RICHMOND HOUSE
INVESTMENT MANAGEMENT

# Investment commentary

**October 2021**

## Market overview

Developed market equities returned 5.7% in local currency terms in October, more than reversing the falls in September and adding to already impressive returns so far this year.

Once again, the US market led the way with the S&P 500 Index reaching new highs as investor sentiment was boosted by some very positive company earnings announcements as the Q3 earnings season kicks off. US economic data was mixed, however, on balance the falling unemployment numbers and other evidence of continued economic recovery was enough to provide encouragement to investors. It was a broadly similar story elsewhere, with economic indicators such as Purchasing Manager Indices ('PMIs') comfortably in expansionary territory in most key regions. Vaccine rollout programs are also broadening globally, which is allowing the further opening of economies.

Returns from emerging markets were more muted but still positive. The Chinese market, which has lagged significantly in recent months, rebounded as concerns over the property sector eased somewhat and data pointed to an acceleration in exports.

Inflationary pressures remain heightened. This is partly being driven by the spike in energy prices where severe supply constraints and increasing demand is having a dramatic effect, most notably on natural gas prices across Europe but also within regions such as Asia in terms of actual breaks in power supply. Broad-based challenges to supply chains are also impacting prices across an array of products and components globally. The US Consumer Price Index ('CPI') is currently over 5% while the latest figures for the UK and eurozone lie between 3% and 3.5%. The potential implications of this in terms of interest rate policy pushed bond yields higher over the month, particularly at the shorter end. The US 2-year Treasury yield rose from 0.28% to 0.5% while the UK 2-year Gilt yield rose from 0.41% to 0.71%.

As has been the case for a number of months, the extent to which these inflationary pressures intensify or recede will continue to drive bond market returns. It will also impact the relative valuations of companies and sectors with different sensitivities to a rising interest rate environment.

## Strategy positioning

In recognition of the heightened inflationary environment and more hawkish tone from the UK Monetary Policy Committee we have further reduced exposure to UK interest rates (duration). We have done this by selling out of a specialist UK corporate bond fund and reinvesting into an absolute return focused fixed income fund with the flexibility to invest across the fixed income universe and also take 'short' positions, allowing it to profit from both upward and downward asset price movements. This move also reflects our view that the excess yield ('spread') currently available on much of the higher quality end of the corporate bond market is not sufficient to compensate for this interest rate risk.

Within the equity portfolio we have also switched some of the existing larger cap exposure into a FTSE 250 Index fund. Merger and acquisition activity remains heightened in the mid cap area of the UK market due to relatively attractive valuations and we believe that there are further opportunities that might benefit performance.

The equity exposure within the mandates remains at the upper end of their corresponding Dynamic Planner risk profiles. Given the strength of markets this year this has clearly been very beneficial to returns, as has the bias towards the US equity market. The global economic recovery remains on track, albeit now at a slower pace, while central banks continue to adopt a very accommodative policy stance to support this recovery. Corporate earnings newsflow remains broadly ahead of expectations in all key regions and we do not see valuations as extreme given the relative attraction of current dividend yields and investors' requirement for real returns going forward.

We would therefore characterise the mandates' positioning as having a full and targeted exposure to equity markets, diversified by uncorrelated and absolute return funds within the fixed income and alternatives allocations, which should be resilient if we do see any short-term volatility.