MWC MANENTIA WEALTH CONSULTING GROUP

Quarterly Market Overview
2Q 2021

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MWC Group
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Is this the Real Life, Is this just Fantasy

Opening lyrics from Bohemian Rhapsody, Queen

Whatever your view on inflation, on a core consumer CPI measure, there is no escaping the fact that the most recent reading in America constitutes the highest seen in 25 years. Causation and correlation are always hard to disentangle, but the world is undergoing its biggest ever experiment in joint fiscal and monetary stimulus. To suggest that there won't be consequences – both intended and unintended – is to miss the point. Even if it's still unclear to what extent the inflationary pressures we're witnessing are cyclical in nature versus more structural, we think it is crucial to recognise that there has been a clear regime change.

Alexander Gunz, Manager of the Heptagon Capital Future Trends Equity Fund, 01 June 2021

The jury is still out

Seemingly on everybody's lips (well, those in the world of finance, at least), is that dreaded "I" word: Inflation.

The most immediate concern is the extent to which inflation will rebound as economies "reopen". This will be influenced by several factors, including the relative speed at which demand recovers and supply is restored, the extent to which any resulting price pressures are absorbed in firms' margins, and the degree to which the rebound in global commodity prices over the past year is sustained.

The rise in inflation so far has largely reflected a combination of a rebound in commodity prices and what can be termed "reopening" inflation – that is to say, a rebound in prices caused by the unwinding of pandemic-era distortions such as supply bottlenecks. These could prove to be transitory, as the Central Bankers would have us believe. However, lurking in the background is a more fundamental concern that the pandemic will spell the end of the low inflation era of the past thirty years and mark the start of a period of structurally higher inflation over the medium term.

The "rebirth of inflation"

One way to think about whether we are now witnessing the "rebirth" of inflation is to consider the causes of its "death" in the preceding decades. Broadly speaking there were three.

- The first was a huge expansion in the potential to supply goods at a global level and generally at a lower cost of production than was previously the case. The most important aspect of this was the integration of China into the world trading system. But it was also underpinned by new technologies that, for example, enabled the fragmentation of supply chains, as well as improving worker productivity.
- The second factor was a determination by governments and central banks to bear down on inflation itself. This played out in different ways in different countries, but a key element was that central banks were made independent of government politics. As a consequence, decisions over monetary policy were very often in strict accordance with inflation targets. Policy was set in a restrictive way if necessary, which both brought down inflation but also anchored inflation expectations at lower levels.

- The final cause was a structural change in wage- and price-setting behaviour. Price controls were abandoned, and a combination of labour market liberalisation and de-unionisation reduced workers' bargaining power. This helped to break the wage-price spirals that fuelled a rise in inflation in the 1970s and set it on a lower path.

All of these factors then fed off one another in a mutually reinforcing way to produce the era of low inflation that has been a hallmark of the global economy over the past three decades.

But some of the key pillars of the low inflation era are now starting to weaken. The huge expansion of global supply potential has slowed. Globalisation has peaked and in some ways is reversing, and demographic changes (ageing populations, low birth rates, etc.) are weighing on labour force growth in many advanced countries. More fundamentally, at some point it is always possible to overwhelm supply with demand. The possibility of this happening has increased substantially following the large build-up of private savings and huge fiscal expansions seen during the pandemic. The risks are particularly acute in the US.

The attitude of governments and central banks is also shifting. After a decade in which deflation has posed a greater threat than inflation, the imperative to continue bearing down on inflation has diminished. The Fed has shifted to an average inflation target and is putting more emphasis on the "full employment" part of its dual mandate. It remains to be seen what this means in practice, or whether other major central banks will follow in the Fed's footsteps but, at face value, this appears to be a break from the past – and more radical changes to policy frameworks could follow.

At the same time, however, powerful headwinds to inflation remain. Globalisation may have peaked but the wave of reshoring that was promised by President Trump has failed to materialise. Labour markets remain highly flexible and the challenges of organising labour in the modern economy continue to limit workers' bargaining power. And the pandemic has accelerated the adoption of new digital technologies that may in time create a new wave of disinflationary pressure.

The result is, therefore, a more nuanced picture than the current polarised debate on inflation suggests.

Home Delivery

One of the consequences of the lockdowns was that it accelerated the adoption of ecommerce, or online ordering, by many years. According to the global consultancy, McKinsey, 10 years of e-commerce adoption was compressed into three months during 2020**.** Even those who had previously been reluctant to set foot onto this digital stage were forced to adopt or go without. Having made our online purchase, our one and only concern becomes: when will the item be delivered and at what time? But did you ever wonder what it takes to land that item on your doorstep?

When it comes to e-commerce, a supply chain is an overarching process of developing and distributing goods. Think of the retail journey as a winding road that begins from the moment you press "purchase." As it stands, the current logistics roadmap is bumpy and fragmented at best. Each step of the supply chain is often segmented between numerous disjointed companies and processes.

The explosion in online ordering exposed the weaknesses across retailers' supply chain operations and inventory management. To highlight but a few:

- Warehouse systems and inventory management are not integrated nor have real-time data;

- Item tracking often only exists from the warehouse to your door, but none from the manufacturer to the warehouse;
- Supply chain solutions were never intended to help a company grow revenue;
- According to CapGemini, the last mile of a product's delivery accounts for over 50% of the total shipping cost;
- Returns and how to manage them.

Some of the technology companies transforming the supply chain are:

- **Manhattan Associates** is the leader in warehouse management systems. Manhattan's cloud-enabled solution helps integrate data from multiple inventory management systems to boost warehouse productivity and improve utilisation. Manhattan uses machine learning and big data analytics to integrate and manage warehouse automation technologies so they can work together seamlessly.

- **Teradyne** is an undisputed leader in industrial automation. With over $3 billion in revenues and over 5k employees worldwide, Teradyne is a top provider of collaborative robotic solutions for the manufacturing sector with its Universal Robots. Teradyne's subsidiaries MiR and AutoGuide offer a broad range of automation solutions for the inventory management industry.

- **Zebra Technologies** has been at the forefront of supply chain innovation with its RFID scanners through its investments in computer vision technologies. Zebra works with leading retailers and logistics providers around the world to drive and improve flexibility within their supply chain process.

- **PTC** has been investing heavily in its digital architecture for the manufacturing sector to enable collaboration and innovation to improve agility in the supply chain ecosystem. With double-digit revenue growth for the past several years, PTC is a provider of smart manufacturing software solutions.

The reason we mention the above? All these companies are components of the underlying index of the L&G ROBO Global® Robotics and Automation UCITS ETF, one of our highest long-term conviction themes. We are not looking to blow our trumpet to say how great we are in choosing funds. Rather, we are happy to see that one of our convictions is a beneficiary of the changes wrought out of the Covid crisis and expect these trends to continue well into the future.

How secure is your computer?

In a recent report published by Bank Julius Baer, not a month goes by without news of another hack or ransomware attack. We cover details from this report in our fund commentary, so will not repeat it here, but will take the time to highlight another of our highest conviction themes that has been a beneficiary of the changes brought about by the way we adapted to the Covid crisis. With, for example, many people continuing to work from home, including your scribe, it becomes an imperative that individuals, corporates and entire countries continue to invest in the architecture needed to protect themselves from malicious attacks. The beneficiaries of this ongoing and, perhaps accelerating, trend will be the companies that provide the tools and services needed for that protection. We expect to remain invested in this sector via the L&G Cyber Security UCITS ETF and the Rize Cybersecurity & Data Privacy ETF for many years to come and hope that you benefit from our conviction.

Our current views on the market

Despite the bullish consensus, we believe 2021 is shaping up to be an 'interesting' year for investors.

On the positive side, the arrival of various vaccines means the end of the COVID-19 crisis is finally in sight. Equities are widely expected to benefit from a gradual re-opening of the global economy, supported by unprecedented monetary and fiscal easing – pushing up global GDP growth to an estimated 6% in 2021, a rate last seen in the 1970s. European equities, which in 2020 suffered their worst year for relative performance since the 1980s could lead the rebound in 2021. The Shiller cyclically adjusted P/E (CAPE) analysis suggests they are now much more attractively valued than US equities on a 5-to-10-year investment horizon.

However, investors should not get too caught up in the general optimism. There are signs of market excess in many places, and important questions remain. 2021 may bring answers that move the market:

- What is the extent of the damage? Government support measures have kept entire parts of the economy afloat in 2020, leading to record low numbers of bankruptcies. What happens when this support tapers off in the second half of 2021? Or will policymakers opt to prolong these measures and "zombify" (continue to provide financial support to non-productive sectors of) the economy?
- What will the new normal look like? Our future economy will not resemble the lockdown economy of 2020 nor will it be a straightforward return to 2019. The pandemic will have non-obvious lasting effects on the way we work, shop, travel, educate our children and receive health care. These should become clearer in 2021 as our economies reopen. But how should investors position their portfolios in areas such as real estate? Retail? Leisure? At MWC, we do have several high conviction themes that start as ideas on the basis of common sense and observation, followed by research and then finding robust investable assets to add to our portfolios. The Cybersecurity and Robotics & Automation themes referred to above are two examples of this process and we believe that thematic investing is arguably the most interesting layer of an asset management thesis.
- Where is policy taking us? The current policy mix has taken us into unknown territory. Monetary easing and fiscal easing are happening simultaneously, in a synchronised fashion across major economies, and on a scale unseen in peacetime. Are we headed for durable inflation, or is this just a temporary blip? Will concerns about debasement of the currency continue growing?

Could politics bring a surprise? Western leaders have lost credibility by failing to respond adequately to COVID19. With the consequences of the pandemic hitting low incomes disproportionately, there is scope for a new political wind. Major events to watch out for in 2021 include: the first year of the new US administration; the Draghi government in Italy; Angela Merkel's final year as German chancellor and a new federal election in September; and positioning ahead of the 2022 presidential election in France. Not to mention the Chinese Communist Party's 100th anniversary.

If the Chinese curse goes something like: "May you live in 'interesting' times", then we hope that the future is somewhat boring.

Economic Data Table

July 2021

Stock Markets	Month	Q2 21	YTD	GDP YoY	Interest Rates	Inflation Rate
United States	2.22%	8.17%	14.41%	0.40%	0.25%	5.00%
Euro Area	0.61%	3.70%	14.40%	-1.30%	-0.54%	1.90%
Germany	0.63%	1.48%	10.69%	-3.10%	-0.54%	2.30%
France	0.94%	7.26%	17.23%	1.20%	-0.54%	1.50%
Italy	-0.27%	1.84%	12.90%	-0.80%	-0.54%	1.30%
Spain	-3.58%	2.81%	9.26%	-4.20%	-0.54%	2.60%
Greece	-1.11%	2.29%	9.38%	-2.30%	-0.54%	0.10%
Switzerland	5.10%	8.10%	11.58%	-0.50%	-0.75%	0.60%
United Kingdom	0.21%	4.82%	8.93%	-6.10%	0.10%	2.10%
Brazil	0.46%	8.72%	6.54%	1.00%	4.25%	8.06%
Russia	3.23%	8.47%	16.81%	-0.70%	5.50%	6.02%
India	1.05%	6.01%	9.91%	1.60%	4.00%	6.30%
China	-2.02%	3.48%	0.24%	18.30%	3.85%	1.30%
Japan	-0.24%	-1.33%	4.91%	-1.60%	-0.10%	-0.10%
MSCI World Equity Index	1.20%	6.93%	11.40%			

Bond Indices	Monthly	Q2 21	YTD
Barclays Capital U.S. Aggregate Bond Index	0.74%	1.38%	-2.61%
Barclays Global Aggregate ex-USD Float-Adjusted Index (Hedged)	0.30%	-0.04%	-2.48%
J.P. Morgan Government Bond Index Emerging Markets Global Core Index (Local Currency)	-1.54%	2.28%	-5.68%
Barclays Global Aggregate ex USD 10% Issuer Capped (Hedged) Index	0.57%	0.44%	-1.97%
The Bloomberg Barclays Global Aggregate Bond Index	0.53%	0.89%	-1.73%

Currencies	Monthly	Q2 21	YTD	Price
EUR/USD	-3.03%	1.08%	-2.94%	1.19
GBP/USD	-2.69%	0.35%	1.13%	1.38
EUR/GBP	-0.34%	0.75%	-4.01%	0.86
USD/CHF	2.86%	-1.96%	4.47%	0.92
EUR/CHF	-0.20%	-0.89%	1.41%	1.10
USD/JPY	1.42%	0.36%	7.64%	111.10
GBP/CHF	0.09%	-1.62%	5.68%	1.28

Commodities	Monthly	Q2 21	YTD	Price
Gold	-7.16%	3.68%	-6.68%	1769.80
Oil (WTI Crude, NYMEX)	10.20%	23.88%	52.83%	73.77

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