

SEPTEMBER 2021

Market and Portfolio Review

Fears of a Chinese financial crisis and fuel shortages swamped headlines this past month. At the centre of the issues in China is the huge property conglomerate, Evergrande. Like many Chinese property companies, Evergrande has borrowed a lot. But it has now borrowed more than any other property company in the world and has liabilities of over \$300 billion. The Chinese government is now taking a tougher stance on excessive borrowing and will more likely than not use Evergrande to demonstrate this by letting the company default and collapse.

The real reason this is catching the world's attention is the potential wider impact on the Chinese and global economies. As it stands, we don't believe that widespread financial damage will be done. Although Evergrande is big, its 2020 market share was only 4%, and Evergrande's bank borrowing is only 0.22% of the systems loans. It's also worth noting that, despite our Asia high yield theme, our exposure to Evergrande is small – 0.04% in a balanced profile. So, the overall impact on our portfolios is marginal.

Last month, we wrote about tapering and how investors shouldn't be worried. This month confirmed that investors should still not be worried. Fed officials indicated that they are ready to begin tapering, and markets didn't seem to care. The S&P continued to rise the afternoon and day after the announcement. Jerome Powell said that the official tapering decision could happen in November, and the process would commence shortly after. He even said that he sees tapering finishing "sometime around the middle of next year", giving markets a good idea of the rate at which tapering will happen. All of this means that markets know what to expect so won't have a 2013 style tantrum when the official announcement is made.

Towards the end of the September, you would no doubt have heard a lot about, and probably witnessed, supply shortages in the UK. An almost perfect storm of labour shortages, new immigration rules, and the hangover of the pandemic has led to considerable supply chain disruption in the UK. As it stands, these shortages do not warrant any change in our portfolios.

Core Investment Views

A new wave of economic growth... For the past decade or so, the virtuous circle of consumption and investment has just not been able to get going. The scars of the financial crisis were too deep – people bought less while governments reined in spending. As a result, companies kept putting off investing in longer-term projects.

The 2020 recession hit the reset button. People are willing to spend again, while governments have ditched austerity. And so, companies are starting to invest for the future. We are now at the start of a sustained period of growth, fueled by confidence and expansion across all sectors of the global economy.

And a little inflation won't hurt... Economists tend to dislike thinking about the psychology of inflation, but in a lot of ways, someone's inflation expectations are a good proxy for their confidence levels. With the right amount of price and wage growth, people are encouraged to make life decisions which are positive for the economy. We haven't heard the word "Goldilocks" for some years now, but there really is an amount of inflation which is just right to keep things humming.

7IM portfolios are positioned for a changing environment... For this coming growth phase, we believe a more selective exposure will be better than a large overweight to the broad equity market. A more robust consumer-driven cycle will see different winners emerge. Regions and industries which have struggled to attract investors over the past decade are better positioned to capitalise than the huge US tech giants (although there are lots of small US companies which will do well).

We've also made sure that our fixed income positioning isn't unnecessarily exposed to rate rises, using allocations to alternatives and to non-mainstream asset classes.

The value of investments can go down as well as up and you may get back less than you originally invested. Any reference to specific instruments within this article does not constitute an investment recommendation.

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