Psigma
Investment Management

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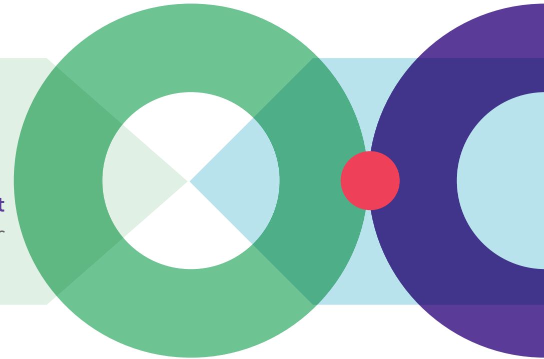

Brief View from Psigma

"No Views is Good News"

Tom Becket
Chief Investment Officer

The fact that we haven't felt it necessary to write a View so far in this nascent year should be considered good news by all. Of course, we can't say that nothing noteworthy has occurred – indeed, global events are still taking place at a furious and frenetic pace – but rather that the market performance at the start of this year has been relatively predictable. As we outlined in the commentaries that we distributed at around the turn of the year, we felt that the gains of risk assets would continue on from last year at the start of 2021, as investors continued to believe in a "better tomorrow", markets found confidence in the desire of central bankers to run their monetary policies "hot", and governments made it clear that they would continue to support their suffering economies. So far in 2021, it has been satisfying to see these views play out and portfolios make positive returns, building on the progress made last year.

So does the arrival of our latest View mean that this "good news" is changing? The answer is both "no" and "yes". From a structural perspective, the three key pillars of our investment outlook for 2021 remain constant. But at the same time, the rapid market movements have triggered some minor adjustments in our investment strategies.

Starting with the global economy, there is an increasingly entrenched (and possibly complacent) expectation of strong economic performance ahead. The second half of this year and 2022 should be a very healthy period for the global economy, as a wider economic "reopening" takes place and pent-up demand for many sectors drives a broadening economic recovery. The question we need to ask ourselves is to what degree this positive economic scenario is already reflected in the increasingly rich valuations across global asset markets. Our view on this has shifted after the wonderful start to the year for certain specific investments, leading to us taking profits from some of those investments that have benefited most from the hope of a bright future. To be clear, we are not expecting a material deterioration in the immediate economic outlook, but rather we have decided that the recent gains for specific assets have arrived "too quickly" and that any economic or medical disappointment could be painfully felt across financial markets, especially at a time when there was such a broad consensus that "all is going be okay". It could well be that the consensus is right, but we feel that recalibrating our clients' portfolios and booking some profits is eminently sensible at this time. Our focus for adjusting allocations has recently been in Asian equities and recovery sectors, which have moved quickly from "unloved" to "en vogue" in extraordinarily short order.

We have also not shifted our forecasts that the world's major central banks will not change course from their unprecedented support of their respective economies and financial markets. The never-ending and unnecessary deluge of commentary from the "Lords of Finance" hints that monetary policy is far more likely to be run too loose for too long, as opposed to any possibility of a pre-emptive tightening of financial conditions. Given how important this has been for asset markets' gains over the last thirteen years, this could be a vital guide as to how asset markets can continue to defy gravity and trade at historically expensive valuations. Whilst this is potentially the good news of the central banks' pursuits, the bad news could also be starting to

appear. Markets are now quickly and aggressively shifting to price in a more inflationary outcome in the coming years, and this has the potential to unsettle the air of calm that has built across investment markets in recent months. As you will well know, this was part of our core investment thesis for the coming years and we have taken steps to ensure our clients' portfolios are protected against these risks. However, the market implications for a return of inflation and a rise in borrowing costs are so vital that risk mitigation can only limit rather than completely prevent "collateral damage". Certainly, any acceleration in such trends could be problematic for various credit instruments after such a strong period of performance, and we are now actively assessing where we might reduce exposure and rotate into assets that could diversify our strategies further.

Government fiscal policy is probably also relatively simple to predict. It is now blindingly obvious that the pressure is now on governments to do more, rather than less, and any hope of any fiscal discipline anytime soon will be dashed. Given that governments have secured the explicit support of central bankers to print money and cover their debts, there is no chance that any difficult decisions will be made in the short term (even if in the UK there might be some targeted tax rises). At least for now, the overriding mantra is "spend now, think later" – or don't think at all. Indeed, the numbers being proposed by the new US government show the new paradigm we are operating in for government deficits and, as you are bored from hearing from us, mathematics and demographics will dictate that we are only in the early innings for gargantuan government deficits as far as we can see into the future. The questions we must ask are whether this will add further fuel to the inflationary fires and if markets will be able to digest the coming new supply of government bonds comfortably. Our core view is that both inflation uncertainty and market volatility will be the side-effects of this unparalleled situation, and we have taken steps in an attempt to ensure that our portfolios' exposure to the potential weak points of global asset markets in this scenario is very low.

So far, 2021 has been a good time to be an investor. It has been particularly pleasing if you have focused on those sectors and investments that will benefit most from a strong economic period in the coming months, as the crippling global recession starts to thaw and a new economic spring takes place. There are obviously risks to this view, particularly if issues emerge with the logistics of the vaccine rollout or we experience uncontrolled mutated versions of the coronavirus, but we still feel comfortable in expecting a full economic recovery. Where we are less confident is in the ability of central banks and governments to prolong indefinitely the extraordinary air of calm and complacency across financial markets. After very strong gains from certain favoured investments, we believe it is appropriate to reduce risk, take some profits and build up some "firepower" for future investment opportunities, while at the same time maintaining our core investment philosophies. The last decade has shown us that periods of tranquillity give way to unrest and if I was a betting man, I would wager on plenty of Views appearing through the years ahead. I just hope people continue to read them!

Tom Becket
Chief Investment Officer

For further insights from our CIO Tom Becket check out the Psigma Voice, our communication platform providng you with a variety of investment and market commentary.

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