QUILTER CHEVIOT

INVESTMENT MANAGEMENT

INVESTMENT REVIEW Q2 2021

OVERVIEW

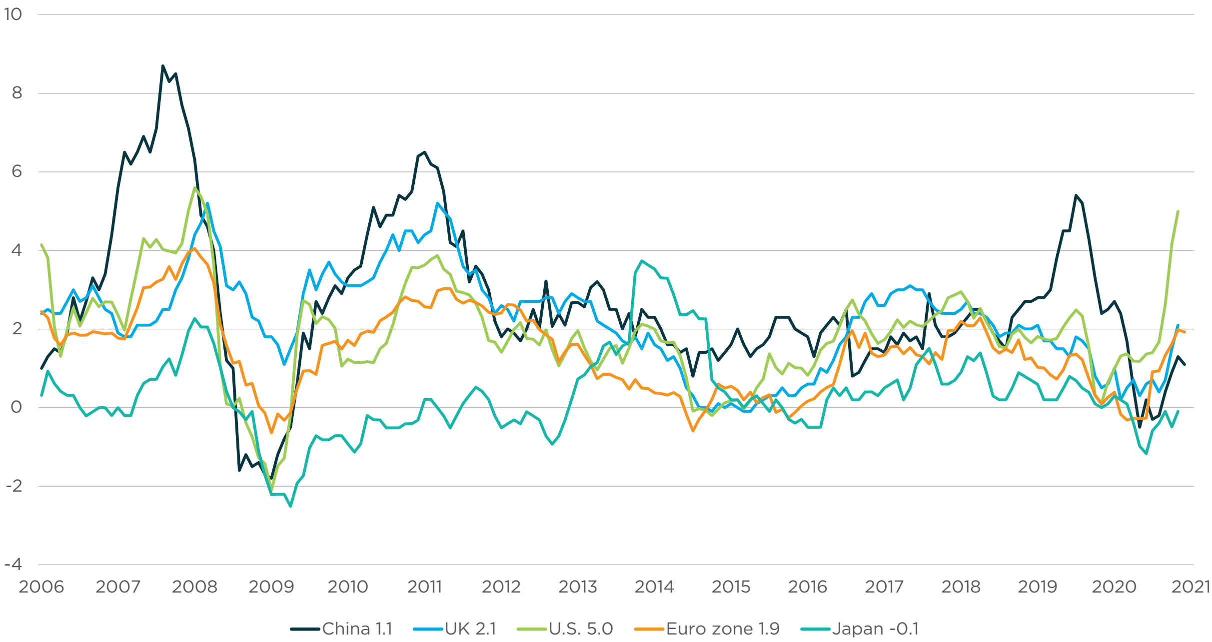
The successful vaccination rollout across advanced economies combined with exceptionally supportive fiscal and monetary policies have helped the global economy regain some sense of normality. The pace of recovery in Q2 exceeded expectations and enabled equities to make further gains. Global markets rose 7% over the period with the broad-based US indices establishing new all-time highs following the late May/June upturn in technology stocks. The UK and Europe also gained 5%-6% while Asia and emerging markets - held back by a stronger dollar - rose 4%. Japan was marginally lower.

WORLD MARKETS 01 APRIL 2021 - 30 JUNE 2021	OPENING LEVEL 01/04/21	CLOSING LEVEL 30/06/21	% CHANGE
MSCI UK	1046.408	1095.633	**4.70%**
MSCI EUROPE EX UK €	171.397	181.313	**5.79%**
MSCI NORTH AMERICA $	4033.239	4379.107	**8.58%**
MSCI ASIA PACIFIC EX JAPAN	1490.452	1549.267	**3.95%**
MSCI JAPAN Y	1190.812	1190.695	**-0.01%**
US $ TO UK £ (WMR)	1.3797	1.38145	**0.13%**
CRUDE OIL BFO M1 EUROPE FOB $/BBL	63.52	75.25	**18.47%**
GOLD BULLION LBM $/T OZ DELAY	1704.74	1765.43	**3.56%**

Source: Refinitiv DataStream. As at 30 June 2021.

After a weak Q1 as inflation concerns took hold, bonds had a better quarter and closed in positive territory. Although most inflation data surprised on the upside - and in many cases exceeded central banks' long-term targets - the official view is that this is transitory and inflation will ease once supply chains return to normal. Some of the cost pressures are coming from commodities such as Brent Crude, which ended Q2 above its pre-pandemic level at $75, and copper which closed near a multi-year high. Others have arisen from a shortage of digital age "commodities" - notably semiconductors where COVID disrupted production just as there was a spike in demand for technology to support home working and learning.

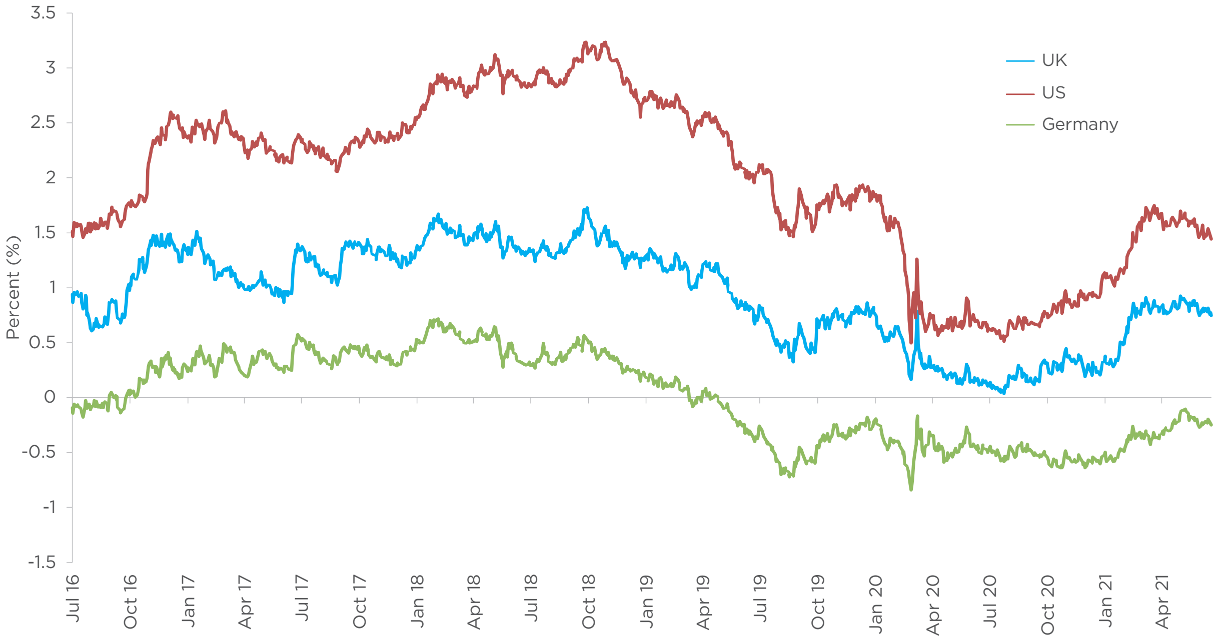
GLOBAL INFLATION RATES



Source: Refinitiv DataStream July 2021.

The sharper than anticipated rise in US inflation has challenged central banks' timescale for normalising monetary policy. The Federal Reserve is expected to discuss tapering asset purchases in August and implement this during the autumn before considering a rise in interest rates next year. Meanwhile, there are mixed views among both policymakers and bond investors on the transitory nature of the inflation uptick. Bond yields have eased back since February with the US 10 year ending Q2 down 25bp at 1.47%. A sustained pick-up in inflation is likely to be driven by labour costs. Companies say finding skilled candidates is difficult and wage inflation has risen 4% year-on-year although jobless claims have plateaued in recent weeks despite there being over 6m fewer in employment than before the pandemic. The phased withdrawal of furlough arrangements could be behind a reluctance to return to work but there are other factors such as the delay in reopening hospitality and leisure.

GOVERNMENT 10-YEAR BOND YIELDS



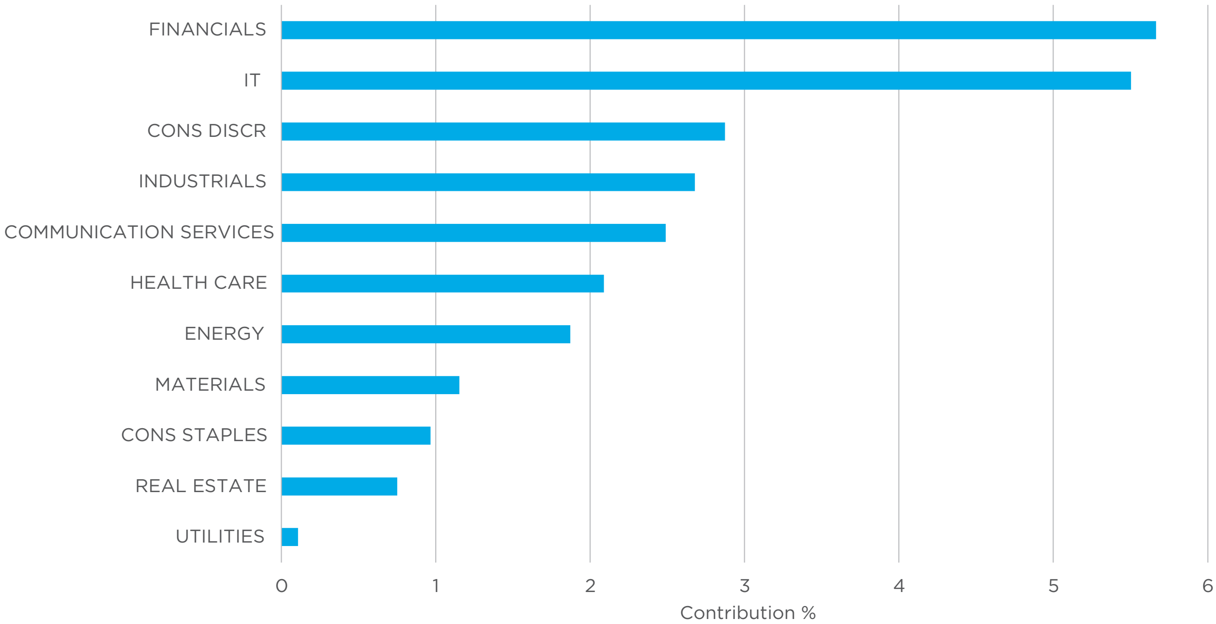
Source: Refinitiv DataStream. As at 30 June 2021.

We have seen further modest upgrades to global GDP and this is now expected to rise 6% this year and just over 4% in 2022 versus expectations of 5.5% and 3% this time last year. No one knows what the "new normal" will look like - not least because of the unequal distribution of vaccines globally and new variants of the virus - but so far the recovery has differed from that after the financial crisis when China led the global investment cycle with a credit-fuelled infrastructure programme. This time it is President Biden's $2 trillion "American Jobs Plan" and the EU's "Next Generation" recovery plan that should, if implemented successfully, have a multiplier effect across economies. This is not to suggest that China will reduce investment spending although there will be more emphasis on security of technology and supply chains in key areas such as semiconductors, quantum computing, biotech, automotive and aerospace. The global economy is always evolving and the "new normal" could see advanced economies move away from an austerity constrained low growth/low inflation environment.

Underlying the optimistic global outlook is high vaccination rates in the US and UK where 50% of the population has now had two jabs. Europe is around 30% while China, Japan and India are 15%, 11% and 4% respectively. However, as the global figure is around 10%, there is still a long way to go. US economic activity has rebounded to pre-pandemic levels, spending on goods exceeds prior levels and services are likely to follow as travel and other leisure activities open up. Housing has remained strong during the recovery with prices up 15% year-on-year. Growth in Europe still lags the US (and UK) but recent surveys suggest it is catching up fast with Spain and Italy expected to report the highest GDP growth this year. Surveys also indicate that the UK rebound is accelerating and output could reach pre-pandemic levels this autumn. The next Bank of England growth forecast in early August may see GDP projected to rise to 8% in 2021 as consumers spend their way to freedom but maintaining this could be challenging given the lack of infrastructure investment by comparison with the US and EU.

Since the Pfizer vaccine announcement last November - and against a backdrop of rising inflation expectations and bond yields - there has been a strong rally in the cyclical/value stocks most sensitive to economic recovery including energy, materials, industrials and financials. Although we have seen growth/technology rebound in recent weeks as bond yields trended sideways, this may not be sustainable over the summer if the inflation uptick is “transitory for longer” and GDP surprises on the upside. This would put upward pressure on real yields and is an environment in which cyclicals usually perform well.

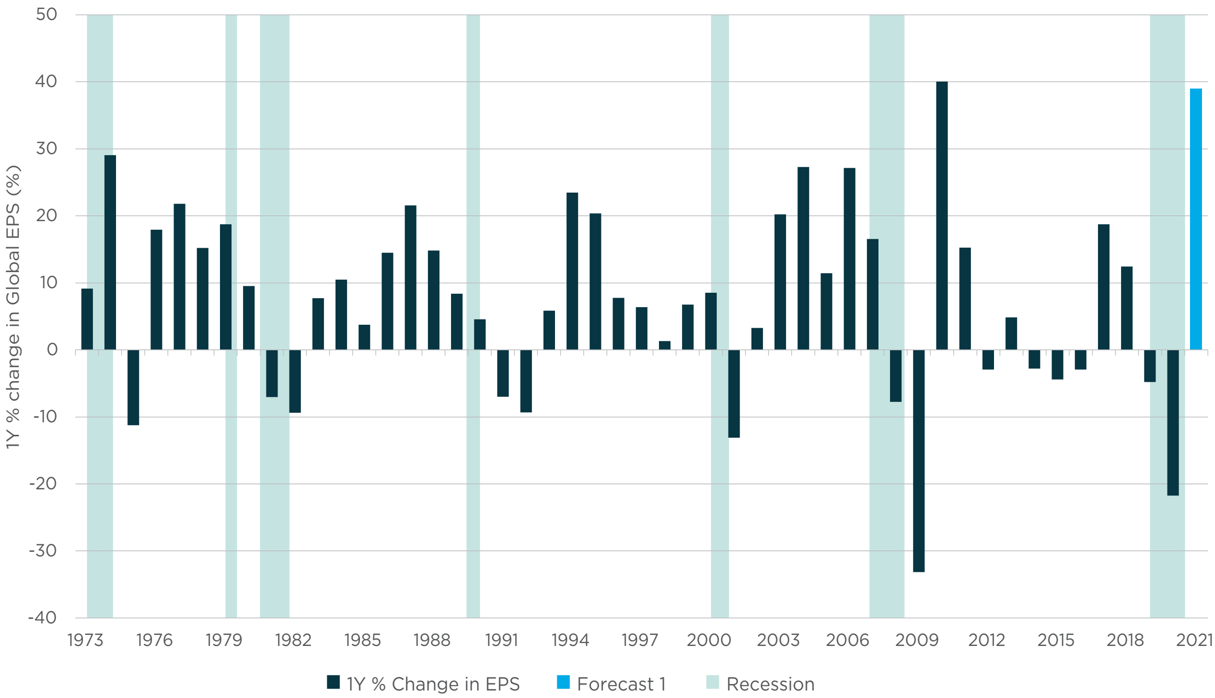
MSCI ACWI SECTOR CONTRIBUTIONS - SINCE PFIZER/BIONTECH VACCINE ANNOUNCEMENT



Source: Refinitiv DataStream July 2021.

Share price movements and style rotation have reflected upward revisions to global corporate profit estimates. After falling 10% last year, these are now expected to increase by 40% in 2021 - some 15% above estimates at the start of the year - and 10% in 2022. The UK has seen the largest revisions followed by the US, Europe and Japan. Cyclical companies have benefitted most particularly energy, materials and financials. While technology has not been left behind, year-on-year comparisons will inevitably become harder. The forces driving markets evolve and, although tech stocks have long been a dominant theme in the US, it is interesting to note that the semi-conductor shortage has helped ASML - a Dutch manufacturer of chip-making equipment - become one of the largest quoted companies in Europe.

GLOBAL EPS AND PERIODS OF RECESSION



Source: Refinitiv DataStream July 2021.

The news flow is optimistic, volatility low and sentiment strong. However, valuations of 20x price earnings are not cheap albeit profit estimates may continue to be upgraded given 4% GDP growth in 2022 implies that earnings per share could increase by around 20%. Meanwhile, there is plenty to concern markets over the summer when GDP momentum is expected to slow and discussions on tapering asset purchases are likely to result in bond yields edging upwards. On balance, we continue to favour equities over bonds but have tempered our optimism in recent weeks.

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