Professional Portfolio International

momentum
global investment management

GLOBAL MATTERS
MONTHLY VIEWPOINT

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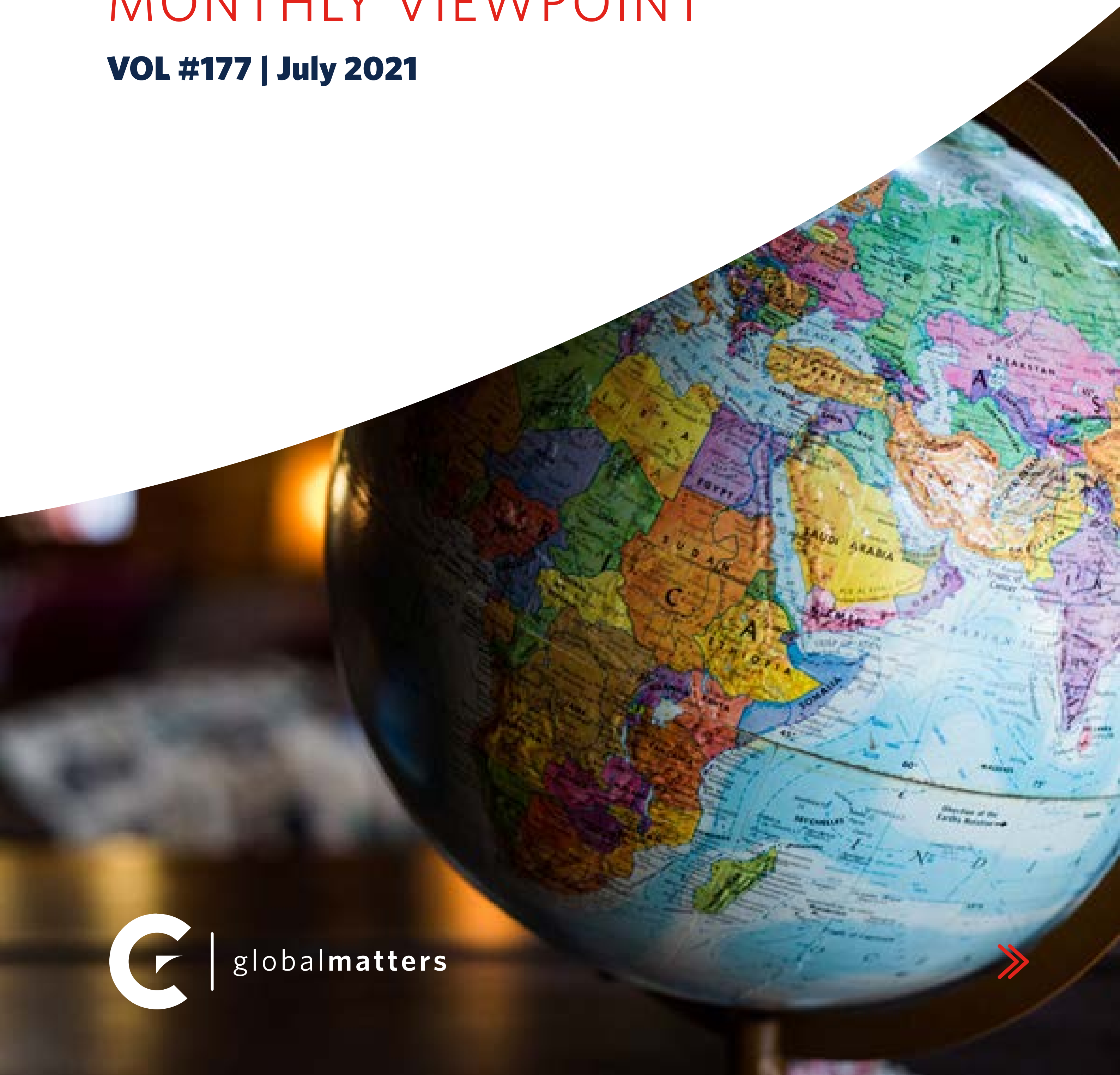

globalmatters

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MARKET REVIEW

In the face of a rapid spread of the delta variant, with daily Covid case numbers up almost 80% in July from June levels, concerns about the sustainability of growth re-emerged. While the spread of the variant is global, its impact falls disproportionately on the developing world, where the vaccine roll-out is much slower than in the developed world and the room for policy support is more limited. The imposition of renewed restrictions in many countries, notably across Asia, raises the prospect of delays in the economic recovery underway and a slower rate of growth ahead. Markets reacted by driving down yields on bonds: the US 10 year Treasury bond yield fell to 1.22% by the end of July, a drop of 25bps in a month, continuing the sharp falls seen in Q2. All of the fall in July was accounted for by a drop in real yields, from -0.87% at the end of June to -1.18% at the end of July, levels rarely seen in history, and which seem unsustainable in the absence of much sharper falls in growth and inflation than currently expected.

The result was a very strong month for bond markets generally, with US Treasuries returning +1.3%, Euro government bonds +1.8%, UK gilts +2.8%, and US Treasury inflation-linked bonds +2.8%, while in equities, growth and quality stocks moved higher with tech and healthcare leading the way while 'reflation trade' stocks lagged. As might be expected under these circumstances, the US market, with its higher weighting towards growth stocks, led the way, up 2.3%. Asian markets lagged, with Japan down 2.2%, but the biggest falls came in emerging markets, with the global EM index down 6.7% in the month, leaving it flat over the year to date, compared with a gain of 15% in the MSCI World index of developed markets.

While the renewed spread of Covid across Asia and other parts of the developing world has become a significant short-term headwind to emerging markets, it was the dramatic further tightening of regulations on the private corporate sector in China which most shook investors. The first warning signs of a regulatory clampdown came late last year with the abrupt cancellation of the IPO of Ant Group, the Alibaba affiliate. This was followed by a series of sanctions and tightened regulations on China's big tech and internet-oriented companies, including Alibaba, Tencent, Meituan and ride hailing firm Didi (timed to perfection, two days after its listing in the US). But the hammer blow came in late July with the over-night crackdown on the after-school tutoring industry, making it a non-profit activity barred from foreign participation. Shares in this sizeable sector listed overseas had been falling sharply from mid-February, along with the big tech companies, but collapsed by 70-80% in two days in late July, taking China's market with them as investors reacted to the impaired profitability and heightened risk of further crackdowns. The MSCI China index, which has a high weight in China's offshore listed companies through variable interest entities, a structure which has given Chinese companies access to foreign capital without explicit formal approval from China's regulators, fell by 14% in July, and 30% from its February peak. Hong Kong followed, down 10% in July, but the more domestically oriented index, Shanghai Composite, held up better, down 5% in the month and 8% from its February peak.

MARKET REVIEW CONT...

Source: Bloomberg Finance L.P, Momentum Global Investment Management

Given the size and global importance of China's economy and stock market, these developments raise serious concerns. Understanding the rationale behind the crackdown is difficult given the opaque and abrupt way in which decisions are taken and communicated in China. The country is not alone in recognising that regulatory oversight has not kept pace with the extraordinary growth, reach and influence of its online sector, but other factors including anti-trust, abuse of market power, data protection, national security, cybersecurity, financial stability, socio-economic and geopolitical factors all seem to have played a part.

We do not believe that China is intent on destroying its global leadership ambitions in technology nor in threatening its thriving private sector, its access to international capital markets and the internationalisation of its currency and asset markets. But the clampdown is a timely reminder of the pre-eminence of the Chinese Communist Party (CCP) in all aspects of life in China, and despite decades of liberalising reforms and a remarkably innovative private sector, their model of state capitalism has inherent risks that are not found elsewhere. With its centennial anniversary upon us and under the leadership of President Xi, it appears the CCP is becoming bolder in asserting its clout, whether that means over-riding its legal obligations like Hong Kong's Basic Law, its de facto constitution, or draconian domestic action with severe financial consequences to rein in private sector practices which risk undermining central control.

MARKET REVIEW CONT...

In our view, this does not make China uninvestable, as some commentators fear, but it does mean that the discount applied to Chinese securities should be sufficiently large to recognise the uncertainties and risks. Appropriately valued and sized, investments in China offer relatively high, albeit slowing, growth opportunities, and periodic sell-offs such as those of the past six months create a longer term buying window.

Earlier this year, investors' biggest worry was the prospect of a surge in inflation as economies reopened. In the event, inflation came in substantially above expectations – the June headline CPI in the US was 5.4% year-on-year and core CPI 4.5%, the fastest since 1991, yet markets were unmoved. Ten-year inflation expectations have remained anchored around the 2.3-2.4% area, the consensus view shares the narrative of central banks that the rise is transitory, bond yields have fallen sharply, and we are probably now at peak inflation levels as base effects fall away and peak levels of pent-up demand are reached. However, we are mindful of the wide range of companies pointing to supply chain constraints, shortages of materials and input price rises, and still see a risk of a test of the Fed's resolve if inflation remains materially above target with an impact on wage rises and inflation expectations.

MARKET REVIEW CONT...

US 10 Year Real Yield

Source: Bloomberg Finance L.P, Momentum Global Investment Management

It is clear, though, that all the major central banks will keep monetary policy very loose for a considerable time. The Fed is likely to begin to reduce its huge asset purchase programme before year end, but this is being well flagged and interest rate rises are a long way off, while the ECB has moved to an asymmetric inflation target of 2%, giving it room to allow inflation to move above target for a period, and has no interest rate rise in sight for years. A combination of highly accommodative monetary policy and continuing fiscal support underpins growth prospects for this year and next, albeit at lower levels than the immediate post-pandemic recovery surge, but still a strong tailwind for corporate earnings.

We therefore remain broadly constructive about risk assets. Given the strength of equity markets over the past year, returns are likely to be harder to come by in the very short term. The recent surge in Covid cases presents short term headwinds to growth but vaccines now clearly show the route out of the pandemic, and financial conditions will remain very easy. This is likely to underpin a long market cycle and we believe that patience and true diversification will be well rewarded in the year ahead.

MARKET PERFORMANCE - GLOBAL
(LOCAL RETURNS)

Asset Class/ Region	Index	To 31 July 2021				
		Ccy	1 Mth	3 Mths	YTD	12 Mths
Developed Markets Equities						
United States	S&P 500 NR	USD	2.3%	5.4%	17.7%	35.8%
United Kingdom	MSCI UK NR	GBP	0.2%	1.9%	11.5%	23.1%
Continental Europe	MSCI Europe ex UK NR	EUR	2.1%	6.9%	17.6%	32.6%
Japan	Topix TR	JPY	-2.2%	0.3%	6.5%[e]	29.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-6.6%	-5.5%	-0.2%	20.6%
Global	MSCI World NR	USD	1.8%	4.8%	15.1%	35.1%
Emerging Markets Equities						
Emerging Europe	MSCI EM Europe NR	USD	0.2%	12.0%	14.7%	30.2%
Emerging Asia	MSCI EM Asia NR	USD	-8.1%	-6.9%	-2.6%	18.2%
Emerging Latin America	MSCI EM Latin America NR	USD	-4.1%	6.4%	4.5%	25.3%
China	MSCI EM China NR	USD	-9.7%	-6.1%	-4.9%	10.3%
BRICs	MSCI BRIC NR	USD	-13.8%	-13.1%	-12.3%	0.3%
Global emerging markets	MSCI Emerging Markets NR	USD	-6.7%	-4.4%	0.2%	20.6%
Bonds						
US Treasuries	JP Morgan United States Government Bond TR	USD	1.3%	2.4%	-1.6%	-3.5%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	USD	2.8%	4.8%	4.4%	6.8%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	1.4%	3.8%	0.1%	1.4%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	0.4%	2.0%	4.0%	10.6%
UK Gilts	JP Morgan UK Government Bond TR	GBP	2.8%	4.0%	-3.2%	-4.3%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.5%	2.5%	-1.0%	1.7%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	1.8%	2.3%	-1.2%	0.6%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.1%	1.4%	0.7%	3.2%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	0.4%	1.2%	3.5%	9.8%
Japanese Government	JP Morgan Japan Government Bond TR	JPY	0.6%	0.6%	0.4%	0.1%
Australian Government	JP Morgan Australia GBI TR	AUD	2.1%	3.4%	-0.3%	-0.3%
Global Government Bonds	JP Morgan Global GBI	USD	1.6%	1.6%	-3.1%	-1.7%
Global Bonds	ICE BofAML Global Broad Market	USD	1.3%	1.5%	-2.2%	-0.3%
Global Convertible Bonds	ICE BofAML Global Convertibles	USD	-1.0%	-0.1%	4.4%	29.9%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	0.6%	3.1%	-2.5%	1.3%

MARKET PERFORMANCE (LOCAL RETURNS) CONT...

Asset Class/ Region	Index	To 31 July 2021				
		Ccy	1 Mth	3 Mths	YTD	12 Mths
Property						
US Property Securities	MSCI US REIT NR	USD	4.8%	8.4%	27.1%	37.6%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	0.3%	6.2%	8.0%	28.0%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-3.9%	-3.6%	2.9%	12.9%
Global Property Securities	S&P Global Property USD TR	USD	2.4%	5.1%	16.6%	30.9%
Currencies						
Euro		USD	0.1%	-1.2%	-2.8%	0.8%
UK Pound Sterling		USD	0.5%	0.6%	1.7%	6.3%
Japanese Yen		USD	1.3%	-0.3%	-5.8%	-3.5%
Australian Dollar		USD	-2.1%	-4.8%	-4.5%	2.8%
South African Rand		USD	-2.2%	-0.8%	0.6%	16.9%
Commodities & Alternatives						
Commodities	RICI TR	USD	1.7%	7.7%	30.6%	53.9%
Agricultural Commodities	RICI Agriculture TR	USD	-0.2%	-0.9%	19.6%	51.4%
Oil	Brent Crude Oil	USD	1.6%	13.5%	47.4%	76.3%
Gold	Gold Spot	USD	2.5%	2.5%	-4.4%	-8.2%
Hedge funds	HFRX Global Hedge Fund	USD	-0.4%[e]	0.4%[e]	3.3%[e]	10.1%[e]
Interest Rates				Current Rate		
United States				0.25%		
United Kingdom				0.10%		
Eurozone				0.00%		
Japan				-0.10%		
Australia				0.10%		
South Africa				3.50%		

MARKET PERFORMANCE - UK

(GBP RETURNS)

Asset Class/Region	Index	To 31 July 2021				
		Ccy	1 Mth	3 Mths	YTD	12 Mths
Equities						
UK - All Cap	MSCI UK NR	GBP	0.3%	2.0%	11.6%	23.3%
UK - Large Cap	MSCI UK Large Cap NR	GBP	-0.6%	1.3%	10.8%	19.3%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	3.0%	3.7%	12.7%	33.8%
UK - Small Cap	MSCI Small Cap NR	GBP	2.4%	0.8%	13.1%	40.1%
United States	S&P 500 NR	USD	1.6%	4.9%	15.6%	28.0%
Continental Europe	MSCI Europe ex UK NR	EUR	1.5%	4.9%	12.0%	25.7%
Japan	Topix TR	JPY	-1.7%	-0.6%	-2.0%[e]	17.9%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-7.3%	-6.0%	-2.0%	13.7%
Global developed markets	MSCI World NR	USD	1.1%	4.3%	13.0%	27.3%
Global emerging markets	MSCI Emerging Markets NR	USD	-7.4%	-4.9%	-1.6%	13.7%
Bonds						
Gilts - All	ICE BofAML UK Gilt TR	GBP	2.9%	4.1%	-3.1%	-4.2%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	GBP	0.1%	0.2%	-0.6%	-0.6%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	GBP	1.4%	2.4%	-2.4%	-2.9%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	GBP	5.5%	7.6%	-4.7%	-6.4%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	GBP	6.3%	9.1%	3.1%	1.4%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15	GBP	2.8%	4.8%	1.5%	0.4%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+	GBP	8.4%	11.8%	3.9%	1.7%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.5%	2.5%	-1.0%	1.7%
US Treasuries	JP Morgan US Government Bond TR	USD	0.6%	1.9%	-3.2%	-8.9%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	0.7%	3.4%	-1.6%	-4.3%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	0.4%	2.0%	4.0%	10.6%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	1.8%	2.3%	-1.2%	0.6%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.1%	1.4%	0.7%	3.2%
Euro High Yield	BBgBarc European High Yield 3% Constrained	EUR	0.4%	1.2%	3.5%	9.8%
Global Government Bonds	JP Morgan Global GBI	GBP	0.9%	1.0%	-4.9%	-7.4%
Global Bonds	ICE BofAML Global Broad Market	GBP	1.3%	1.5%	-2.2%	-0.3%
Global Convertible Bonds	ICE BofAML Global Convertibles	GBP	-1.0%	-0.1%	4.4%	29.9%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	-0.1%	2.6%	-4.2%	-4.5%

MARKET PERFORMANCE (GBP RETURNS) CONT...

Asset Class/Region	Index	To 31 July 2021				
		Ccy	1 Mth	3 Mths	YTD	12 Mths
Property						
Global Property Securities	S&P Global Property TR	GBP	1.6%	4.6%	14.5%	23.4%
Currencies						
Euro		GBP	-0.4%	-1.9%	-4.5%	-5.2%
US Dollar		GBP	-0.5%	-0.6%	-1.7%	-5.9%
Japanese Yen		GBP	0.8%	-1.0%	-7.4%	-9.2%
Commodities & Alternatives						
Commodities	RICI TR	GBP	1.0%	7.2%	28.2%	45.1%
Agricultural Commodities	RICI Agriculture TR	GBP	-0.9%	-1.4%	17.5%	42.7%
Oil	Brent Crude Oil	GBP	0.9%	12.9%	44.7%	66.1%
Gold	Gold Spot	GBP	1.8%	2.0%	-6.1%	-13.5%

Interest Rates	Current Rate
United Kingdom	0.10%
United States	0.25%
Eurozone	0.00%
Japan	-0.10%

Q2 MARKET REWVIEW
MARKET PERFORMANCE (GLOBAL)
MARKET PERFORMANCE (UK)
ASSET ALLOCATION DASHBOARD

ASSET ALLOCATION DASHBOARD

Main Asset Classes	Change	Negative	Neutral	Positive
Equities	-	○ ○	●	○ ○
Fixed Income	-	○ ●	○	○ ○
Alternatives	-	○ ○	○	● ○

Our Overall View

We continue to favour equities over fixed income in recognition of their leverage to a sustained global economic recovery. Most fixed income looks expensive today against the reflationary backdrop but pockets of credit offer some value. Alternatives, including in favour infrastructure, are attractive for their diversifying qualities as much as the return potential.

EQUITIES	Change	Negative	Neutral	Positive
Developed Equities	-	○ ○	●	○ ○
UK Equities	-	○ ○	○	● ○
European Equities	-	○ ○	●	○ ○
US Equities	-	○ ●	○	○ ○
Japanese Equities	▲	○ ○	○	● ○
Emerging Market Equities	-	○ ○	●	○ ○

Equities offer the potential for decent forward returns as the global economy leaves the pain of 2020 behind. Huge stimulus programs, central bank support and pent up consumer demand and savings paint a favourable backdrop. The UK looks attractive as it shakes off its Brexit discount and is well positioned sectorally to benefit from the economic recovery. We also favour Japan on valuation grounds and for the accompanying Yen exposure.

FIXED INCOME	Change	Negative	Neutral	Positive
Government	-	○ ●	○	○ ○
Index-Linked	-	○ ●	○	○ ○
Investment Grade Corporate	-	○ ●	○	○ ○
High Yield Corporate	-	○ ○	●	○ ○
Emerging Market Debt	-	○ ○	●	○ ○
Convertible Bonds	-	○ ○	●	○ ○

Bonds remain expensive today. Yields have lifted off their lows but remain unattractive at current levels, notably so in the quality sovereign bond space. Inflation linked bonds have marginally better prospects but the easy gains there have been made. We remain fundamentally constructive on higher yielding credit but see limited upside and returns to come mostly from carry in the near term. Convertibles play an important role in multi asset portfolios but look fairer value today.

REAL ASSETS / ALTERNATIVES	Change	Negative	Neutral	Positive
Commodities	-	○ ○	●	○ ○
Property	-	○ ○	●	○ ○
Infrastructure	-	○ ○	○	● ○
Liquid Alternatives	-	○ ○	●	○ ○

Real assets look attractive on both fundamental and valuation grounds, with a bias to infrastructure assets which ultimately should benefit from government policy initiatives. Investors are paid reasonably well to wait, and the diversifying qualities, also offered by the more esoteric liquid alternatives allocation, is attractive today in a world of expensive bonds.

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CURRENCIES *vs. USD*	Change	Negative	Neutral	Positive
GBP	▲	○ ○	○	● ○
EUR	-	○ ○	●	○ ○
JPY	▲	○ ○	○	● ○

US yields creeping higher makes it challenging for the more rate anchored currencies not to depreciate. Against that, a global recovery tends to benefit higher beta currencies and idiosyncratic factors drive nearer term dynamics making Sterling attractive today. The Yen has already weakened meaningfully this year and its defensive qualities make it attractive as a portfolio diversifier.

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