STONEHAGE FLEMING

8 October 2021

Dear Equity Client

GLOBAL EQUITIES – 3rd Quarter 2021

World equity markets experienced a lacklustre third quarter, with September being the weakest month of the year, true to historical trends. The MSCI World Index (including Emerging Markets and dividends) decreased -1.1% (US$ terms, +1.4% UK£ terms) over the quarter, bringing the return for the nine months to a still attractive +10.6% (US$ terms, +12.7% UK£ terms).

Investors had to contend with material uncertainties in both of the two largest economies over the quarter. Following decades of focus on economic and infrastructure developments, the Chinese government initiated a new strategic economic programme of rebalancing their economy towards 'common prosperity' and social responsibility to uplift the large portion of their population with low income. Regulation has not remotely kept pace with said developments, with the government now having huge catch-up work to do on this front. Aggressive new regulatory steps have been introduced, with the Education, Health Care, Property and Technology sectors particularly vulnerable in this context. The Evergrande Property/Debt debacle has elevated the debt issues in the property sector with needs for bailouts and material risk of debt defaults.

US Investors have been climbing a wall of worry on several fronts over the quarter. The US government has been struggling to lift its debt ceiling in time with risk of running out of funds to settle their normal operational costs. Central Bank tapering suddenly seems to be closer than previously thought. Political forces on the left are seeking to replace Powell as the Federal Reserve Chair. Continuing major supply chain issues deter economic growth and may extend the transitory phase of high inflation. Views of potential stagflation are therefore also gaining some traction.

The risk of investing in China has now been fully exposed, and also further elevated. There is little communication with foreign investors, with the result that they perceive the chances for further negative surprises being greater than the chances for positive surprises. Whilst many Chinese share prices have dropped materially and seem to trade at attractive valuation levels, we fear that some structural damage to investor confidence has occurred. We remain, though, optimistic about their consumer market and continue to invest indirectly in China through global operators rather than directly through Chinese franchises.

Against this, we do not believe a major portion of the issues negatively affecting US investor sentiment are structural in nature. Longer than expected supply chain effects from the pandemic are the dominant cause for the disruptions that cause both weaker economic growth and higher costs. These issues will pass over time – as already apparent in some of the commodity prices. It is now also becoming clear how effective the vaccines are in containing the virus's negative health effects and that the world can live with it. Business life is quickly adapting to the new normal.

We thank you for all your support.

With best wishes

Gerrit Smit
Partner – Head of Equity Management

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