ESTATE CAPITAL INVESTMENT PORTFOLIOS

OUTLOOK

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Global growth is still on track but inflation could last.

Leading fund management groups remain confident of a robust recovery in the world economy but this outlook has tilted in a stagflation direction as growth momentum fades and price pressure rises. Global growth is still on track but the resultant inflation could last.

The immediate post pandemic growth phase is coming to an end with peak growth behind us as the world now contends with weak supply chains, labour shortages, energy and commodity price rises, the growth in the infection rates of Delta Covid and a spike in inflation. Inevitable rising prices will have an impact upon demand with wholesale energy, petrol and food costs increasing.

The signals that the initial recovery growth phase is slowing comes from PMI data. This was first signalled with a recent weakness in copper prices which is consistent with a slowdown in industrial demand. The increasing spread of the more infectious Delta variant has also slowed activity. Delta Covid is exacerbating the headwinds currently facing the world economy. Firms have run into bottlenecks in supply and then had to ease back on their own production for lack of components. This is typified by new car production that has stalled due to the limited supply of semiconductor chips. Order levels are high, but back logs and delivery times are delayed. The result has been price rises as buyers have chased suppliers.

Production has been hit by a lack of labour which may be surprising given the level of vacancies and unemployment still above pre-pandemic levels. There are currently over 1 million unfilled vacancies in the UK and a 4.5% unemployment rate. The speed of re-opening combined with a lack of forthcoming applicants means vacancies have been left unfulfilled. The UK has for many years relied upon overseas labour and due to lockdown, many have left to go home and yet to return. Some worker shortages are down to childcare support, whilst as has been the case in the USA, many are better off on enhanced unemployment benefits. The recent uplift in unemployment payments have now come to an end so should encourage a higher labour participation rate.

The rate of labour participation in developed markets has been slower than business need. In particular sectors people have simply not returned in the numbers desired. This has caused additional shortages in production chains. Against this background of increasingly tighter labour markets, wages are inevitable going to rise.

The US Federal Reserve is keeping a close eye on US labour participation ratios. This is the percentage of over 16's that are working or looking for work. In the US there is still slack in the labour market with unemployment standing at 4.8%. There are three million people still unemployed as compared to pre-pandemic levels of February 2020.

With inflation pressure comes the need for action to control it. The Fed is starting to tighten policy for the first time since the financial crisis of 2008 with the well-received announcement of its intention to start reducing the level of quantitative easing (QE) bond purchases. The tapering will start in December at a pace of US$15bn per month reduction and therefore take 8 months to end the QE programme. Somewhere near the end of the QE programme and

up until perhaps early 2023, it is expected that the Fed will make its first interest rate rise.

While it may be over a year before the Fed will contemplate a rate rise, the Bank of England (BoE) have also signalled that they may start modest rate rises before Christmas. The decision over an interest rate rise will seek to dampen inflationary pressures but will have consequences for borrowers. Markets have priced in a December rise to 0.25% and expect the BoE to continue to rate rise through 2022 ending the year at a base rate of 1%.

The ECB may be the last to rise rates as Eurozone inflation is not universally as high as the US and UK. The overall Eurozone rate of inflation is 3.4% but in Germany it is 4.1% while in France it is 2.2% and Italy 2.1%.

The ECB have continued to purchase European government bonds which has helped weaken the Euro. The extent to which the ECB will continue with QE will be made at the end of the year. The good progress that Eurozone governments have made in vaccination rates and the reduction in restrictions as well as the pent-up consumer demand has improved analysts' expectations for eurozone GDP growth to 5.1%.

The UK has been hit by rising Covid infection rates with new cases a day recently hitting 45,000. This added to energy price and fuel increases as well as supply shortages and food inflation would suggest a disappointing outlook. However, the outlook for the UK is improving. The Office for Budget Responsibility (OBR) has lifted its prediction for economic growth in 2021 to 6.5%, up from its previous forecast of 4%. It has also reduced its estimate of the long-term "scarring" effect of Covid-19 on the economy from 3% to 2%. The OBR is now expecting the economy to return to pre-pandemic levels six months earlier than it had forecast previously.

UK CPI inflation was down at 3.1% in September but it is expected to hit 5% over the winter months before falling back as supply issues are resolved. The BoE are confident in the UK recovery, but will monitor the employment market as the demand for workers has been stronger than expected at a time when the number of younger and older workers having left the labour market has grown. They will need to be encouraged back. The labour market is a key indicator of inflation as raw material prices are cyclical. If wage inflation starts to be embedded and in line with the rising cost of goods, inflation will be more persistent.

Any counter inflation interest rate rises could reverse these hard-earned growth forecasts. This is why the Fed is holding back interest rate rises until the US economy can take them more easily. The UK housing market has seen significant growth on the back of lockdown lifestyle considerations and a stamp duty holiday that extended to June. Any increase in mortgage costs could have an impact on house prices.

The major fund management houses continue to expect above trend economic growth through to the end of 2022 and see an upside in equity earnings as economies around the world further re-open fully and pent-up demand both materialises and can be delivered on. The momentum of growth did fall back in September but the earnings season results has been very encouraging and led to a recovery in stock market values.

Global Outlook

Third-quarter earnings season began in earnest during the second full week of October, led by banking giants JPMorgan Chase, Citigroup and Wells Fargo. Analysts at US financial data group FactSet estimate an earnings growth rate of 30% for S&P 500 companies, which would mark the third highest year-on-year earnings growth rate reported by the index since 2010. The S&P 500 hit an all-time high of 4659 in the second week of November.

While businesses are facing headwinds an economically supportive backdrop remains in place with high liquidity, strong household balance sheets and an expectation over government spending plans.

The bond markets are likely to offer negative real returns throughout 2022. The 10-year US Treasury bond yield is currently standing at 1.56% having been 1.2% in July. Some analysts are predicting that yields rise to as high as 2.2% over the months ahead meaning that bond holders will likely to see falls in prices and value to compensate for the improving yields. We have reviewed our bond holding to ensure that we have exposure mainly to short dated and inflation linked credit which are more stable in these conditions. We have also researched the use of target return bond funds to aid our fixed interest performance and control volatility.

Japan was behind in its vaccination program at the end of June as compared to other developed nations but since then it has rapidly improved and now has a high vaccination rate, ranking the country among the top three in the Group of Seven (G7) nations. Of Japan's population of 125 million, 70.1% had received two doses of a Covid-19 vaccine.

Japan's previously endless lockdowns had hindered economic recovery but the vaccination rates have reduced hospitalisation and deaths and with it their restrictions have eased. Meanwhile improving global trade will support Japanese manufacturing as well as technology and industrial companies.

China's economy has seen a decline in 2021. Year on year GDP growth was 18.3% in Q1, 7.9% in Q2 but fell to 4.9% in Q3 which is slower than many analysts had predicted. The Chinese economy had enjoyed a rapid V shape recovery after the first 2020 lockdown and benefited from early recovery growth but this has led to the authorities in Beijing putting the brakes on an overheating economy.

There have been disruptions to supply chains so that global inventories have been reduced. However, the months ahead should be ones of re-stocking and should stimulate the manufacturing sector.

Beijing has also put pressure on regional governments to reduce their carbon emissions in line with the nations goal to be carbon neutral by 2060. Twenty provincial governments have implemented electricity rationing which caused black-outs for homes and factories. This rationing coincided with the country's largest coal producing regions suffering from torrential flooding, leading to coal prices hitting new highs and the government abandoning the production caps.

Domestic coal production has needed to increase as China is no longer importing Australian coal. Regional power companies are expected to make a loss due to the power pricing policy imposed upon them by Beijing. This policy controlled how

much they can charge the customer. Now that this production cap has been lifted then capacity can improve.

Power black-outs have hit the cement, steel and smelting industries that use high levels of energy, resulting in factory gate prices rising.

These energy supply challenges have come at the same time as the property real estate sector was rocked by the heavily US$300bn indebted Evergrande Group not being able to pay its bond holders. Authorities in Beijing are seeking to manage a re-structure and protect home buyers. Evergrande is China's second largest property developer but has borrowing levels which are far higher than any other peer. China does need companies that fail and to teach speculators that there is risk and not expect a government bail out. It is expected that the failure of Evergrande will be a lesson to the property sector but contagion is unlikely. The Chinese banking sector is well capitalised and can afford a major write down so the failure of Evergrande will not be a Lehman Brothers. However, it will impact the general property sector with some resistance over lending and as the wider property and property related sectors make up 25% of China's GDP then it could impact on growth. Interestingly however, the wider Asian credit market has seen record credit issuance which is a positive signal about confidence.

India has overcome its devastating second Delta Covid wave and while the vast numbers of people hospitalised or who tragical died was heart breaking to see, India has got through it. Inflation is the new challenge facing the Reserve Bank of India (RBI) as inflation hit 6% driven by supply disruption and commodity price rises. The RBI left its benchmark interest rate at 4% during its October meeting, as widely expected, saying it was maintaining an accommodative monetary policy stance as long as necessary to support economic growth and to help mitigate the negative impact of Covid-19. Meanwhile, the RBI lowered its projection for retail inflation for the full year 2021/22 to 5.3% from 5.7 % amid the easing of food prices. The Bank maintained projected GDP growth at 9.5%. Like many other central banks, the RBI expect inflation to fall back to around 4.5% by the end of Q1 and therefore transitory in nature.

Russia has been blamed for taking advantage and exasperating the current gas shortages. Russia is an energy power in both oil and gas and can control the global price of natural gas. Not surprisingly the Russian MICEX stock market index is up 26% this year to end of October, while Russian GDP growth is forecast to hit 4.5% in 2021. However just like other countries, inflation is the issue challenging the Central Bank of Russia (CBR). Russian inflation is currently 7.4% and interest rates 7.5%.

A key risk to the world economy at this time is an energy crisis over this winter that drives up the price of gas, coal and oil which in turn impacts upon production when there is a supply side shortage problem at play now. Any stubbornness in inflation will have an impact upon consumer confidence and challenge government debt management.

Capitalist economies are good at sorting out shortages with the movement of capital and resources to areas of bottlenecks, but this could take longer than normal. As supply improves prices will fall and inflation decline.

The recovery from the Covid 19 pandemic has been quite extraordinary.

We should not lose sight of the fact that the recovery from the Covid 19 pandemic has been quite extraordinary. Nothing in living memory has matched it. By the summer of 2021, global GDP had not only passed its pre-crisis level but was catching up on the pre-crisis trend levels of economic activity that we might have expected if the pandemic has not struck. We are therefore further ahead in our recovery than the IMF and OECD predicted at the beginning of 2021.

This economic activity has supported some optimistic equity market returns throughout both 2020 and 2021. The S&P 500 is up +35% over its February 2020 level while Japan's Nikkei 225 is up +20% and Europe Euro Stoxx 50 up +10% but the UK's FTSE 100 is still down –4.2%.

Despite this encouraging background, world markets have turned their attention to some of the near-term consequences of this growth. Global supply chains have been put under pressure with shipping and haulage struggling to match demand. This has resulted in headline grabbing shortages and backlogs, leaving inventories at exceedingly low levels. This has been compounded by labour markets that have struggled to meet the redeployment of workers to match the manufacturing and service sector demand despite high unemployment. The higher transmission rates of the Delta variant of Covid have had an impact on workforce productivity.

Supply shortages have been most acute and sensitive in the energy sector with natural gas prices soaring over the course of 2021. UK natural gas futures are now US$228 p/therm up from US$60 p/therm in January, a rise of 380%. This has resulted in many smaller and newer players in the gas distribution market being unable to match the contract price and force into administration.

The inevitable result in supply disruption and commodity price rises while demand is high is inflation. To some extent the high inflation growth now is a result of lower costs 12 months ago. In this context it could be seen as a spike and ultimately short-lived, once business resolves its supply chain inefficiencies. As the months go by the rolling 12-month inflation growth figure will slow and then decline. Higher inflation will remain well into 2022 and place pressure on central banks to end their stimulus programmes and think about interest rate hikes.

We expect the benchmark 10-year US treasury yields to move higher when the Fed starts to taper its QE asset purchases in December at a rate of US$15b per month. While interest rate rises may come somewhat later, the only direction treasury yields are expected to go is upwards.

Europe is catching up the USA in economic activity so we can expect European inflation rates to pick up. While there is an expectation for US interest rate rises in 2023 there is no such feeling that the ECB will take action that early. European equities therefore can benefit from lower for longer interest rates. The European recovery has broadened to include more nation states and a return to pre Covid levels of activity should also be a stimulus for equity markets. The ECB QE programme is due to expire in March 2022 but analysts expect the programme to continue

beyond that cut off. ECB interest rates are still in negative territory at -0.5% with inflation at 3.4%.

The economic slowdown in China this year has been the result of the authorities seeking to cool an overheated Chinese economy and this has had an impact. Beijing has been unwilling to loosen fiscal policy and to reverse the credit tightening that was recently imposed. China is now focused upon rebalancing their economy toward low to medium income families and to deleverage. For this reason, they have been less active in credit driven fiscal stimulus. With the recent coal shortages and electricity blackouts to contend with China's recovery has slowed. Many commentators are now expecting Beijing to start to ease fiscal constraints and support the economy more.

China is continuing on the path of greater state control with social objectives having some primacy over growth. GDP rates have declines on a rolling 12-month basis to levels in Q3 that policy makers can no longer ignore and therefore after a period of tightening there is an expectation for loosening of fiscal and monetary controls. Therefore, after a six-month period of lower exposure to China we are planning to marginally increase our allocations. Hong Kong's Hang Seng Index has had a very disappointing summer falling 17.7% since February's high point. But a shift in fiscal policy will give markets some encouragement and has given the index a healthy lift in both October and November.

Looking ahead we have not seen significant reductions in the excess savings built up during lockdown. These savings will at some time be spent. This will create demand as fears over Delta Covid and supply problems ease. If this demand runs ahead of economic capacity to supply then price rises will continue. Persistent inflation will cause central banks to tighten monetary policy sooner than markets would want. Any early intervention by central banks and particularly the Fed or PBoC could be an issue of concern but at this point does not look to have impacted markets.

Equity markets can tolerate price inflation unlike the fixed interest market. Credit markets are more vulnerable to rising yields and inflation than equities. For this reason, we have extended our inflation protection in our bond holdings to include such assets as floating rate funds, target return bond funds and maintaining a majority of short durations.

Tactically we will maintain our equity exposure as we expect to see in due course a re-acceleration in activity and interest rates to remain relatively low. Areas of the equity markets that look most appealing are US small and mid-cap markets as they will benefit from domestic activity, European equities are attractively valued and are now benefiting from a strong growth backdrop and lower for longer interest rates. The UK markets are fairly valued but still have some trading challenges to overcome that may last longer than business would want. Japan will be aided by the global recovery and enjoy attractive valuations, while China after a weak period is expected to pick up. Indian equities have been performing well and showing a positive outlook for an economy that alongside China is taking up more of the world's GDP growth.

Bonfire night brings sparkle to the stock market!

Friday 5th November was another good day for world stock markets. In fact, the first week of November gave a lift to the world's leading equity markets.

That week saw the Federal Reserve announce that it would be starting the tapering of its US$120bn per month quantitative easing programme at a rate of US$15bn per month reduction. The level of reduction is US$5bn per month more than many expected, but shows that the Fed is confident the US economy can take this level of stimulus out of their economy. At this rate the QE programme will end in June 2022.

Markets took the news well as it has been trailed successfully. The US S&P 500 and Dow Jones Index both hit new highs. US 10-year treasury bonds yields fell to 1.45%.

The Fed also announced that it can be patient about rising interest rates. Fed Chairman, Jerome Powell has again expressed his opinion that price rise pressure is temporary but will persist well into 2022 but then fall back in Q2 and Q3. Mr Powell also confirmed that a US interest rate rise will not come until after the tapering support has ended.

The rise in stock market confidence is not just about the economy being able to take tapering but also that this quarters earning season has produced better than expected corporate profits. 82% of companies publishing their Q3 results came in higher than analysts had forecast. On top of this news the US economy was given a further boost with US employers taking on 531,000 new jobs in October. This follows 312,000 new jobs in September and 483,000 new jobs in August. Wage inflation is also rising at 4.9% over the past year which is ahead of US CPI inflation at 4.4%.

These solid job numbers are showing a consistent pattern of a return to work and that the Delta variant has not hindered this. The US economy is showing some momentum and there is an expectation that even larger numbers will return to work in November and December. If this is a pattern in the US, then it could be replicated in other developed countries as well.

The Fed will be under some pressure if the US job numbers keep on improving to look at interest rate rises sooner than 2023. The 531,000 new jobs in October indicates the fading impact of Delta Covid and helped put the recovery back on track. US unemployment rates fell from 4.8% in September to 4.6% in October. Whilst the recent job growth numbers have been encouraging, The US economy has struggled to lure millions of workers that became inactive during the pandemic, back

into the jobs market. If there is not the return to the labour markets due to people simply deciding post lockdown that they do not want to, then full employment rates may come sooner than expected. A permanently smaller pool of workers could mean that the US economy reaches maximum employment earlier than anticipated.

A tighter jobs market is likely to be inflationary and therefore may prompt the Fed to hike rates in 2022 rather than 2023.

The Federal Reserve were not the only central bank to make a monetary policy announcement last week. Governor Andrew Bailey, confirmed that the Bank of England (BoE) monetary committee had, after earlier trailing the likelihood of a UK interest rate rise, instead voted to keep UK rates at 0.1%. The BoE committee voted 7-2 in favour of leaving rates unchanged as 'there was value in waiting to see how the jobs market will come to terms with the end of the furlough scheme' Mr Bailey did not rule out a rate rise in the months ahead.

Many analysts had suggested that they thought the BoE may be premature in rising UK interest rates as a rate rise would not solve the supply chain and labour shortages.

Chancellor Rishi Sunak, has had the good fortune to be able to use the improvement in the UK economy to be able to announce some big spending plans in the Budget on 27th October. The Chancellor was also keen to ensure that UK government debt will be falling by the end of the parliamentary term. Mr Sunak's desire to get the public finances in order is another reason why many thought that the BoE's earlier forward signalling over a rate rise, however modest was unlikely at this stage.

Despite the fears over supply chains, inflation, energy prices and labour shortages, the S&P 500 produced its best week performance in the past three months. The success of the S&P 500 was also matched by the European Euro Stoxx 50 and Euro Stoxx 600 hitting all-time highs and the FTSE 100 reaching 7348 which is a post pandemic high point.

Our own portfolios benefited from this rally with performances across the range beating the respective national average returns over the past one, three and six months.

The Journey to Net Zero.

The generally agreed world target to achieve net zero carbon emissions is 2050. The combined forces of both governments and markets are moving towards this becoming a real outcome.

The use of renewable energy has significantly risen in the UK. At the end of Q2 2021 renewables generated 43% of the UK's electricity supply while fossil fuels provided 38.5%. Unsubsidised new wind and solar power have reached parity with fossil fuels in many countries across the world.

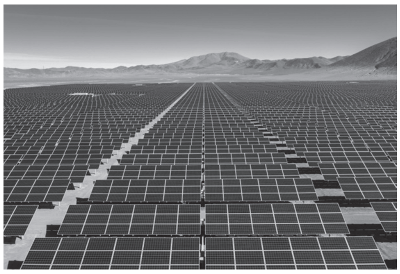
On 20th October the Prime Minister Boris Johnson launched the UK government policy to achieve a Net Zero strategy. The 368-page policy document set out the UK's plan to fully decarbonise electricity generation by 2034 through a switch to renewable and nuclear energy and carbon capture blue hydrogen. The policy paper confirmed that UK citizens will not be able to purchase a new petrol or diesel car from 2030 or buy a new home with a gas boiler from 3035.

At the launch, Chancellor Rishi Sunak acknowledged that green energy projects have a GDP growth multiplier of over 2 in that they pay for themselves twice over and would raise the UK investment and productivity rate. The investment needed in green energy in order to get the UK to net zero would provide a major boost to the British economy. Oxford University has forecasted that the world could gain a US$14tn boost in GDP over the next 25 years.

Obviously, this transition will take a high level of initial investment. This is a challenge and for sceptics, a reason not to and retain the current power sources. However, when capital can see such significant returns, the momentum is with green energy. For example, fund managers are directing capital to sustainable energy companies and away from the old energy sources.

The International Energy Agency (IEA) have been for decades, the voice of the fossil fuel industry and have in the past been dismissive of renewable energy. However, in their 2021 annual report they have provided data for solar, wind and bioenergy as well as oil, gas and coal. The IEA make it clear, ahead of the COP 26 conference in Glasgow, that if investors continue to invest in dirty energy, they will lose money. They predict by 2050, 80% of international energy will come from solar, wind, wave, tidal and hydrogen and that the critical minerals and materials will replace oil as the energy commodity.

While the world is moving to a position of far less dependency on fossil fuels, it is still clear that we are still a long way from that objective. The IEA predicts a 2% global rise in oil demand until 2025 and then start to decline while gas usage is expected to rise by 3% pa until 2030 when it will decline. While we are developing new renewable energy sources, we will still be reliant upon the grubby stuff. It also takes energy to build renewable energy capacity. For the US$16tn of the planned global green energy investment to take place, it will mean a rise in the



demand for oil. Despite this need, but also as a result of the direction of government policy, the investment in new gas and oil capacity has fallen by 50% since 2013.

As the world grapples with severe weather changes, the move from carbon to renewable energy will in itself require heavy mining of minerals and raw materials. This transition is a key factor for a potential commodity super cycle. Copper, lithium and rare earth metals will be needed to build fuel cells, batteries and green power grids. The nations with these commodity resources and the business that mine them, will become the main beneficiaries of the new mineral wealth.

The IEA report gives an optimistic outlook for the decarbonisation of the world leading to economic growth. The five million jobs that are expected to be lost in the oil, gas and coal industries will be replaced by twenty four million green energy jobs around the world. The report predicts falling energy costs and that the domestic cost of heating, lighting and transport will fall. Green energy can be local so transportation costs would be reduced in the form of shipping, pylons and grid infrastructure.

The post pandemic crunch in gas and coal illustrates that we still have a long way to go before we are no longer reliant on carbon energy and therefore the faster, we advance green energy capacity the less of an issue this will be. IEA are suggesting the world needs at least three times the current level of green energy production to overcome reliance. The IEA are predicting that peak oil demand will be in 2025, only 4 years away, and decline thereafter. No new oil fields will be needed and output is forecasted to fall from 100m barrels per day to 24m by 2050 mainly for use in the plastics industry and for non-electric transport.

The IEA predict that peak natural gas will be 2030 and then decline. Natural gas is likely to have a role if the wind or sun are not strong enough.

The latest solar park in Saudi Arabia's Al Shuaiba PV project has achieved electricity production at a cost of US$10.4 per mega watt hour. This is remarkably cheap. Desert solar is so cheap that it is likely to lead to vast areas of North Africa, India and Australia becoming massive solar energy parks able to sustain much of the world's energy needs.

Hydrogen is also a source of green energy as hydrogen when burnt does not produce CO2 making it attractive to high energy using industries such as steel making, and glass production. The UK government is keen to expand the sector and turn hydrogen from a relatively small player to a significant green energy source.

Hydrogen is produced either from natural gas or from water using electrolysis. The production from natural gas for it to be green, it needs to be coupled with carbon capture. It is therefore classed as blue hydrogen as compared to water electrolysis which is green hydrogen.

We hold positions in both the Guinness Sustainable Energy Fund and the Baillie Gifford Positive Change Fund. Both invest in renewable energy companies and battery technology businesses. We expect this sector to provide investors with good longer-term returns.

Winter is Coming.

The global shortages of natural gas have revealed the worlds continuing dependency despite the drive to renewable energy sources. The dramatic spike in energy prices have come as a bit of a surprise and shock to many. Oil has now hit US$85pb up from US$52pb in January, a rise of 63%. UK natural gas futures are US$228p/therm up from US$60p/therm in January, a rise of 380%. Coal has also risen 315% since January and has been a leading growth asset this year.

The 2021 EU Emissions Trading Scheme has caused a steep rise in carbon pricing which when added to the recent spike in natural gas prices have led to huge increases in European and UK energy costs. The most obvious impact is on the domestic consumer, and a further hit to economic growth, particularly if this winter is colder than normal and that gas supplies do not improve. It is possible that for many, but not all, the additional savings households have made through lockdown will cushion the impact of rising energy costs but sectors heavily reliant upon energy will be vulnerable. Industries in the chemical, building materials, paper, glass and food manufacturing sectors may as a result see closures.

Europe has historically relied upon Russian gas imports and Liquid Natural Gas (LNG) shipments from Qatar. However, these Qatar shipments are being gazumped and heading for Asia. There are also claims that Russia is slowing gas supplies in order to pressure Europe into finalising the Nord Stream 2 gas supply pipeline from Russia directly to Germany passing under the Baltic Sea.

France is a keen to develop its nuclear power capacity through the use of small modular nuclear reactors, which are much quicker to build and commission. France wants to build a pro nuclear alliance within Europe to overcome German resistance to new rules that would classify nuclear energy as a ‘green technology’. Due to the EU Climate Change policies the cost of generating electricity from fossil fuels has increased at the time when retail gas prices have quadrupled through the

course of this year. European wholesale natural gas prices have risen 380% since January.

The EU saw a strong take up in 'green bonds' in October, the proceeds of which must be spent on environmentally friendly projects and France wants that to include modular nuclear reactors. Rolls Royce leads a consortium that have small modular reactors under development and should be available from 2030. Rolls Royce sees this energy source as being able to power data centres so they are not reliant upon the grid as well as support the grid. As a further boost Rolls Royce expects to create 6000 new jobs in the regions of Britain over the next 5 years and 40,000 jobs over 15 years as the modular nuclear reactor industry grows to an expected 16 reactors over the next 20 years.

It is quite possible that a harsh winter could push the world into the grip of an energy crisis. Energy restrictions have in the past accelerated inflation and therefore portfolios may need further inflation protection measures over the months ahead. In the UK, the combination of energy price rises, labour shortages and supply chain difficulties are only going to make things more challenging.

We added JP Morgan Natural Resources fund into our portfolios at the last review, in order to access the demand for metals such as copper that play a major part in the electrification and battery technology. Commodities have historically been good at the end of a cycle when inflationary pressures grow. In purchasing this fund, we were not expecting the added returns that have come from oil, gas and coal production which has seen this fund grow 37.23% in the past 12 months. We will extend our holdings in the new Edition 36 portfolios.

It is quite possible that a harsh winter could push the world into the grip of an energy crisis.

The Bank of England delay a rate rise.

The October fall in UK CPI inflation from 3.2% to 3.1% should not been seen as a signal that UK inflation has peaked. The direction of price rise travel is upwards with CPI expected to hit 5% in the near term with some commentators suggesting 6%.

Therefore, there has been pressure on the Bank of England (BoE) to seek to control inflation because of the threat inflation poses to economies. The usual instrument to quell inflation is interest rate rises. This would come at a time when the UK government, business and mortgage holders could very much do without higher borrowing costs.

In almost every developed country inflation is rising. In the USA it currently stands at 6.2% and this may be the near-term peak for US inflation. This is not the case for Europe or the UK. Here inflation is expected to peak at around 5.5% over the winter months. In Europe inflation is expected to climb to 3.5% but reaching over 4.5% in Germany.

The Bank of England Governor, Andrew Bailey had recently signalled that interest rates will rise sooner than later and that this could start in December with a rate rise from 0.1% to 0.25%. This would be a relatively gently touch on the brake but if inflation persists further rate rises will follow and would hit economic growth. The Bank of England Chief economist Huw Pill has warned that CPI could exceed 5% in the new year. He added that 'this is a very uncomfortable place for a central banker with an inflation target of 2%'.

However, at the BoE monetary committee meeting on 4th November it was decided by a 7-2 majority to delay a decision over rate rises. This came as a surprise to markets as the BoE had clearly signalled a rise. Sterling fell on the news, which boosted the FSTE 100 and gilt prices as yields fell. Investors should now expect a delay in any rate rise decision.

Any decision over an interest rate rise will seek to dampen inflationary pressure but will have consequences for borrowers. Markets expect the BoE to raise rates through 2022 ending the year at a base rate of 1%. The BoE has certainly changed from its earlier view and policy over rate rises. This change is a response to supply chain pressure as well as petrol and heating cost increases.

The current inflationary pressures are driven by supply problems rather than excessive demand. Prices are up because of inefficiencies in freight, haulage, shipping, manufacturing capacity, inventory reductions, labour shortages and high commodity and energy prices. People have reduced spending and still hold historically high levels of savings.

Inflation can be eased as business sorts itself out and greater numbers participate in the labour market. Economists are expecting inflation to ease as we move into Q2 2022.

Covid has moved the world to a position of shortages, where supply is not matching demand and inflation is the outcome. Global supply chains have been managed to optimum efficiency with just in time deliveries not able to cope well in a crisis. The move from fossil fuels to renewable energy has left us with limited back up and on top of this there are in excess of one million job vacancies unfilled in the UK.

Many economists and commentators think that a rate rise will not help the supply problem but could make it worse. Markets are concerned that the BoE could make an unnecessary policy error by prematurely rising rates which they may have to reverse if the economy weakens.

Andrew Goodwin the chief UK economist at Oxford Economics said that he 'finds it hard to understand why the Bank of England is moving closer to hiking rates when higher inflation is caused by global developments that it does not control and it is hard to find evidence that justify concerns about inflation staying high further out'.

Some members of the BoE own Monetary Committee are concerned about rising rates early as employment is still not full and inflation looks to be transient. The labour market is a key indicator of inflation as raw material prices are cyclical. If wage inflation starts to be embedded and in line with the rising cost of goods, inflation will be more persistent. Perhaps it is this fact that Andrew Bailey is seeking to get ahead of.

Some fund managers do not expect the BoE to follow through on its hint of rate rises this year and will delay a decision well into next year.

All central banks have to consider their massive national debts. The attraction of inflation is that in real terms it reduces the size of the debt but the threat of inflation getting a grip in an economy is that interest rates will have to rise to rein it in. This is why bankers will want to keep interest rates low for as long as possible. If UK interest rates hit 1% at the end of 2022 this will have a cost implication to the Treasury as the servicing costs of the UK £2.2tn national debt will rise from the £24.8 b per year it cost us now up to an expected £33.7 b by 2025. For every full 1% rise in base rates, the annual cost to the Treasury of servicing the interest payments on our national debt increases by £25bn.

Any rise in inflation can be controlled by companies if the pricing of their goods or services can cover the additional supply costs. Equity markets will not be overly affected by a short-term spike to inflation but would be if inflation was both high and stubborn.

US inflation has hit 6.2%

The US congress has been working through several key pieces of legislation including a bill to ensure that the government continues to be funded. Each October, at the end of the fiscal year, Congress votes on extending the debt ceiling. This vote became a stand-off between Donald Trump and Democrats a few years back when workers were stood down and wages not paid for two months. This time the vote was split along party lines and Congress agreed the funding which averted another shut down.

The US$1.3tn infrastructure and green energy bill and the so called US$3.5tn 'build back better bill' are both being debated as they pass through Congress. We expect both to be passed but the final cost will depend upon the outcome of internal Democrat Party negotiations between the conservative centrists and the progressive left wing of the party.

US economic growth slowed sharply in the third quarter of the year, as the fast-spreading Delta variant of coronavirus dampened consumer spending. The economy expanded at an annualised rate of just 2% in the three months to September - down from 6.7% in the previous quarter. It came as the US faced supply chain issues, rising inflation and new Covid restrictions in some places. But infection rates are falling and some experts think growth will pick up. Despite this business sentiment remain good as companies have been able to pass on inflation increases to their customers. It is expected that a recovering labour market and consumer spending will grow this year and next.

The Federal Reserve's 2021 inflation forecast has been reviewed upwards again. This is a sign that the Fed is acknowledging the more persistent nature of the current inflationary pressure. In November the Fed announced the start of the tapering of their QE programme with a monthly reduction of US$15bn and take eight months to bring the programme to an end. Markets have taken this policy change well.

The outlook for US inflation and labour markets is what will influence US policy makers over interest rate rises. The US CPI inflation rate has just hit a new high of 6.2%. This is a sharp jump from last quarters year on year figure of 5.4%. This is the fastest rise in CPI since 1990. It is however, forecasted to fall in Q1 and Q2 and heading back to a mean forecast of 2.2% inflation by Q3 of 2022. This form of transient inflation will suit the Fed as it will put less pressure on interest rate rises but many analysts think that inflation will be more stubborn for longer.

US equities continue to command a premium valuation perhaps due to the higher weighting of global technology leaders. The surge towards this sector has led to concerns about these valuations, yet earnings momentum remains strong and many of these companies are global leaders that only increase revenue and market share.

US markets continues to shine in October and November when the Q3 earnings results were published. These better-than-expected results prompted a rise in global markets.

Eurozone earnings growth is expected to outstrip the US going forward.

The eurozone economy has outperformed expectations as it grew by 2.2% in Q3, matching the previous quarter. This leaves the level of economic activity just 0.5% below its pre-pandemic peak, meaning that the recovery in GDP should be complete this quarter.

Whilst the eurozone GDP figures surprised to the upside, the results within the major member states were more mixed. France provided the biggest upside surprise, growing by 3% compared to 1.3% growth from Q2. This was thanks to a strong rise in household consumption, which was helped by the further easing of pandemic-related restrictions and an improvement in consumer confidence.

In contrast, Germany disappointed as it grew by 1.8%, down from Q2 growth of 1.9%. Although 1.8% quarterly growth is still high by historic standards, it is clear that supply bottlenecks have hampered the recovery in Germany's manufacturing sectors. The level of German GDP is still 1.5% below its pre-pandemic peak, compared to France which is just 0.1% below.

A concern for Germany is that it may have missed its chance to take advantage of the strong recovery in global demand for goods. For months, new orders have outpaced output, causing a major backlog, depleted inventories and long delivery times. Companies appear to have responded by raising their prices, though part of this will have also been driven by the higher cost of raw materials.

In the latest data from business surveys, it appears that demand is now fading, reducing the potential upside for German manufacturers. This may be partly due to weakness externally, especially in China and Asia, but it may also be due to a loss in competitiveness, which is more concerning.

Spain saw activity accelerate from 1.1% growth in Q2 to 2% in Q3, but this was below estimates of 2.7%. Though some tourism returned during the quarter, it appears that delays in lifting restrictions may have contributed to the disappointment. Spanish GDP remains 6.6% below its pre-pandemic peak, highlighting the challenge ahead to return to normality.

The Eurozone inflation figures released in the last week of October show headline eurozone inflation reached 4.1% year on year. – the highest rate of inflation since July 2008. Energy inflation reached 23.5%, contributing 2.1 percentage points to the headline rate. This was caused by the recovery in wholesale oil and gas prices which fell sharply last year during the height of the pandemic.

Overall, the latest growth figures are broadly positive and point to an ongoing recovery, particularly in service sectors which were badly impacted by the pandemic. However, there are growing concerns that external demand for goods is fading, especially in response to rising prices which are mostly caused by supply bottlenecks.

Meanwhile, inflation is expected to rise further, potentially denting consumer confidence, and reducing the contribution from household spending, which is expected to be the biggest driver of growth in 2022.

For the European Central Bank (ECB), the message following the October meeting was loud and clear that the governing council sees good progress being made in the recovery, but that there is further to go. The ECB kept all policy unchanged and provided a cautious but optimistic message on the outlook.

The ECB warned of higher inflation on the horizon, but it sees most of the factors driving prices as temporary. The ECB is set to end the portion of its quantitative easing programme related to the pandemic by the end of March next year. But it is expected to keep some other purchases going beyond March and it is clearly not ready to raise interest rates anytime soon.

The potential returns from European equities remains favourable. European markets have been amongst the leaders in this year's rally. The next few months could see a change in sentiment as economic and earnings momentum switches from the USA to Europe. Eurozone earnings growth is expected to outstrip the US going forward.

Despite the sharp rise in Delta variant transmission readings from across the Eurozone, PMI suggests that business confidence is more resilient than other developed markets.

Overall, the latest growth figures are broadly positive and point to an ongoing recovery,

A return to Chinese fiscal support should provide a boost for global assets.

China has taken action designed to limit the power of major internet providers.

This regulatory tightening in the summer sent some jitters through markets. This shift in regulation was to support a more common prosperity by limiting the profits of certain business sectors and should not be seen as an attack on the private sector. The Beijing authorities targeted internet platforms to limit child access to the internet and after school tutoring companies in order to cut the cost to parents of after school education.

Common prosperity is a commitment to improve the welfare of low to middle income households through better income, improved public services and a strong social safety net. China has balanced its domestic objective with its growth objectives. Despite this re-assessment of priorities high growth is still important to China if it is to hit its goals of doubling national GDP growth by 2035.

China's post pandemic economic recovery is slowing and as a result there is some expectation that Beijing will start to loosen their purse strings once again. Without some renewed stimulus, the slowdown could be hit by the impact of the authority's regulatory crackdown, Evergrande's failure, power rationing and Delta variant restrictions.

One factor that links financial market conditions to the performance of Chinese equities is the demand for new credit and this has been reducing. This added to the Chinese governments reduced stimulus will impact growth and add to the calls for fresh stimulus. Analysts feel that the peak of Chinese credit tightening has now passed and that a return to Chinese fiscal support should provide a boost for global assets.

Japanese earnings growth could soon outstrip the USA.

The Nikkei 225 index saw significant growth at the end of 2020 but has achieved little in 2021. Despite the flatlining look of the index's performance this year to date, Japanese corporate earnings momentum remains strong. There are many good value buys in the Japanese equity market particularly in the tech and industrial sectors offering the opportunity for growth at a reasonable price. Something that is harder to find in other markets. Some analysts are suggesting that Japanese earnings growth could outstrip the USA.

Japan was behind in its vaccination program at the end of June as compared to other developed nations but since then it has rapidly improved and now has a high vaccination rate, ranking the country among the top three in the G7 nations. Of Japan's population of 125 million, 70.1% had received two doses of a Covid-19 vaccine.

Japan's previously endless lockdowns had hindered economic recovery but the vaccination rates have reduced hospitalisation and deaths and with it restrictions have eased. Consumption has been improving along with wage growth. Meanwhile improving global trade will support Japanese manufacturing as well as technology and industrial companies.

New Prime Minister Fumio Kishida, is very likely to continue the policies of former Prime Minister Shinzo Abe who recently stood down due to his poor health.

The Nikkei 225 index saw significant growth at the end of 2020 but has achieved little in 2021.

Half of India's population is under 25 and the middle class is expected to grow from 50m to 475m by 2030.

Back in 2013 emerging market economies were hurt by the Federal Reserve's action to reduce the rate of its post financial crisis QE. This sent stock markets and foreign currency values into correction territory. Today as the current Fed confirmed the reduction of their QE programme, emerging market banking is far more robust and the thought of Fed tapering QE has not affected markets. In fact, it is the emerging economies who have been the most pro-active with Poland, Russia, Mexico and Brazil already raising their interest rates to get ahead of global inflation.

Many emerging economies are energy exporters and are benefiting from the higher price of natural gas and oil. Russia is an energy super power and half of Russia's stock market is made up of energy companies. Not surprisingly the Russian stock market has done very well this year. Moscow's MICEX stock market index is up 26% this year to end of October, while Russian GDP growth is forecast to hit 4.5% in 2021. Russia is getting richer and more assertive.

India has overcome its heart rendering second wave of Covid emergency and has seen its stock market perform very well this year and this is expected to continue. The Bombay Stock exchange (BSE) Sensex Index is up 24% since the turn of the year. It is not the rise in energy prices that has driven this growth as India is a net importer of oil and gas but through a boom in new company listings due to India entrepreneurs. Quite uniquely almost half of India's population is under 25 and the middle class is expected to grow from 50 million to 475 million by 2030. Wage costs are a third of those in China and for these reasons companies are moving to India. Apple for example is transferring 20% of its production from China to India.

This growth in stock markets has led to India stock trading at a high price to earnings ratio of 30.34 that are about the same as the USA S&P 500 which is trading at 30.49. This is rare for an emerging market and twice that of the UK FTSE 100 trading at 13.66. High P/E ratios are a sign that the market values a stock for future growth. We are concerned about how volatile the BSE Sensex index could be on such high ratios. For this reason, we have accessed Indian stocks through general emerging market funds in the past 12 months as compared to direct holdings prior to that. We will review this position in our next edition. Without doubt the long-term outlook for the Indian stock market is very attractive given the demographics and Prime Minister Modi reform minded government policies.

China has been hurt by the energy crisis. Power cuts have hit as many as twenty provinces leading to blackouts and power rationing. Flooding in the northern Shanxi province near Beijing is a major coal mining area and the torrential rains hindered coal mining and forced up prices to an all-time high.

China is heavily reliant upon coal, of which over half is imported. Almost 60% of all energy is generated by coal fired power stations. The recent strong recovery in the Chinese industrial sector since Covid has boosted energy demand. China's domestic energy producers have not been able to keep up with this demand as environmental and emission targets have curbed mining activity. China has stopped importing coal from Australia after Canberra questioned the original source of Covid 19. This has sent coal prices soaring by over 315% this year. China's power companies are unable to pass these price rises on to Chinese consumers due to government policy and are unwilling to supply power at a loss. Provincial governments are unwilling to run down their winter reserves of coal so have instead cut supplies resulting in black outs.

The solution would be to relax emission targets, boost coal production and subsidize loss making energy companies if the Beijing authorities do not want higher prices hitting consumers. This may be the outcome but as the world seeks to move to a carbon neutral future these are challenges for the Chinese government. China currently produced 29% of the worlds carbon and President Jinping disappointingly declined to attend the COP 26 Climate Change Summit in Glasgow. The ambitions of the COP 26 Summit will be undermined without a commitment from China to dramatically reduce its use of coal and carbon emissions.

It is not just China that faces a squeeze from higher coal prices. Several other important players in global supply chains such as Japan, South Korea, Taiwan and Vietnam are also very reliant upon coal to generate power. The result of the higher coal price is likely to increase production costs for goods destined for the rest of the world. Therefore, until this energy crisis is solved, it is not likely that price rises or supply restrictions will ease.

After a very strong recovery, the global economy has shown signs of nervousness.

After a very strong equity recovery in 2020 and early 2021, this summer and autumn has seen the global economy show signs of nervousness. We are suffering what should be short term energy price spikes, supply chain weaknesses and labour shortages that should in time be corrected but there is also a feeling that things are not going as well as we might like. While vaccination rates are globally improving so is Delta variant transmission. Interest rates remain low but inflation is now haunting financial markets and particularly the fixed interest bond markets as central bankers consider the best course to control inflation and maintain growth.

It is quite possible if we can avoid an energy crisis this winter, that the world will transition to a more stable form of growth as markets are progressively weaned off the generous central bank support.

We can expect US interest rates to remain modest while the Feds QE tapering starts. Economists would expect the yield curve to start to rise as tapering continues and the US$ strengthens. As treasury yields rise then expect fixed interest asset prices to fall to compensate.

The opportunity for real estate assets in the right sectors is strong as yields rise from a relatively low base. Property rents do give some protection over inflation. Our alternative assets to equities will in this Edition 36 be focused on property, index linked and short dated credit, target return credit, gold and commodities.

We will retain our equity holdings with some movement to US small cap and mid cap, Chinese and Indian equities and European equities at the expense of US large cap and UK mid cap. Positive returns are expected over the next 12 months from High Yield bonds, equities, real estate and commodities. We are holding some global investment grade bonds and UK gilts as there has been a recent lift in returns and as equity downside protection.

The resurgence of Delta Covid in many parts of the world is seeing high levels of transmission as schools, universities, bars, clubs and as business re-open. However, the vaccine roll out has cut the numbers of people hospitalised and died due to the illness. This resurgence has threatened the economic performance in some parts of the world that had previously managed the initial pandemic well with their stringent lockdown measures such as Japan, Australia and New Zealand.

In both the USA and Europe, the pace of economic growth has slowed as compared to levels of the second half of 2020 and the first half of 2021. This is evidenced by lower retail sales growth from April onwards. This has been interpreted as a pause by analysts as the global economy moves from its early recovery mode to a more normal growth pattern. Early recovery was boosted by government stimulus. The supply chain pressure is a function of this demand. While government and central banks remain supportive the transition to a new normal growth will result in moments of concern and fears of correction, just as we have experienced over the past few months. With the energy problems a very good example. Market volatility is often higher when economic growth slows. For this reason, equity markets can be expected to be choppy. So far markets have taken the Feds decision to start QE tapering very well and emerging markets have not shown nervousness.

As we are in the early to mid-expansion phase of the economic cycle, the cyclical assets that would tend to do well in this phase have again showed that this is the case with property and commodities performing well while the preferred assets for a recession phase such as gilts and gold have generally underperformed but have just recently picked up.

This does not mean we are at all complacent as the world economy is threatened by a number of different challenges from energy supply, labour participation, inflation pressures, central banks tightening and Delta Covid transmissions. Any policy mis-step could result in a correction as we remain in an on-guard state but do expect growth to come through.

We are very aware of the potential impact of inflation and why central banks wish to control it. The rise in the cost of living could continue longer than analysts expect. There is still a majority view that favour a transitory interpretation to the current inflation rate growth. As the global economy returns to a steadier growth pattern, the imbalances that have driven inflation should ease and inflation return to the 2% target range. The labour markets will give the signal for more longer-term inflation expectations.

If we did find ourselves in a longer-term inflationary world of between 3% and 5%, it would be difficult for all asset classes to contend with this well. Our strategy is to invest into index linked bonds, gold, financials and commodities.

Ten-year US Treasury bond yields hit 1.74% in early March and have since declined to 1.3% in August and has since risen to 1.48% in early November. This may suggest that markets are less worried about longer term inflation and that the US has hit peak inflation at 6.2%.

It is against this background that we make our recommendations.

12th November 2021

PORTFOLIO SELECTIONS

2021 has been a remarkable year for investment with as much happening that both supports and undermines market confidence. We started 2021 with President Biden Democrats winning the Georgia State Senate run-off election and with-it overall control of the US Congress. President Biden's show case legislation in the form of the US$3.5tn Build Back Better bill and the US$1.3tn Infrastructure and Clean Energy bill were expected to make swift progress and America launch an unprecedented capital spending programme. This would be a great boost to the recovery but also the beginning of the concern that inflationary pressure would grow.

The 10-year US treasury yields spiked in mid-March, up from 1.4% to 1.74% as a market reaction to the threat of inflation building in the US economy. This spike had a negative impact on our Edition 34 portfolios at the time as we had exposure to longer dated bonds and gilts that were hit by rising yields and the resultant compensatory price falls. Longer dated credit is more impacted by inflation due to their durations. We had also maintained our US tech holdings but had added a new iShares Clean Energy ETF, which had been doing exceptionally well and, in a sector, expected to perform on the back of Biden's spending and the global shift away from carbon. The clean energy and tech sectors in general are heavily leveraged and therefore at the time, hit by the chances of a US interest rate hike earlier down the track than either wanted or expected. The combination of long dated credit and iShares Clean Energy Fund losses left our portfolios behind the national averages and in need of restructure.

We took action with a mid-term rebalance to reduce exposure to long dated credit as the likelihood of rising inflation would further hit duration and the removal of the iShares Clean Energy ETF as being too volatile a holding and replaced by the Guinness Sustainable Energy Fund and Baillie Gifford Positive Change Fund. Both of these funds have done well and will remain holdings in Edition 36. As of 8th November, these funds had grown 20.95% and 20.39% over the past six months respectively. All our portfolios suffered from being behind the recent national averages through the summer, but due to changes we made in April and then again in July we have recovered and are back ahead over the past 3 months and 6 months.

Markets have over recent months been nervous for a number of reasons. We have seen the impact of global supply chain weakness, spikes in natural gas prices, labour shortages in key areas and high levels of transmission of the Delta Covid impacting upon the workforce. Despite these headwinds, the economic fundamentals are still good, PMI indicators are positive, US earnings season was very successful, interest rates remain very low, The Federal Reserve's tapering has been well received, vaccination rates in developed countries are high, US new job numbers are healthy and growing and over time supply chains will get fixed and inflationary pressure ease.

Economic growth has certainly slowed from the first half of the year. The authorities in Beijing have tightened in order to cool their overactive economy. The current rate of growth of 4.9% in Q3, which is slower than many analysts had predicted, is expected to prompt a reversal particularly after the blackouts and power outages. US growth has also slowed but with a new 531,000 jobs created in October there is still growing demand to come through.

It has been the bond markets where we have been most nervous as inflation will hurt fixed returns. For this reason, our last Edition 35 holdings were particularly defensive and heavily allocated to short dated and index linked to protect assets from inflation. Our average duration in Edition 35 was 3 years. This strategy certainly worked right through to early November when a shift in sentiment over equity returns also saw an improvement on long dated credit returns.

The new Edition 36 bond allocations are more diversified and less concentrated. We have retained a majority of short dated and index linked but have reintroduced some global corporate bonds and UK gilts to the mix along with some new asset backed securities, some target return bond funds and floating rate bonds as we anticipate interest rate rises in 2022.

It is due to the potential for inflation to become more established within the economy, mainly through wage pressure and supply chain problems that we have added a holding in gold. The BlackRock Gold and General Fund is a play on the demand for gold going forward.

Fund management groups see inflation as increasingly likely to be with us for longer that first expected. However, many feel that the US has hit peak inflation and that the rate of price growth will ease. The UK is yet to hit peak inflation which the BoE expect to be April 2022 and could hit 5%. Due to the massive gas price rises Finch expect UK CPI inflation to hit 4.3% at the end of 2021.

With inflation ahead and interest rate rises to come we want to hold fixed interest holdings that have some protection within. We are therefore holding index linked and floating rate allocations.

Investment returns are influenced by economic circumstances. The value of the future cash flow is sensitive to expectations over interest rates, inflation, growth outlook and central bank policy. Due to the differing tensions within the global economy, it is particularly important to maintain a very diversified portfolio going forward across the asset classes, sectors and regions. This policy of diversification has held us in good stead this year and we expect the same in 2022.

Our allocation to equities remains in line with the portfolio risk profiles however, we have increased our allocation to property funds in Edition 36. Both equities and property do a better job against inflation but not high inflation. Markets that might be hardest hit by high inflation would be the US as they have the richest values. With the US expected to have hit peak inflation this issue seems to be less of a threat. The places to find downside protection from inflation is precious metals, infrastructure, commodities, financial stocks, property and index linked credit all of which are held in our portfolio's. We have also added three new funds that have a target return objective. The BNY Mellon Real Return Fund, which we have held in the past, the Artemis Target Return Bond and the Royal London Diversified Asset Backed Securities Fund to bring some additional volatility management and diversification to the overall portfolios.

As far as the year ahead is concerned there are some key themes to consider. The tapering of US Federal Reserves quantitative easing programme and the timing of a future US interest rate rise. The development of the US labour market and future wage inflation rates. The success of the Biden Administration in implementing its Build Back Better investment programmes that will create demand within world economies. We will watch with interest how China overcomes the eventual collapse of the Evergrande property company and manage the likely fallout and hit on economic growth.

Business will fix the supply chain inefficiencies, but it will take time and the world will progressively recover from Covid so that we can expect an improving economic environment. The one thing that we cannot underestimate is a policy error that causes markets to react and correct. We are in high value stock market territory particularly in the US so this is always a concern when growth rates slow.

The recent US earnings season has put life into equity markets. It is also quite possible that optimism over the ongoing recovery and correct policy decisions in Washington and Beijing will see markets perform well over the months ahead. All eyes will certainly be on the Fed over the next year.

As of the 8th November 2021, the best performing funds held in our portfolios over the past 6 months have been:

Guinness Sustainable Energy	20.95%
Baillie Gifford Positive Change	20.39%
Polar Capital Technology	18.24%
T. Rowe Price US Large Cap Equity	16.28%
Allianz Continental Europe	16.23%
Baillie Gifford America	15.76%
JP Morgan Japan	15.33%

The growth in the clean energy sector has continued and we expect this to remain a strong investment theme for several years ahead. The regions and sectors that rebounded from the Covid crisis and continued to do well through 2021 due to large government stimulus, low interest rates, effective vaccination programmes where Europe, Japan, and US and this has resulted in strong equity returns.

As of the 8th November 2021, the poorest performing funds held in our portfolios over the past 6 months have been:

Jupiter UK Mid Cap	-2.71%
Schroder Asian Income	-1.97%
Vanguard Emerging Markets Index	-1.15%

For differing and unique reasons these sections of the global equity markets underperformed in 2021. We have replaced the Jupiter UK Mid Cap fund but the others remain as we expect improvements.

As far as the 36th Edition of our portfolios are concerned, across all six portfolios, nine new funds have entered our selections while eight funds have either been dropped or substituted. We have done this for several reasons. These being performance related, cost related, or that a fund has lost an analysis rating. There are also sectors that we no longer wish to invest in.

The funds removed are: -

	TER
Liontrust UK Smaller Companies	1.48%
Royal London Investment Grade Short Dated Credit	0.24%
Aegon Strategic Bond	1.21%
Royal London Short Duration Credit	0.35%
Schroder High Yield Opportunities	0.93%
Artemis Income	0.97%
Franklin UK Mid Cap	1.17%
Jupiter UK Mid Cap	1.07%

The funds added are: -

	TER
Comgest Growth Europe Ex UK	1.10%
JP Morgan Emerging Markets Income	1.02%
Stewart Investors Indian Subcontinent	1.16%
Lindsell Train UK Equity	0.71%
Royal London Sustainable Leaders Trust	1.07%
BYN Mellon Real Return	1.08%
Royal London Diversified Asset Backed Securities	0.36%
Artemis Target Return Bond	0.65%
M&G Global Floating Rate High Yield Bond	0.77%

Collectively our six portfolios outperformed their respective benchmarks on 32 out of 40 occasions.

We are happy to report that at the time of writing, our six portfolios have performed well compared to the relevant national Investment Association (IA) benchmarks over time periods from 3m to 5 years. However, our 1-year relative performance has been hurt by our exposure to the iShares Clean Energy ETF and long dated credit in Q1 2021. The relative performance is measured over seven time periods: - 3 Months, 6 months, 1 year, 2 years, 3 years, 4 years and 5 years. Collectively our portfolios outperformed their respective benchmarks on 32 out of 40 occasions which is an 80% competency.

Our performance is reported on the next page of this Outlook report as well as on our website **www.estatecapital.co.uk**

PORTFOLIO PERFORMANCE

The Estate Capital Investment Portfolios

The Estate Capital Investment Portfolios now offer six risk related investment strategies designed for medium to long-term investors seeking capital growth and income from a portfolio of leading investment funds. The individual funds that make up our diversified portfolios are selected on the quality of the fund manager and both the quality and consistency of past performance.

There is a wide range of asset classes across global markets available to investors. Our portfolios bring together a diversity of global equities, fixed interest securities, cash deposits, commodities, precious metals, infrastructure and property. The global balance of investments across differing asset classes is the primary driver of portfolio returns.

Our asset allocation is built using a fully modelled asset allocation tool. This system is powered by research from actuaries Willis Towers Watson and investment data from Financial Express.

This modelling system offers us great accuracy to build and test the most efficient blend of assets for our six model portfolios. Each new edition of our portfolios is published on our website with fact sheets, performance figures, risk ratings and range of returns.

We benchmark and publish our portfolio performance against the most relevant national averages and are happy to say that our selections have enjoyed an enviable track record.

The global balance of investments across different asset classes is the primary driver of portfolio returns.

Cumulative Portfolio Performance from 12th November 2021

Below are the past five year's gross investment returns for each of our portfolios from 12th November 2021.

Portfolio	*6 months*	*1 year*	*2 years*	*3 years*	*5 years*
Cautious	3.64%	4.54%	9.03%	16.39%	29.26%
Conservative Alpha	4.21%	6.47%	13.67%	22.47%	
Balanced Beta	6.05%	11.37%	13.82%	23.57%	38.57%
Balanced Alpha	6.19%	12.90%	23.83%	34.04%	57.24%
Speculative Beta	7.09%	15.09%	18.82%	30.22%	48.58%
Speculative Alpha	6.64%	11.67%	23.89%	35.55%	64.00%

Discrete Portfolio Performance from 12th November 2021.

Below are the gross investment returns for each of our portfolios for each 12-month period over the last five years from 12th November 2021

Portfolio	*2021*	*2020*	*2019*	*2018*	*2017*
Cautious	4.54%	4.30%	6.75%	0.54%	10.47%
Conservative Alpha	6.47%	6.76%	7.74%		
Balanced Beta	11.37%	2.20%	8.57%	-1.17%	13.47%
Balanced Alpha	12.96%	9.63%	8.24%	-0.03%	17.34%
Speculative Beta	15.09%	3.24%	9.60%	-1.36%	15.67%
Speculative Alpha	11.67%	10.94%	9.41%	0.60%	20.27%

The value of investments can fall as well as rise. Past performance is not a guide to future performance. Cumulative and discrete performance charts show % growth from 12th November 2021 calculated using bid prices with income reinvested into the fund net of tax.

Asset Allocation January 2022 - Edition 36

Portfolio	Risk	Money Markets	Fixed Interest	Property	UK Equity	US Equity	Europe Equity	Asian Equity	Japan Equity	Global Equity	Other Assets
Cautious	3	19%	50%	4%	4%	8%	3%	3%	0%	5%	4%
Conservative Alpha	4	18%	38%	6%	5%	12%	5%	5%	1%	6%	4%
Balanced Beta	5	15%	30%	8%	7%	19%	4%	4%	2%	6%	5%
Balanced Alpha	6	10%	29%	7%	7%	18%	6%	6%	2%	8%	7%
Speculative Beta	7	7%	23%	8%	9%	26%	6%	5%	3%	6%	7%
Speculative Alpha	8	7%	22%	7%	10%	21%	6%	8%	3%	9%	7%

Perspective Range of Return & Volatility

Portfolio	Risk	Return	High	Low
Cautious	3	3.05%	17.11%	-11.02%
Conservative Alpha	4	3.61%	20.92%	-13.70%
Balanced Beta	5	4.21%	25.08%	-16.66%
Balanced Alpha	6	4.78%	29.06%	-19.49%
Speculative Beta	7	5.32%	32.79%	-22.15%
Speculative Alpha	8	5.89%	36.77%	-24.99%

Investment Ratios

Portfolio	Risk	Beta	Alpha	Sharpe Ratio	Info Ratio
Cautious	3	0.92	0.06	0.21	0.18
Conservative Alpha	4	0.75	0.16	0.42	0.11
Balanced Beta	5	0.95	0.06	0.36	0.19
Balanced Alpha	6	1.04	0.63	0.72	0.52
Speculative Beta	7	0.92	0.03	0.47	-0.13
Speculative Alpha	8	0.89	0.18	0.61	0.28

Maximise your returns with a level of risk you're entirely comfortable with.

Financial Advice & Wealth Management

INDEPENDENT FINANCIAL ADVISER

Chartered Financial Planner

7 Uplands Crescent
Swansea
SA2 0PA

Phone: 01792 477763
Email: mail@estatecapital.co.uk
www.estatecapital.co.uk

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