this may seem too good to be true, investors do need to sacrifice a few things as part of this: they forgo dividends on their investments (which, in the case of the FTSE 100, is around 3%); they (in some cases) take on the issuing bank credit risk; and they do not receive upside in excess of this – should the underlying index (FTSE 100, for example) perform better than the product defined return (in this case 6-7% per annum).

How do they work?

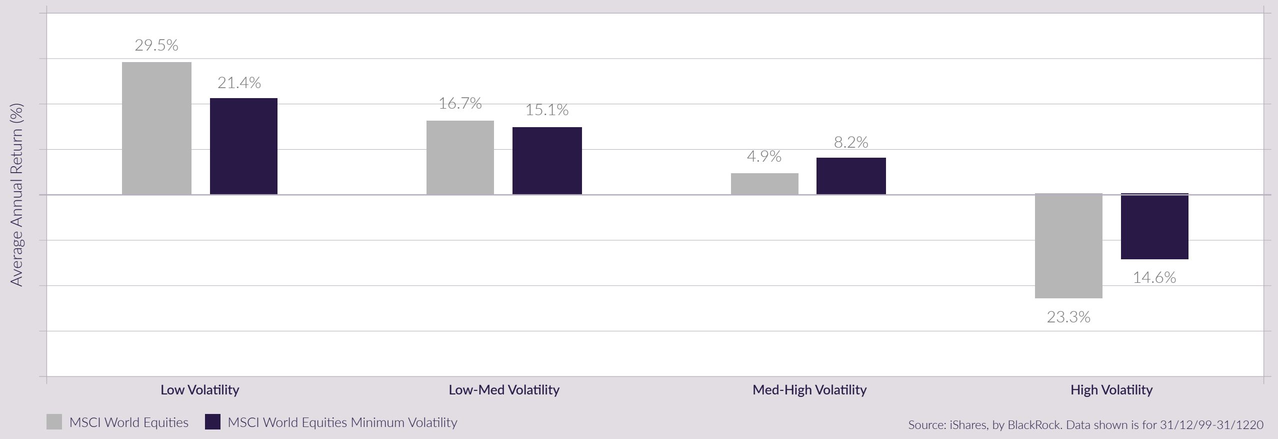
Structured products are created using a bond from the issuing bank (e.g. HSBC) and a package of derivatives to create the designed payoff structure. The payoff structure may be an enhanced performance of an equity index (e.g. super tracker); benefiting from a range bound market (e.g. range accrual or autocallable); or generating a return providing an index does not fall below a certain level (e.g. synthetic zero). These would be individual products tailored to a client's specific views.

In recent years, there have also been unitised funds created that are a professionally managed package of structured investments. The most popular being a fund of autocall structured products. An autocall is a structured product that pays a high coupon if the underlying – typically one or more equity indexes – is above a predetermined level at annual observations dates, at which point it automatically matures and the investor's principal is returned, alongside any potential coupon return.

Defensive features can be incorporated into the products, where equity indices may be some way below their initial level and the investors can still receive a return. Two examples of funds in this space are the AHFM Defined Return Fund and the Fortem Progressive Growth Fund.

We have introduced exposure to these strategies in our discretionary range recently and whilst we are confident that current valuations are underpinned by robust earnings, we feel exposure to these approaches helps to diversify return, particularly through bouts of increased volatility.

Strategy Returns Under Different Volatility Environments



Source: iShares, by BlackRock. Data shown is for 31/12/99-31/1220

Spotlight: Pension planning

Christian Poziemski Head of Wealth Planning

Introduction

It must be said, pensions are definitely not the most exciting topic for a spotlight article. However, pensions are complex, often misunderstood and the relevant pension legislation is nigh-on impossible to decipher. Pensions provide benefits that are worthwhile understanding and perhaps beyond the standard notion of an income stream in one's 'twilight' years.

This article does not attempt to cover every aspect of pension advice, but instead aims to outline the basic concepts of how you might make your pension work best for you. As with most things in life, with pensions there are options. Hopefully, this article will raise questions in your mind about how you wish to treat your pension. For example, you may choose to access your pension savings or alternatively consider preserving these assets as part of a transfer of wealth to the next generation. Inheritance Tax (IHT) planning is a key focus for our clients and the potential use of the pension pot forms an integral part of that discussion and we hope this article will provide food for thought and will aid future planning discussions.

Pensions are a tax-efficient savings vehicle which allows individuals to make annual contributions of up to £40,000. The carrot on HM Revenue and Customs' stick is the incentive of income tax relief on personal contributions and corporation tax relief on employer-sponsored contributions. Personal contributions receive basic rate tax relief with the ability to claim additional tax relief up to your marginal rate of income tax via the self-assessment tax return. Additionally, investment gains on the underlying pension assets are free from capital gains tax (CGT) as well as being ringfenced from inheritance tax (IHT).

You can access your pension during your lifetime and/or bequeath the benefits as part of a wider succession strategy on death. The current statutory minimum age for accessing your pension savings is 55, but this is due to rise to 57 in 2028.

Importantly, it is not necessary to retire to take benefits from your pension savings. Since 6 April 2015 (Taxation of Pensions Act 2014), individuals have been able to take as much or as little from their pension from the time they have reached the minimum age.

There are many different types of pensions but, following pension simplification on 6 April 2006 (referred to as A-day), there are two main types of pension schemes.

Firstly, Defined Benefit (DB), more commonly known as Final Salary pensions. The value of DB savings is based on time served and an applicable salary. DB benefits are sometimes referred to as 'gold plated' as they offer a guaranteed pension income for life regardless of the performance of the underlying investments. This guarantee is expensive and not surprisingly, new schemes are few and far between.

DB schemes are governed by their applicable scheme rules and primarily offer access to a guaranteed income. On the death of the pension member, a proportion of the income can pass to the surviving spouse or a dependant. However, unlike a personal pension, the underlying value of the pension asset cannot be passed to a nominated beneficiary.

The second is the Defined Contribution (DC) pension, also known as money purchase pensions. DC pension values are based on the total contributions and the underlying investment performance.

From a succession planning perspective, a consideration may be to review existing DB benefit to determine the suitability of a possible transfer of the underlying value to a personal pension scheme. By doing so, the DB assets are not 'lost' on the death of the surviving spouse, remain ringfenced for IHT and can be preserved for future beneficiaries.

Annual Allowance

Pension contributions can be paid by an individual, an employer or by a third party. The maximum contribution that is eligible for tax relief is the greater of £3,600 p.a. or 100% of your employment income.

The annual allowance is the total amount you can contribute during a tax year without incurring a tax charge. The annual allowance is currently set at £40,000.

In addition to receiving tax relief, pension contributions can also help regain some or all of your income tax allowance (£12,570 p.a.). The personal allowance is reduced by £1 for every £2 of income above £100,000 resulting in an effective rate of tax of 60% for income between £100,000 to £125,140.

The example below shows the impact of that a pension contribution of £10,000 (gross) would have for an individual with an income of £110,000:

	Before	After	Difference
Gross Income	£110,000	£110,000	-
Tax	£33,432	£27,432	£6,000
Balance	£76,568	£72,568	£4,000
Pension	£0	£10,000	£10,000

This means that for £4,000 less net income, the investor has managed to add a further £10,000 to their pension savings. The contribution has the effect of regaining the allowance, thereby increasing the amount of tax-free income as well as increasing the basic rate band. A contribution of £10,000 has saved £4,000 in tax and received tax relief in the pension of £2,000 – an effective rate of tax relief of 60%!

Lifetime Allowance

The Lifetime Allowance (LTA) was first introduced in 2006 and is the amount of pension savings that can build up in a tax-advantaged environment. The current LTA is £1,073,100 and is measured against the aggregated total of all pension savings. If your pension savings are within the LTA, no tax charge will be levied. Any excess is subject to a 'lifetime allowance excess tax charge' of 55% or 25% depending on how the assets are drawn. Since the introduction of the LTA, it has been possible to protect the LTA at a higher level and therefore your available LTA may be much higher.

The value of your pension assets will be tested against the LTA at one of 13 specific events (typically when the pension comes into payment) known as Benefit Crystallisation Event (BCE). Should you decide to pass on your pension assets to the next generation, the LTA test will take place at age 75. Pensions that are in drawdown will be re-tested at age 75 on the growth of the fund following the prior LTA test. A member's death will trigger a BCE regardless of age, except where the pension assets have previously been tested at age 75.

Taxation

Capital Gains Tax (CGT)	Not applicable. CGT does not apply on the growth of the underlying pension investments.
Inheritance Tax (IHT)	Not applicable. IHT does not apply for assets that remain within your pension.
Annual Allowance Tax Charge	Payable on the total contributions you make/receive that are in excess of the applicable annual allowance at your marginal rate of income tax.
Lifetime Allowance Tax Charge	Payable on the value of your pension in excess of the (applicable) Lifetime Allowance at the point of accessing your pension or at age 75.
Tax-Free Cash	Tax-Free. Typically, 25% of the fund value or the available Lifetime Allowance. Important, once the lump sum has been paid into your estate, it will be subject to IHT. You can access your tax-free cash from age 55 until age 75 after which the option will expire.

Pension Drawdown – Income Options

As we said above, the key things to be aware of with your pension are your options. You have an important choice on how the benefits should be taken. The first choice to consider is whether to take advantage of withdrawing tax-free cash. If you also wish to receive a regular income, most registered pension schemes can pay an income in two different ways - as secured pension income or as flexible income. Secured pension payments are guaranteed for life and are available via a scheme pension or an annuity. If you would prefer a more flexible income a flexi-access drawdown pension may be an option to consider.

The table below lists the main income options available during a member's lifetime.

Payment	Type	Taxation	Expiry
Secured/ Guaranteed	Scheme pension	Income	Lifetime
Secured/ Guaranteed	Lifetime Annuity	Income	Lifetime
Flexible/not guaranteed	Flexi-access drawdown	Income	Lifetime (subject to available funds)

Flexi-access drawdown offers flexible income directly from the pension fund. Flexi-access income is not guaranteed insofar as it can only be paid if the pension has sufficient assets to meet the income requirements. Historically, income could also be accessed via capped drawdown which is no longer available as funds needed to be designated into capped drawdown prior to 6 April 2015.

Tax-free Cash Option

As part of drawing an income from your pension, you would likely consider the withdrawal of your Pension Commencement Lump-sum (PCLS), more commonly known as tax-free cash. The PCLS is typically 25% of your fund value or up to a maximum of 25% your available LTA.

An Uncrystallised Funds Pension Lump Sum (UFPLS) offers access to some or all of your uncrystallised or unused pension as a lump sum.

One common misconception we often observe is how benefits are treated for IHT. The decision to access tax-free cash or draw an income does NOT in fact 'adversely' impact your IHT liability as the pension will remain ringfenced from IHT.

Uncrystallised/Unused Pensions

Taking benefits from your pension is a crystallisation event. Therefore, a pension is said to be uncrystallised if the savings have not been accessed. Pension savings could also be classed as unused.

Unused (funds) is the term used by HMRC to describe funds that have not been crystallised but where the member has reached age 75. The reason the term changes from uncrystallised to unused is because they have been tested against the member's LTA and therefore, any future beneficiaries will not incur any further LTA tax.

What happens when I die?

Upon death, your pension can pass to a dependant, a nominee or a successor. Upon death, your pension can be passed on to a dependant, a nominee or a successor. The decision on who this will pass to must be decided upon within two years following the member's passing.

Relevant to long-term inheritance tax planning, pension funds received by the beneficiary can be passed on again on their death to a nominated successor. This makes the pension an effective inter-generational IHT planning tool.

With the payment of death benefits, two factors will determine the tax treatment of the pension assets and the taxation of the benefits in the hand of the recipient.

The factors are:

1 Whether the member's death occurred pre or post age 75, and

2 If the pension value is in excess of the LTA.

For an uncrystallised/unused pension, where the member dies BEFORE age 75, the value of assets will be tested against the applicable LTA before the asset can be paid to the beneficiary who will have no further tax liability. If the pension fund is in excess of the LTA, the responsibility to pay the tax lies with the executors.

For an uncrystallised/unused pension, where the member dies AFTER age 75, the assets are not tested against the LTA as this will have happened automatically at age 75. Post age-75 lump-sum payments paid directly to the beneficiary are taxable at the recipient's income.

With a pension already in drawdown (capped or flexi-access), it is again relevant whether the member's death occurred pre or post age 75.

For those in drawdown, where the member's death occurs pre age 75, the payment is not subject to tax and is not tested against the LTA (as this will have already occurred at the point of crystallisation). Conversely, where the member's death occurred post age 75, the payment will be taxable. Where it is payable directly to the beneficiary, it is taxable as the recipient's income.

To draw this article to a close (thankfully I hear you say), pensions have historically been equated by the simple formula of Pensions = Income in retirement. Whilst for many this may still be the case, pensions offer additional benefits which we urge our clients to consider. These benefits are significant and are more akin to a trust. The biggest benefits are tax-free growth, inheritance tax protection and the ability to pass assets to successive generations.

You will perhaps agree with me that it is difficult to describe pensions in a nutshell. It has certainly been a challenge to avoid being overly technical, yet relevant but it is probably impossible to make it captivating.

However, we hope it has triggered your interest in your specific pension objectives and if nothing else, you may wish to consider the following questions:

1 What types of pensions do I have?

2 What is the objective for my pension?

3 Is my pension currently in line with my life ambitions?

4 What are the relative benefits of maximising my pension contributions?

5 Is it sensible to let my pension assets grow beyond the Lifetime Allowance?

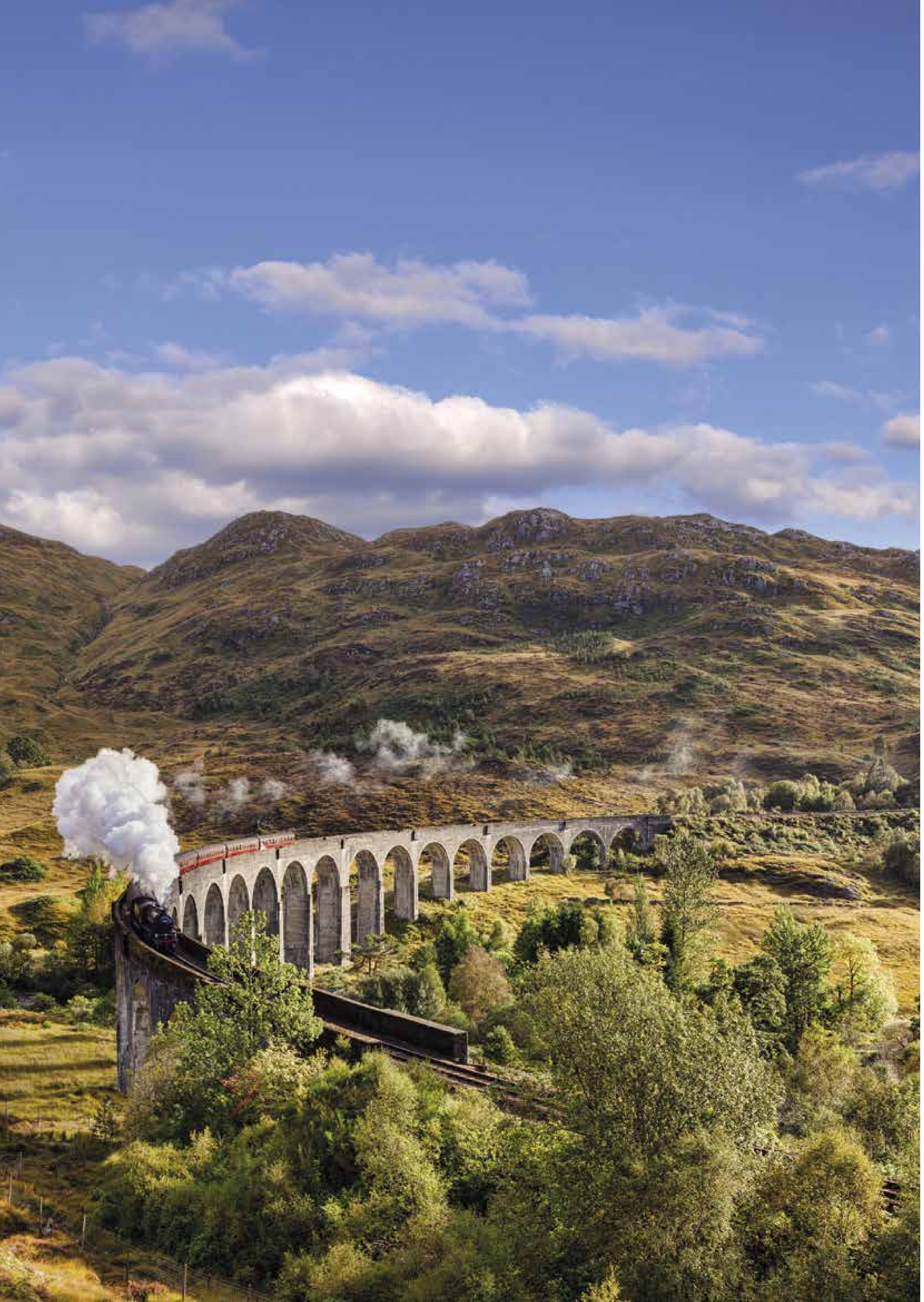
6 Should I take tax-free cash if it does not affect my IHT position?

7 Do I benefit from a higher Lifetime Allowance? And if so, have I informed my administrator?

8 Should I draw assets before age 75 in advance of the automatic LTA test?

9 Do I want to leave my pensions assets to the next generation?

10 Have I nominated my beneficiaries and who should I choose in the context of a long-term IHT strategy?



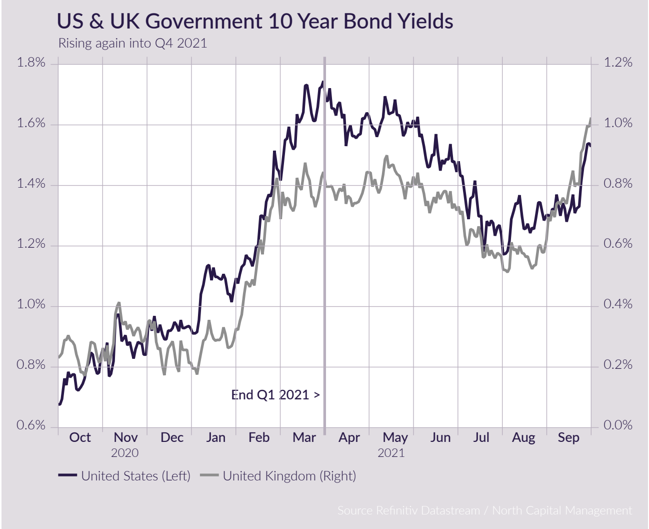
Market overview: Macroeconomic overview

Daniel Brawley Investment analyst

The past six months ended with bond yields at the epicentre of financial markets, much like they were in our last publication. Government bond yields represent the borrowing rate for governments over a certain timeframe, but this single value contains a concoction of expectations on economic growth; inflation; monetary policy; and fiscal / political stability (mostly in emerging economies). The United States 10-year yield is one of the most followed metrics in capital markets and has been rising again since the end of July. The main catalyst has been expectations of "tighter" monetary policy from central banks, via higher interest rates and reduced quantitative easing. More precisely, the trigger has been monetary policy becoming tighter at a faster pace than previously expected.

Rising yields once again had a negative impact on equities, with the S&P 500 falling -4.7% in September, marking its worst month since the start of the pandemic. Central banks base policy decisions on inflation, economic growth, and employment; although inflation has recently taken centre stage as we have seen some of the highest rates since 2000. Most central banks have said that currently high levels of inflation are transitory and will normalise, citing low base effects (comparing to depressed prices early in the pandemic) and short-term supply constraints. Supply chain issues have certainly been visible, with shortages in almost everything from toilet paper to new cars. With demand overwhelming supply, some normalisation is required for inflation to abate; however, global supply chains are highly complex and restarting them has so far proved tricky.

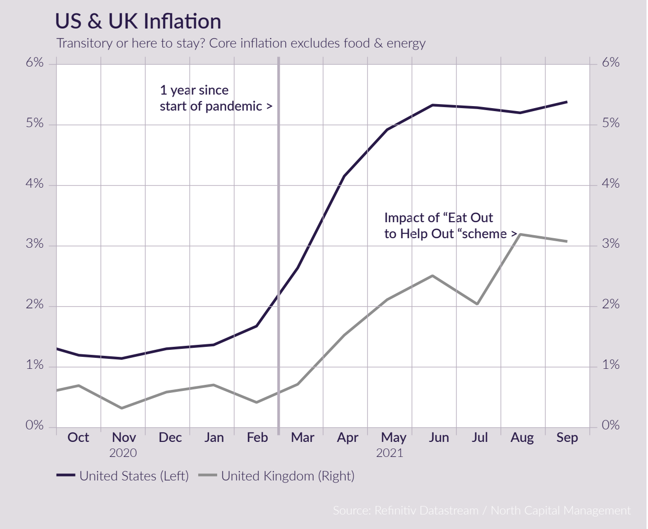
When policy makers consider economic growth, they refer to the change in economic output (GDP). This is adjusted for inflation and known as "real GDP". Although there has been a strong rebound since the worst of the pandemic, at the end of the second quarter output in the United States had only just surpassed pre-COVID levels. Output in the United Kingdom was still below pre-COVID levels, but this is expected to change when the Q3 data is released due to the easing of COVID restrictions. It is tempting to fixate on the recently high growth rate due to low base effects; for example, GDP in the United Kingdom increased 24% year-on-year in Q2 2021 due to the economy collapsing in Q2 2020, but the average annual growth rate over 2000-2019 was only 2%. Growth will inevitably decline but is forecast to remain strong and above trend for the next couple of years.



US & UK Government 10 Year Bond Yields

Rising again into Q4 2021

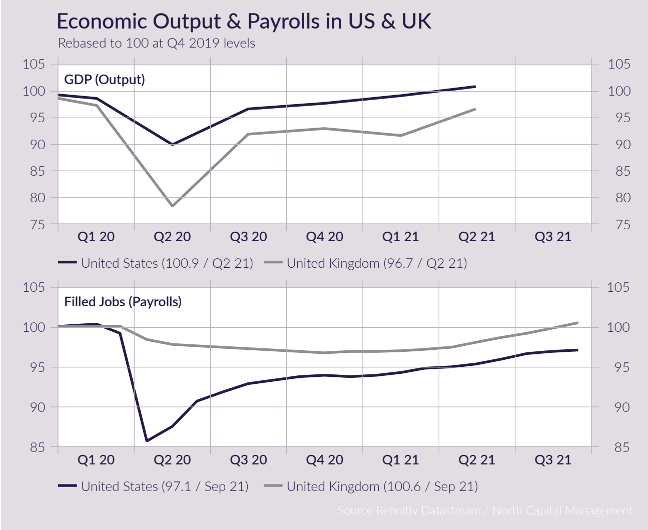
Source Refinitiv Datastream / North Capital Management



US & UK Inflation

Transitory or here to stay? Core inflation excludes food & energy

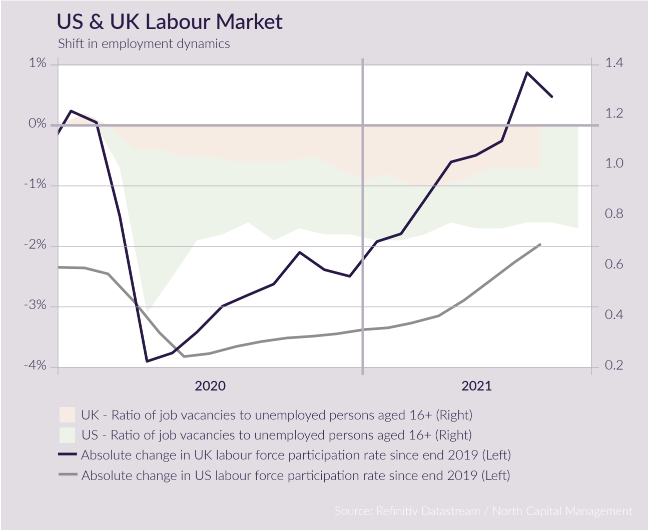
Source: Refinitiv Datastream / North Capital Management


Economic Output & Payrolls in US & UK

Rebased to 100 at Q4 2019 levels

Source: Refinitiv Datastream / North Capital Management

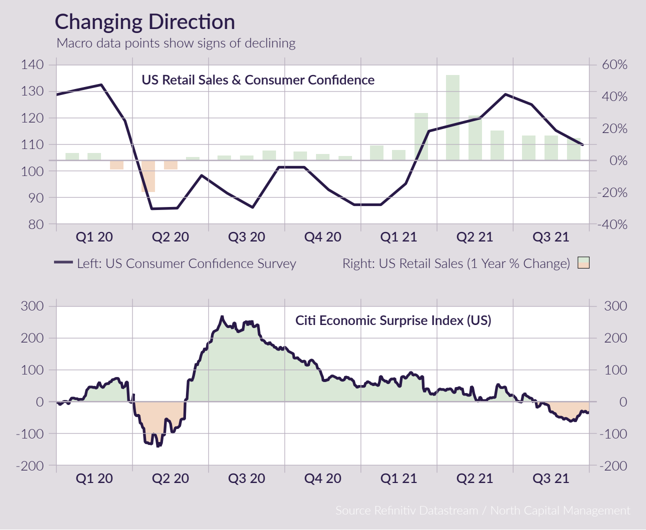
The chart above also shows that the number of filled jobs (payrolls) is below pre-pandemic levels in the US; it is marginally higher in the UK but below pre-pandemic projections. Reduced payrolls are partly due to the direct results of COVID which have discouraged labour market participation (e.g. caring for children staying at home or having the ability to rely on unemployment benefits) but there are also structural changes impacting the labour market. For example, more people than usual retired during the pandemic, and the shift to remote working has encouraged "jobs" not captured in traditional employment data (e.g. Instagram influencer). Furthermore, the ratio of job vacancies to unemployed persons has increased rapidly, and in the United States there are now more job openings than there are people unemployed (i.e. ratio above 1). People may either not want the jobs that need filling (think HGV driver crisis in the UK) or are unable to transfer skills once important to jobs lost during the pandemic.


US & UK Labour Market

Shift in employment dynamics

Source: Refinitiv Datastream / North Capital Management

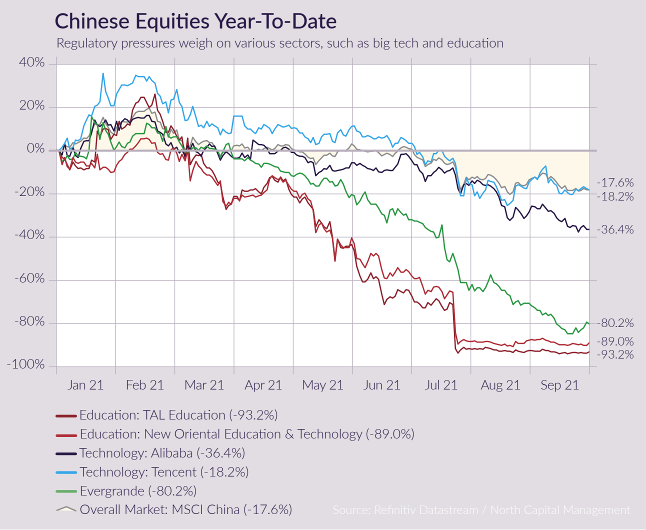
It is evident that we are going through a period of substantial structural change. The pandemic resulted in widespread economic collapse that was swiftly followed by a rapid, yet bifurcated, rebound. This low-to-high pattern can be seen in many economic and financial datasets, especially those focused on rates of change due to low base effects. As we enter the new "normal" these high values will either revert to historical means or persist due to fundamental regime changes. The top chart below shows two examples of this in the United States through retail sales and consumer confidence. The bottom chart provides a high level view on how actual economic data compared to economist expectations; interestingly it shows a similar pattern, with "surprises" to the upside (data better than expected) having gradually declined since peaking in Q3 2020.


Changing Direction

Macro data points show signs of declining

Source: Refinitiv Datastream / North Capital Management

Away from the Western world, China has been in the spotlight for a number of reasons. Having initially been one of the strongest large economies early in the pandemic (due to strict containment of the virus) it has recently shown signs of waning momentum, with disappointing retail sales and industrial production. A more direct impact on equity markets has been due to waves of regulatory crackdowns, with Beijing targeting various sectors from education to cloud computing. The second largest domestic property developer, Evergrande, also weighed on risk sentiment in September due to its potential default on high levels of debt; although the Communist Party is unlikely to bail out the company, the risk of a widescale contagion in the event of its collapse is relatively low.


Chinese Equities Year-To-Date

Regulatory pressures weigh on various sectors, such as big tech and education

Source: Refinitiv Datastream / North Capital Management

Market overview:
Asset class round up

Connor Davidson Investment Analyst

Equities:

- Equities continued their solid performance over this six-month period with most major indices seeing modest gains as economies continued to rebound from the pandemic as vaccine programmes progressed.
- Second quarter earnings were broadly positive with many companies, especially within the US, beating earning expectations.
- Markets have softened in September as concerns surrounding China's largest property developer, Evergrande, - who has failed to pay interest payments on its debts – have led to fears that the fallout could cause contagion across broader international markets.
- Inflation fears have also weighed on markets in September as central banks have raised inflation expectations while hinting at rate rises in the near future.

Bonds:

- Ten-year yields in the US had initially fallen from their year highs set in March but picked up again towards the end of September.
- UK's benchmark bond yield, ten-year gilts, has risen sharply surpassing 1% where it has not traded regularly since May 2019.
- The main catalyst for this uptick is increased inflation expectations which is likely to be proceeded by a corresponding increase in interest rates.

Oil:

- Oil prices have seen a sustained rise over the past six months, finally surpassing pre pandemic levels. Prices briefly topped $80 per barrel (pb), for the first time in three years before finishing September at $78 pb.
- Prices have risen as demand for oil has continued to surge, largely driven by increased consumption across most sectors of the economy as pandemic restrictions are lifted. Although consumption is yet to surpass 2019 highs.
- OPEC+ have continued to keep supply tight, despite the phasing out in August of pandemic induced supply cuts, further adding strength to price levels. Shale producers within the US have also struggled to keep up with demand after years of underinvestment in drilling sites.

Currency:

- Major currencies pairs have remained largely unchanged from the levels they began this six-month period on. With the dollar finishing only slightly stronger against most major currencies.
- The pound performed well throughout May this year against the dollar, reaching $1.42 for the first time in almost three years as the UK saw improved economic data. However, this slumped to $1.35 by the end of September as the fuel crisis compounded fears that an economic slowdown is on the horizon.
- The dollar climbed back to its end of March high against a basket of major currencies as the market reacted to the increased likelihood that the Federal Reserve will begin to taper back the large monetary stimulus which has been seen over the last eighteen months.

Hedge Funds:

- Hedge fund returns have remained volatile across this six-month period with returns differentiating significantly among investment approaches.
- Returns within hedge fund portfolios as a whole has been positive although they have remained largely in line with market indices.

Private Equity:

- Private equity has continued its strong recent performance as it has proved to be resilient across both the recent pandemic as well as in the early stages of recovery.
- Deals amongst distressed companies have decreased as governments have been able to prop these companies up over the pandemic period through initiatives such as the Furlough scheme.
- Private equity funds have been busy, with total deal value across the industry set to surpass recent yearly records.

Precious metals:

- Precious metals have performed disappointingly across this six-month period, with all four (Gold, Silver, Platinum and Palladium) finishing September close to their year lows.
- Gold has seen a modest rise in price since March, while Platinum and silver have fallen consistently across this period to reach year lows. Palladium has been the worst performer with prices for the rare metal being in freefall since August.

Cryptocurrency:

- Bitcoin headed in a volatile downward trajectory dropping 25% over the last six months to reach a price of $43,800 on the 30th of September. Other cryptocurrencies such as Ethereum have seen modest gains over the period while also experiencing cryptos trademark volatility.
- Bitcoin's fall has been driven largely by fears of increased regulation from governments after China banned financial institutions and payment companies from any activities related to cryptocurrencies.
- This follows the turbulent implementation of Bitcoin as legal tender in El Salvador which saw technical difficulties and even protests, with the price dropping 10% during the first day.
- Although increased adoption has been seen with well-established payment companies such as PayPal adding Bitcoin to their payment wallets, as well as positive noises being made from both Visa and MasterCard.

Market overview: So what does this mean for investors?

Equities

- Equities look to continue their impressive rebound from the pandemic as earnings growth is expected to continue.
- While the post COVID economic growth begins to slow there are concerns surrounding inflation and the resultant changes to monetary policy, this seems likely to result in equity market volatility.
- US markets continue to perform well while opportunities exist in less favoured markets such as the UK.
- Diversification across both value and growth companies, as well as between large-cap and small-cap, will be key as demand continues to increase.
- The economic backdrop for equities continues to look positive, albeit potentially more volatile, active management will play a pivotal role in selecting the best performing stocks.

Fixed Income

- Inflation will continue to be the main concern for fixed income investors.
- We have yet to see any concrete evidence of inflation rates dampening and expectations are, at least in the short term, that they will stay above central bank targets.
- As bond yields have risen across this six-month period, it is expected that tapering of pandemic induced stimulus will be introduced and central banks may be pressured to increase interest rates.
- Higher quality emerging market and corporate bonds could offer higher yields while developed market government bonds continue to offer poor returns.
- Some opportunities will persist among fixed income securities while it will remain an important tool in the diversification and risk management of portfolios.
- Bonds are still and important asset class for many investors even if yields are rising and prices are falling.

Alternatives

- With increased asset price volatility we would expect the diversification benefit provided by alternatives to become more clear-cut.
- Precious and industrial metals have been mixed with gold remaining static but others such as Silver, Platinum and Palladium falling significantly since April, further volatility expected.
- The pick-up in inflation (which we believe is temporary) supports the investment case for alternative assets such as real estate and infrastructure.
- As demand for some materials has rocketed so have prices - cement, timber and steel in particular, no sign of this pressure reversing.
- Hedge funds continue to provide a complimentary benefit in well-diversified portfolios.
- Activity in the private equity sector has increase significantly as post-pandemic opportunities start to emerge and looks set to increase.

Noteworthy

Two Horses' Asses

The US standard railroad gauge (distance between the rails) is 4 feet, 8.5 inches. That's an exceedingly odd number. So why did the Brits who built these railway tracks do so to such a precise measurement?

Because the first rail lines were built by the same people who built the first wagon tramways, and that's the gauge they used. So, why did 'they' use that gauge then?

These original wagons needed to have a particular wheel spacing for the tramways in order to maximise their strength and durability on the relentless old and long-distance roads in England. We can point the finger at the Imperial Romans for building these long-distance roads. So why did they go for the 4 feet, 8.5 inches option?

Roman war chariots formed the initial ruts, which everyone else had to match or run the risk of destroying their wagon wheels. Therefore, the US standard railroad gauge of 4 feet, 8.5 inches is derived from the original specifications for an Imperial Roman war chariot. Bureaucracies live forever.

So, the next time you are handed a process and wonder 'What horse's ass came up with this?', you may be exactly right. Imperial Roman army chariots were made just wide enough to accommodate the rear ends of two war horses.

Take two...

Egypt's Suez Canal recently saw the return of the 200,000-ton troublemaker, the Ever Given.

The colossal container ship became grounded in late March of this year, wreaking havoc on the world's global supply chain, bringing an estimated $9.6bn of trade per day to a screeching halt.

After 3 months of impoundment, one death and a $550m fine the ship made the trip back along the canal and on the high seas; we can only hope with a new skipper at the helm.

The Magic Box

It is claimed that whilst in the bath, inventor John Shepherd-Barron first concocted the idea of an automated teller machine (ATM).

Barclays loved the idea so much that they immediately jumped on board and by 1967 the first bank notes started spilling out of these magic boxes in the wall. A slight catch was that original card itself contained the isotope Carbon 14. A little bout of radiation was a small price to pay, however, as the early ATMs didn't charge a fee.

It has now been more widely recognised that it was a Mr. Goodfellow who first had the idea of the ATM patented, and it is thanks to him that we have the radiation-free plastic cards and PIN codes we use today.

Testament to these inventors' invention came in December of 2016 when a record £730m was withdrawn in a single day from ATMs in the UK.

Floating Gold

A small group of Yemeni fishermen and their local communities have been lifted out of poverty following the miraculous discovery of something called 'ambergris'.

This little known, solid, waxy, dull grey substance is unique to sperm whales and grows inside their intestines over the years until the whale either dies or dumps it in the ocean. It is rare though, being found in less than 5% of carcasses.

So, what's all the fuss about?

It's worth a small fortune. Ambrein, an odourless alcohol, can be extracted from the ambergris and is used to make a perfume's scent last longer. As such, this haul of 'whale vomit' found by these fishermen was valued at a staggering £1.1m. But don't let that put you off next time you give yourself a spray.

Disclaimer

All data as at 30th September 2021

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Asset Class	Index Name
Corporate Bonds	Bloomberg Barclays Global Aggregate Corporates
Government Bonds	Bloomberg Barclays Global Treasury
Oil	Bloomberg Brent Crude Sub
Gold	Bloomberg Gold Sub
UK Property	Nationwide UK House Price Index
Hedge Funds	IA Targeted Absolute Return
GBP Cash	LIBOR GBP 3 Months
EM Equities	MSCI Emerging Markets
Developed Equities	MSCI World

Total Return. Local Currency. Source: Lipper

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