KING & SHAXSON
ethical investing

Fund Managers Report
Second Quarter

Fund Managers Report – Long Version - 31st March 2021 – 30th June 2021

The path back.

We reflect back on another positive quarter. Equity markets have returned between 10% and 13% so far in 2021, and between 5.5% and 7.7% in the last quarter. These gains are at a more sedate pace than the volatility of 2020 and the returns for fixed income and infrastructure have been more subdued.

Towards the end of the last quarter, we noticed a shift back away from the reflation trade that had dominated 2021 (favouring oil and consumption-based investments), back towards a more growth focussed market, which in turn enabled ESG and impact investments to recoup some of the relative underperformance in 2021.

Whilst the virus is far from gone, and the pandemic continues to wreck lives and livelihoods around the world, the vaccination programs has taken effect in the UK, US and some other G7 countries, where in some region's restrictions are being slowly lifted. The new Delta variant has added to the uncertainty, and coupled with the vaccination's effectiveness, the relationship between the new variant and serious illness and death has changed. This has created a new level of uncertainty.

The reflation trade fixes the focus of equity markets firmly towards the current macro-economic recovery, and less on how the post pandemic economy will look, which remains the focus of the growth-orientated investments. This leads the market to vacillate between the two types of investments.

To date the markets recovery expectations have been met, and even exceeded in certain developed nations, with strong recoveries in the UK and US in particular. As markets begin to enter the summer reporting season (starting mid-July), attention will be firmly focussed on business outlooks and the continued relaxation of Covid restrictions.

The good news concerning the recovery so far comes with a huge caveat that the market is very cognisant that it is supported by very cheap and abundant money from Central Banks, something that is not sustainable. How, when and at what pace this all changes are the key questions for markets right now, and there are a number of views as to the pace and implications of these changes.

In addition to this concern, the other big unknown is when governments will lift many of the support mechanisms they have put in place. When these life support systems are turned off, we have no doubt some businesses will fail. This failure will not be on the apocalyptic scale implied by some, but some sectors will not recover fully. On the flip side of this, the crisis has caused an acceleration in innovative ideas and a desire to 'build back better', which will no doubt benefit a number of sectors.

Central Bank policy has the biggest impact in the debt markets. We have seen a rise in inflation and to a large extent this is wanted and welcomed by Central Banks after years of low inflation and low growth. There are some concerns in the market that inflation may be harder to control, but these concerns are largely driven by history, and we see the recent inflation issues as more cost-push than demand-pull driven, with issues such as the chip shortage and a shortage in global shipping adding pressure to global supply chains.

We do not see inflation as the risk for the market; we are more concerned about future demand for fixed income investments at a time of increased supply. For us, debt only remains attractive for the ethical nature of the underlying investment; such as immunisation bonds with IFFim, poverty alleviation with microfinance or because we seek to reduce risk. We continue to prefer Floating Rate Notes, where there is no interest rate risk, should rates rise faster than expected.

The cost of debt also impacts the yield-based infrastructure investments that form a core part of most portfolios. With regards to property, we have been pleased with the returns from social, affordable and homeless housing, we continue to avoid office and retail as in these areas there is some pain to come as rent arrears and failed retailers will need to be addressed.

Renewable energy yield companies have been a victim of their own success, and there are concerns over falling electricity prices, both spot (for purchase today) and longer-term prices (a number of years ahead). We see this as a short-term issue as further UK nuclear capacity will go offline soon and battery parks and storage will mitigate some of the variability of renewable energy. We added an investment that owns and operates energy storage plants to the portfolios in the last quarter. Renewable energy was one of the poster children for last year's surge in ESG and Impact investing. Sadly, it is still lagging the market this year, but not as much as in March, and we see the recovery potentially speeding up as investors and customers demand more and faster climate action. You could argue the net zero targets are not being priced in to some of the sales growth expectations, with the International Energy Agency's scenario for renewable energy growth pointing to a 13% compound annual growth rate in the GW required between now and 2030.

Our focus remains on the global economy in 2-3 years' time rather than the near-term reflation from the crisis. From an environmental perspective, we see further acceleration ahead of the COP26 in Glasgow later this year and scrutiny of pledges and performance in this sector is increasing. Notably, pressure is rising on offenders. Likewise, company's social behaviour and governance (in particular on pay and dividends) has improved. The paradox of these changes is an increase in Greenwash and data abuse as it begins to encompass more of the market.

Outlook

Over the summer, we expect the market focus to shift from the crisis and the crisis recovery, to how the colossal stimulus measures are withdrawn. A move that is widely anticipated, much will depend on how expectations are managed. The path of the virus will also remain front and centre, particularly in those countries such as the UK, who are going down the route of learning to 'live with it' rather than to keep restrictions in place. We continue to favour the longer-term investment horizon, seeing any weakness as an opportunity. This forward-looking focus may lead to tilts towards economies and sectors that are focussed on structural growth trends, meaning the path ahead will be bumpy and uneven. Where question marks over whether we have reached peak positivity coincides with the latest quarterly reporting season, and coupled with concerns over the virus, we expect a lot of noise and maybe some volatility along the way.

Disclaimer

Please remember that the value of investments and the income arising from them may fall as well as rise and is not guaranteed. All information contained in this document has been prepared by King & Shaxson Ethical Investing. All opinions and estimates constitute our judgement as of the date of publication and do not constitute general or specific investment advice. Nothing in this document constitutes an offer to buy or sell securities of any type or should be construed as an offer or the solicitation of an offer to purchase or subscribe or sell any investment or to engage in any other transaction. The information contained in this document is for general information purposes only and should not be considered a personal recommendation or specific investment advice.

King and Shaxson Asset Management Ltd. (Reg. No. 3870667) has its registered office at 1st floor, Cutlers Court, 115 Houndsditch, London, EC3A 7BR. The Company is registered in England and Wales and is part of the PhillipCapital Group. King and Shaxson Asset Management Ltd. (FCA Reg. No. 823315) is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN.