CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

September 2021

Winter is Coming

The benign market that equity investors enjoyed over the summer and for much of the last year, came to an abrupt halt in September, when volatility returned to markets. There were all manner of events for bears to get their teeth into – from the impending default of one of China's biggest property developers, to a brewing energy crisis stoking inflationary forces. Winter appears to be arriving early in the UK: with the end of Furlough; the £80-a-month boost to universal credit; and the cut to housing stamp duty. If you manage to find a pump, filling up your car will cost you nearly £1.40 per litre, and a beer at your destination will set you back a great deal more than it did before the pandemic. It is abundantly clear that inflationary pressures are re-emerging and less transitory than central banks have anticipated. Investors should prepare themselves for the prospect of a stagflation winter – characterised by slowing economic growth and rising inflation.

However, that is not to say investors should be throwing in the towel in the equity bull market just yet. Whilst we are seeing economic growth slowing, we do not believe it to be recessionary. Therefore what is important is purposeful asset allocation to position for real (inflation beating) returns, over time. For investors in a multi-asset portfolio, this will likely mean having a below benchmark weighting in bonds. Inflation is a bond investor's nemesis and especially so in the current environment – starting from a very low base (in yields). But outside conventional bonds, investors can look to inflation-linked bonds, which seek to provide a degree of inflation protection or floating-rate notes, which see coupons rise with interest rates. Within equities, companies with low levels of debt and strong pricing power are likely to fare well in such an environment. Value stocks (such as banks, industrials and resources) could also have a renaissance after a summer lull, and typically fare well when inflationary forces are present. And finally, some exposure to real assets (commodities, gold, infrastructure and property) appears prudent. Whilst this latest bout of inflationary pressure will be a concern for central banks, the transitory (inflation being elevated for a short period of time) narrative is still the base case rather than inflation spiralling out of control. Over the medium term the market believes inflation will run at 2-4% and this has historically been a good environment for stocks.

We are in little doubt, however, that the autumn volatility in markets has some way to run through the rest of 2021 and we will likely continue to see sentiment ebb and flow on inflationary dynamics, as well as the outlook for economic growth. Worries over the health of the Chinese economy are real and the situation with property developer Evergrande has some of the hallmarks of the beginning of the financial crisis, which Chinese authorities will wish to avoid at all costs. The opportunities for active management (both in asset allocation and security selection) appears more abundant than over much of the last decade (where assets rose in unison), as investors adapt to a new post pandemic regime and adjust portfolios accordingly.

CS INVESTMENT MANAGERS

43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com

www.csmanagers.com