gemini asset management

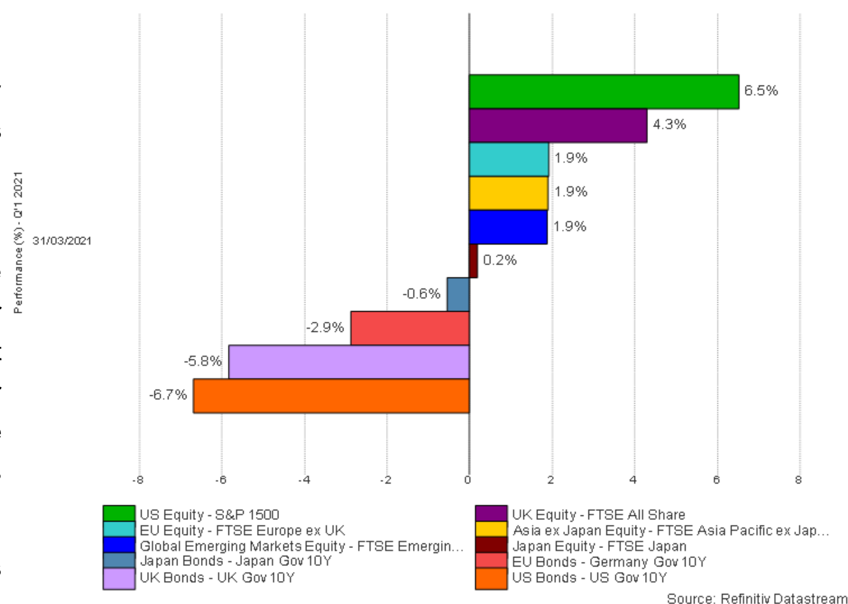
marketmatters

Market Matters Quarter 1 2021

The first quarter of 2021 has been a little dramatic but, given the last 12 months we have all faced, I am sure that will not come as any surprise!

As we have discussed in our Investment Briefing videos, the main things driving asset market performance in the last few months have been the massive stimulus packages put forward, the success of vaccine rollouts, and the inflation expectations associated with both.

In a nutshell, bonds have performed poorly in the face of rising expectations of inflation, and equities have benefitted from a broad rally whereby many of the hardest hit sectors rebounded higher as society attempts to return to a semblance of pre-covid normality.



The chart on the right shows the performance of various equity and bond benchmarks over the first quarter of 2021. We can see that government bonds sold off heavily this quarter whilst there has been notable positive performance achieved by UK and US equities during this period.

Bonds were sold off after inflation expectations increased (more on this later), whilst the increases in equity markets was mostly due to the positive sentiment surrounding the global economic recovery and a potential return to normality after strong vaccine programmes. Much of this rally in equities was a continuation of the trend we first witnessed in November 2020 when vaccines were first given the green light to be administered in the UK. The performance has mainly been driven by some of the most beaten-up sectors throughout the covid-19 crisis so far, with Financials and Energy rallying strongly as these sectors benefit greatly from economic growth. These sectors also make up a large proportion of the UK equity index, and as such we have seen an excellent bounce in the FTSE All Share returning 4.3% in this first quarter of 2021.

Another main cause of the market movements has been the vast spending plans instituted by the Biden administration over in the US. Biden took a leaf out of his predecessors' playbook and released a new round of direct stimulus by putting cheques in citizen's pockets to help stimulate consumer spending and propel economic growth upwards. The boost felt from stimulus also did not stop there as the new administration also pushed through a huge $1.9 Trillion infrastructure spending plan, after galvanising their majority in the House and the Senate by winning the Georgia state run-off. This election victory allowed the Democrats free reign to push through whichever policies they see fit to help the US climb out of the depths of pandemic misery, and so far with direct cheques and infrastructure spending have been their tools of choice.

Both the vaccines rollouts – which have allowed societies to operate more similarly to pre-pandemic norms – and these stimulus policies have given substantial credence to the idea of positive economic growth in 2021 and enhanced positive sentiment in risk assets. Of course, there is a lot that needs to go well in order for the 2021 growth hypothesis to be proven correct, not least is the successful and consistent rollout of vaccines globally, as well as their continued evidenced effectiveness.

Figure 2:

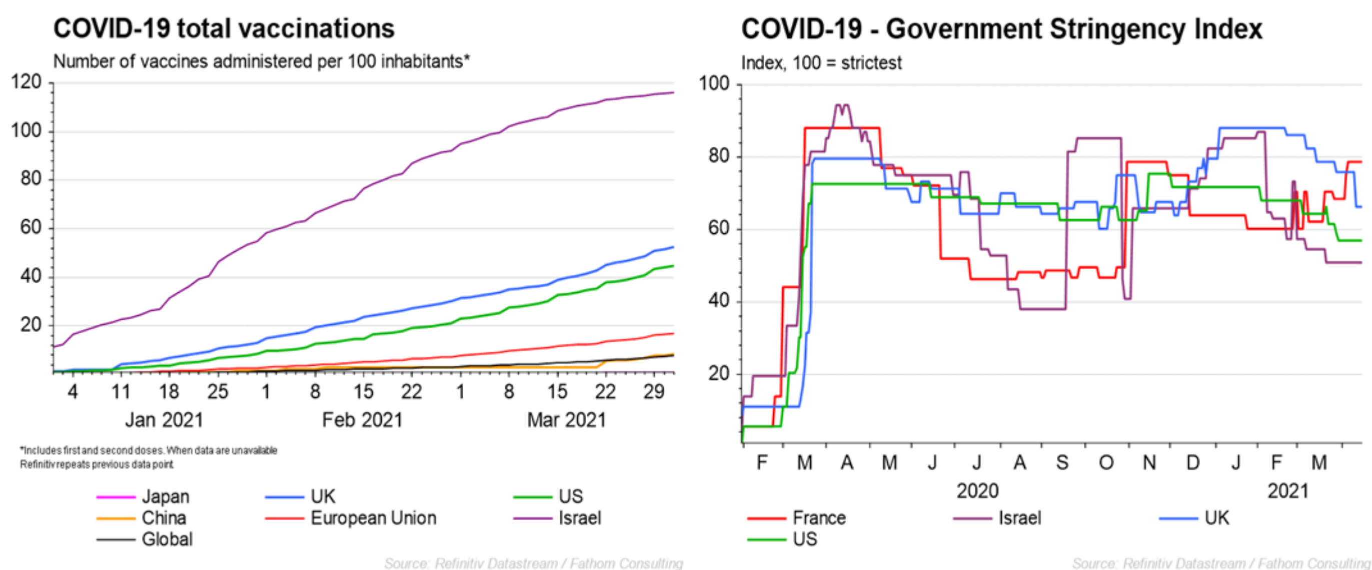


Figure 2, on the left-hand-side (LHS) shows the total number of vaccines administered per 100 inhabitants in the first quarter of 2021, whilst the chart on the right-hand-side (RHS) shows the Government Stringency Index – an index created to show how strict each government's Covid-19 lockdown measures have been.

In these charts we can see a clear pattern that the countries which have managed to administer the most vaccines in Q1 have also started on the path of loosening the lockdown restrictions, whilst countries such as France, where vaccine rollouts have been less successful, has become more stringent with their lockdown policies. The vaccine rollout success is therefore correlated with how well an economy is expected to perform in the near future as it is used as a measure of how close a country may be to returning to pre-pandemic normality.

Essentially, the main driver for market performance in quarter 1 has been the increasing economic growth expectations. This increase in the expected economic growth, spurred on by the stimulus plans and vaccine rollouts, has also reawakened a debate which has been relatively dormant in recent years; the debate surrounds inflation as it is intrinsically linked to strong economic recoveries, and it has an impact on all investment returns.

Inflation is a two-sided equation driven by demand and supply dynamics and it is used as an indicator to gauge the levels of price increase or decrease over time. Essentially, if there is a shortage in supply for something, and there is also a high demand for it, the price tends to increase. Conversely, if there is abundant supply and limited demand, prices tend to decrease. Given the disruption to supply chains caused by this global pandemic and given the potential for a large 'pent-up -demand' to be released when economies finally exit lockdowns there is credence to the idea that inflation may take off again, and especially so when considering the massive amount of stimulus (which is also seen as inflationary) that has been provided by policy makers in Governments and Central Banks over the last year.

Inflation is important an any increase in inflation will erode the purchasing power of money and in turn the purchasing power of people and businesses which operate within the economy. Inflation also impacts investment returns too, as an increase in inflation will erode any returns achieved – for example, if the return of an investment is 10% and inflation is 2%, then the real return of the investment would be 8%. Some inflation is a good thing though, as it is a sign of a healthy economy, but too much inflation will erode too much of the purchasing power of money and investments to a point where is can be damaging.

Figure 3:

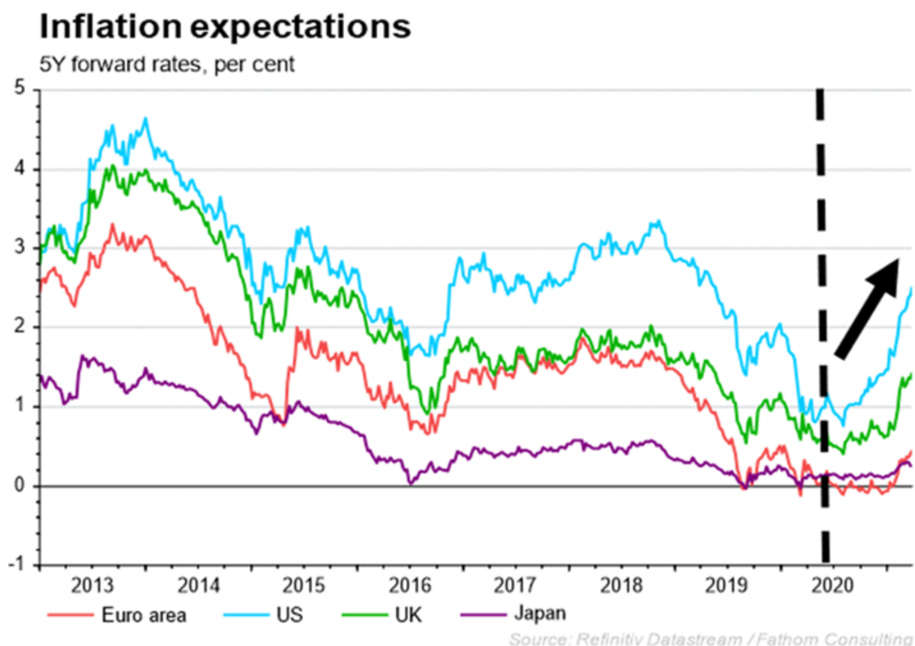


Figure 3 shows the 5 Year 'Breakeven Rate' for some key regions around the world. The 'Breakeven Rate' is a metric used by investors to assess how much inflation the asset markets are expecting per year over the next 5 years. For example, the UK 5 year breakeven is 1.4% on 31st March 2021 – this shows investors, over the 5 year period between 31st March 2021 and 31st March 2026, are expecting the average inflation to be 1.4% per year. The increase in expected levels of inflation is clear to see to the right-hand-side of the dotted black line where we can see it has risen above the pre-pandemic levels so far in 2021. This expected inflationary spike led to the outperformance of equity sectors such as Financials – which benefit from higher interest rates -- but has also contributed to the fall in Bond prices and relative underperformance of Emerging Market equities — which are negatively impacted by expectations of rising interest rates.

Policy makers, such as central banks, can both encourage and discourage inflation so the same policy makers that provided the stimulus which contributes to the inflationary picture can also utilise other tools in their toolbox to help slow down potential inflation too, such as increasing interest rates to encourage people to save and limit the propensity to spend.

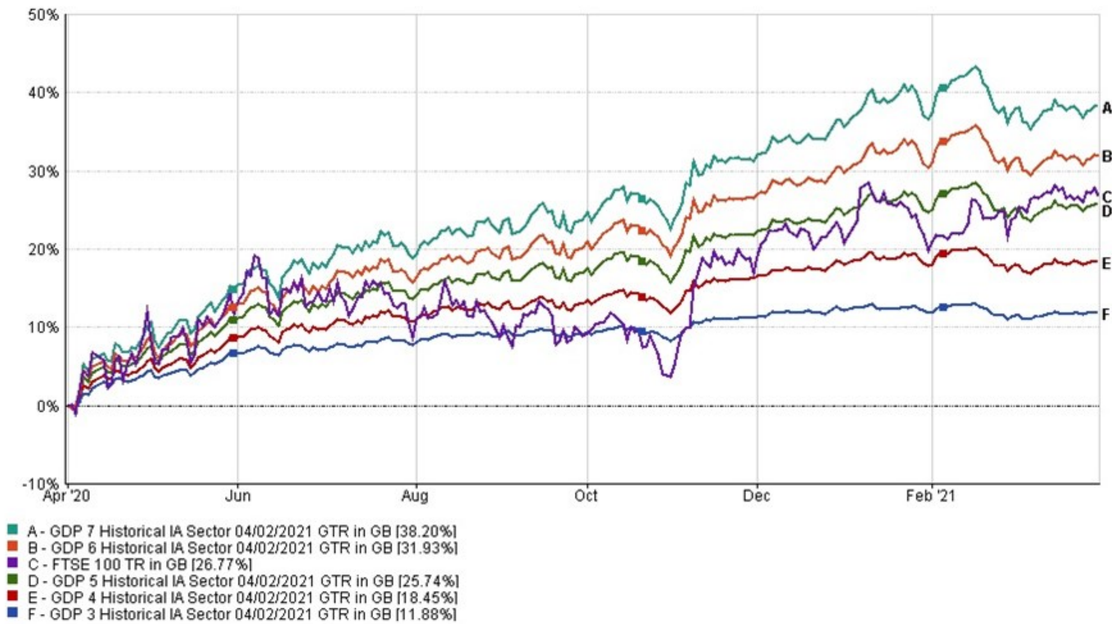
Investors shouldn't be too taken by the idea of runaway inflation just yet however, as expected levels of inflation remain within the bounds of policy makers' inflationary targets. Since the turn of the year, central bank chiefs around the world have stated that whilst they are closely monitoring the inflationary signals within their economies, they are more concerned about levels of unemployment and are trying to ensure businesses are in a strong enough position to continue to employ workers once many of the support schemes – such as the Furlough scheme in the UK – are withdrawn.

Overall, quarter 1 of 2021 further advanced the reversal in fortunes first experienced in November 2020 after the vaccines began to be administered en-masse and, given the huge economic disruption caused by the pandemic, the expected boost in economic activity should also be welcomed with open arms. The unpredictable nature of this a global pandemic, however, means that we should under no circumstances become complacent about the recovery and it is along these lines that we continue to run the portfolios.

Portfolio Performance

The following charts show performance of our discretionary risk rated portfolios over the course of the last 1 and 5 years. The charts are based upon our existing discretionary models looking back and so only take into account the asset allocation and fund changes made since March 2017 i.e. since the models were created. The data beyond this therefore presumes investment in the same funds and asset allocations as of March 2017. The charts compare performance against the FTSE 100 in order to demonstrate the importance of spreading risk through diversification. Whilst a direct comparison of our portfolios with an equity index such as the FTSE 100 is not like for like it does give an indication of volatility and performance differences on a risk-adjusted basis.

Portfolio Performance – 1 year:



Source: Financial Express Analytics data 31/03/2020 to 31/03/2021. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees.

Portfolio Performance – 5 year:

Source: Financial Express Analytics data 31/03/2016 to 31/03/2021. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees.

The value of investments can fall as well as rise. You may not get back what you invest.

Asset Allocation and Fund Review

The investment committee reviewed the existing asset allocation models in conjunction with the recommendations and capital market assumptions put forward by our independent actuary, Dynamic Planner. **As a result of this there were no changes made to the asset allocation models and the funds for those plans that receive our discretionary fund management (DFM) service during the first quarter of 2021.**

For plans held under our advisory service we are also not recommending any changes to the asset allocation models.