James Hambro & Partners

Investment update

June 2021

As the global recovery from the health crisis unfolds, we continue to tilt portfolios to companies and sectors that benefit from an opening up of the economy and rising interest rate expectations.

Investment outlook

Major economies should have returned to their pre-pandemic trajectories by the latter part of this year as vaccination programmes allow for the resumption of normal economic activity. Central banks are committed to looking through any immediate inflationary pressures, keeping interest rates low and liquidity in the system until they are convinced of recovery. The US Federal Reserve (Fed) has explicitly shifted its focus to employment growth even if that means that inflation runs temporarily at a higher rate.

Governments in major developed markets continue to provide a fiscal backstop to support the recovery. More recent rhetoric points to government spending enduring post pandemic, but with a focus on achieving social and structural objectives; whether those are levelling up in the UK, infrastructure renewal in the US or the environmental agenda implicit within the European Recovery Fund. We expect to see more of this in the second half of this year.

The combination of normalising activity, loose money and active governments mean that economic recovery is running above trend rate. Momentum should continue into 2022, although this will likely slow as time progresses back towards trend.

Inflationary pressures are clearly evident in the system, with resource and goods prices much higher than a year ago, there are also anecdotal signs of tightness in labour markets. The present spike reflects short-term supply bottlenecks and distortions given the violent price swings driven by the pandemic (especially in oil). We expect pressures to subside, in line with guidance from the Fed. However, given the speed of the recovery and scale of stimulus there is a risk that higher inflation becomes more embedded, forcing policy makers to respond which would have major implications for markets. We continue to watch developments closely.

Our positioning

Our investment strategy remains unchanged from May. However, in response to data confirming the strength of the recovery and inflationary risks we have continued to tilt the balance of our exposure in portfolios to companies and sectors that are more sensitive to an opening up of the economy, rising bond yields and inflation.

Bonds in aggregate remain unattractive. Given current yields, we expect bonds to lose money in real terms and see little attraction in corporate credit where the additional yield offers little compensation for the added risk. With yields so low, bonds' primary use is as protective rather than return generating assets. The majority of our exposure is through inflation-protected government securities. US and UK government bonds will prove havens in the event of a market shock, while the index-linking mitigates risks should inflationary expectations become unanchored.

Equities are our favoured asset class, providing the best opportunities for long-term growth. However, after a strong period since the US election and vaccine announcements of last November a period of consolidation is under way. We would not be surprised to see equities track sideways over the summer, given that positioning and sentiment is somewhat extended.

Further out, equity markets should be supported by recovering corporate earnings and optimism as to future economic prospects. Valuations are full by historical standards, but not extreme, and are well-underpinned by the low returns on other assets, particularly cash and bonds, where valuations are unattractive and returns anaemic.

With progress on vaccinations, investor focus has moved to monetary policy and the trajectory of interest rates. Given the importance of liquidity and low rates in supporting asset prices over the last year markets are likely to prove sensitive to small changes in data and central bank rhetoric. More important for longer-term returns is the strength and growth in the earnings of our companies – here we continue to see real progress and growth potential.

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