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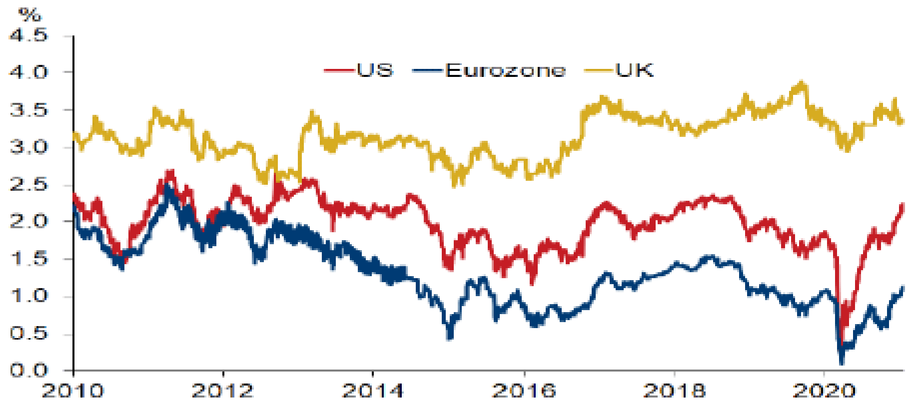
The first few weeks of quarter one 2021 started off mostly in the same vein as the tail-end of 2020. At this stage, the stay-at-home theme regarding Covid was continuing, and although the theme itself was getting 'tired' it was still benefitting the Information Technology sector in particular, to the benefit of the portfolios. The prospect of large-scale vaccination roll-outs to the global population in the fight against Covid-19 buoyed both the biotechnology and healthcare sectors, which experienced their biggest fund-raising year ever in 2020, with a low interest rate environment, scientific advances, mergers and acquisition activity, and other additional factors boosting valuations in these sectors. Prospective further monetary and fiscal stimulus from global central banks and governments respectively were also beginning to have a knock-on effect upon assets which are cyclical or sensitive to the economic growth cycle.

In the initial days of the new year, the MPL Investment Team positioned client portfolios for the impact of a return of economic normality or something close to it, by increasing exposure in the main to companies which thrive during periods of economic recovery and growth. This was carried out in several geographic areas including Asia, Europe, the US, UK, and Emerging Markets, and utilising cash holdings which were maintained through part of 2020.

Inflation

Mid-way though the quarter, as the Biden Administration in the US moved towards the finish line on its $1.9 trillion fiscal stimulus package to American households and businesses, the prospects for higher inflation resulting from this stimulatory largesse increasingly influenced political commentary and Wall Street trading, despite proponents of the package insisting that it would not stoke increased inflation. Forward-thinking financial markets had a different point of view however, which led to negative volatility as JP Morgan Chief Executive Jamie Dimon estimated that circa $1 trillion plus of excess savings which had built up in the United States during the pandemic, remained unspent and would be spent once any unlocking of the economy allowed this to happen.

5 Year Inflation Swaps Market



Source: Oxford Economics/Refinitiv

In the 5-year Swaps market, where agreements are made to exchange cash flows for a set period-of-time (and for simplicity are determined by a rate of interest), the above chart suggests that in recent months investors have been buying more inflation protection to safeguard their assets against higher future rates, with the resulting impact widespread across markets.

After a period of falling real rates (that is nominal interest rates less inflation) and rising macroeconomic activity over recent months, higher resulting inflation could lead to higher future interest rates at central banks, which in turn would lead to higher long-term bond yields, to the detriment of the global economy, which sees low rates as very pro-growth.

In bond markets, investors would demand a higher rate of return particularly on their longer-term bond holdings, as compensation for the higher inflation that they expect to eat away at their bond income in the future. This trend has already been evidenced in US Government Bond markets, which have seen the stronger growth outlook push 10-year yields up from around 1 percent at the beginning of the year to around 1.6 percent now, a 60 percent increase.

This in turn would lead to higher costs of borrowing for both governments and corporations, placing constraints upon economic output and potential. This explains the negative reaction seen in equity markets recently, with higher bond yields forcing a reassessment of equity valuations (which were at lofty levels in some quarters), as the discount rates used to calculate the present value of future corporate earnings (which in turn is used to calculate the valuation of equities) are determined by bond yields. Higher discount rates invariably lead to lower equity valuations.

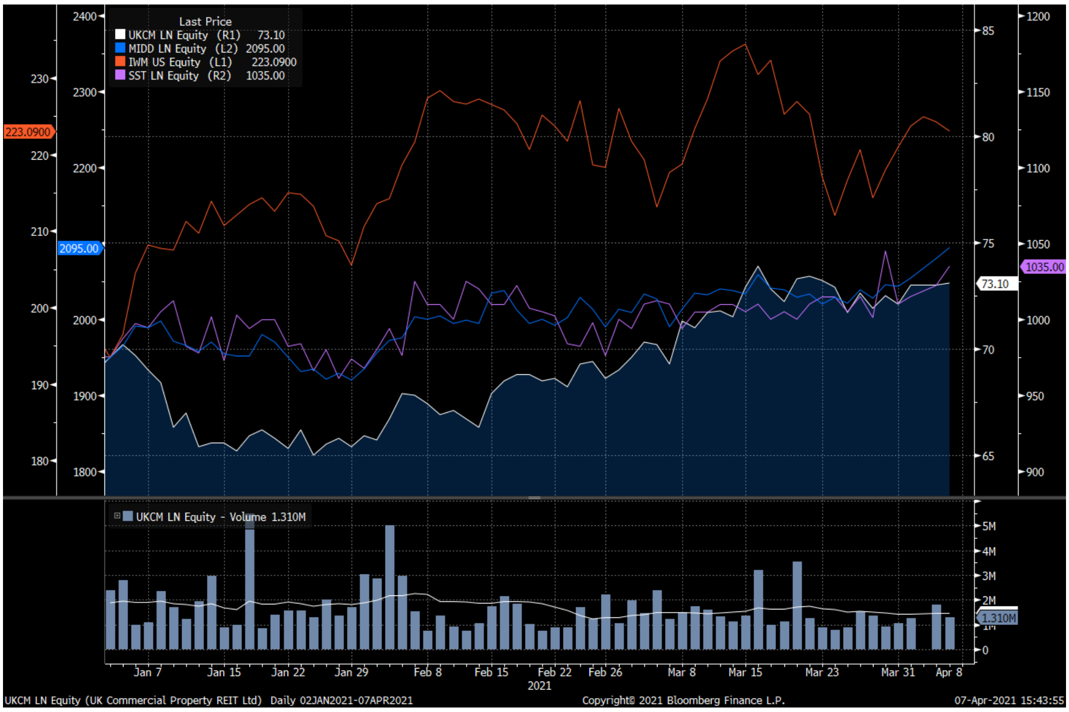
The jury is out on whether the rise in inflation will prove to be enduring or short-lived, however. The United States Core Personal Consumption Expenditures (PCE) indicator is a measure of consumer spending nationally in the US, and constitutes the US Federal Reserve's preferred inflation measure given that personal consumption drives nearly 70% of US economic output. This indicator, as reported in March, fell to an increase of 1.4% annualised in February following an increase of 1.5% annualised in January. These notably muted increases in inflation went some way to allaying fears of any sharp rise in inflation in the short term, leading to the recent volatility in equity prices reducing . At the same time, Federal Reserve Chairman Jerome Powell told lawmakers that "the anticipated rise in inflation over the course of the year will be neither particularly large nor persistent".

We must not forget however that some inflation is good for the economy - it signals the presence of significant economic growth and creates room for central banks to control the economic cycle by adjusting interest rates. Indeed, this factor has been beneficial (in the short term at least) for the cyclical economically sensitive assets mentioned earlier.

The UK Commercial Property sector, which had a torrid time throughout the pandemic, has had a brighter start to 2021. This sector is undoubtedly cyclical in nature, and in a simplistic sense property prices increase in an inflationary environment, hence bricks and mortar based investments can provide the benefit of inflation-protection in this type of environment. Cyclical economically sensitive sectors within global small-to-mid cap equity markets have also risen in value so far this year, in tune with the enhanced prospects for global economic growth.

The chart below shows an example of the year-to-date performance of some of the holdings within MPL client portfolios, which are representative of these cyclical assets.

YEAR TO DATE PERFORMANCE OF UK COMMERCIAL PROPERTY, AND ASIAN, UK, and US ECONOMICALLY SENSITIVE EQUITIES



Source: Bloomberg

The UK Commercial Property Trust (UKCM LN) which contains commercial property holdings in prime strategic locations throughout the UK, is charted in white. In the global small-to-mid-capitalised equity sectors, the UK iShares FTSE-250 Index Exchange Traded Fund (MIDD LN) is shown in blue, the US iShares Russell 2000 Exchange Traded Fund (IWM US) is shown in red, and the Far East Asian-focused Scottish Oriental Smaller Companies Investment Trust (SST); is shown in purple.

<u>Portfolio Changes.</u>

As mentioned above, early in 2021 and in order to pre-empt the likely increased stimulus plans in the US and the resulting anticipated increases in global growth rates, we increased exposure within client portfolios to Asia via the Fidelity Asia and Scottish Oriental Smaller Companies funds.

Existing holdings of the Fidelity European Investment Trust were also increased, this to gain additional exposure to large-cap European cyclical areas with a global tilt, given that Europe remains an export-led economic story. Additionally, the small-to-mid cap European sector exposure was increased within the Carmignac Grande Europe fund.

Here in the UK, we increased exposure to the domestic equity markets so as to increase the focus on what should prove to be a capital recovery theme in fast-moving UK equity markets, particularly as in the post-Brexit environment the UK is once again becoming perceived as an investable market by overseas players. This increase was achieved by adding to existing positions in the FTSE-100 and FTSE-250 Exchange Traded Funds.

Kind Regards

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