R.C. BROWN
investment management plc

MARKET COMMENTARY NEWSLETTER

Q1 2022

CONTENTS

The World According to Glenn………….

Glenn Meyer
Head of Managed Funds
glenn.meyer@rcbim.co.uk

In a, so far, successful attempt to avoid watching Squid Game on TV, a little while ago I looked around the house for some erudite reading material and surprisingly came across Einstein's own explanation of his theses on Special and General Relativity. This slim, but densely written, volume possibly fell through a wormhole in spacetime to arrive on the bookshelf, as nobody remembers buying this 1920 translation from the original German. Well I say translation, but most of the equations were still in Greek, and required hard work to get even a cursory understanding of such original thinking. The upside, however, is that I now never have to wait to be served in a pub as I can clear the bar in no time flat by offering to discuss the derivation of the Lorentz transformation equations only to see the punters fleeing the premises with their hands over their ears in imitation of Edvard Munch's painting The Scream. And once I have been served my pint I have taken to sitting and thinking about relativity and how our perception of an event differs according to our position when we observe it. For instance, using the Lorentz transformations, Einstein showed that to an observer on a train travelling at a constant velocity, if a ball is dropped it will be observed to fall to the floor of the carriage in a straight line, whereas, to an observer on an embankment adjacent to the line on which the train is running, the ball will fall in a parabolic curve and to a spaceman on a distant planet the ball will fall in a three dimensional curve, the like of which I have neither the mathematics or language to describe.

Relativity in physics is clearly a big topic (and one that takes more than a bit of thought to get one's head around) but in the investment world we are constantly bandying around relative performance numbers, often without properly considering the reference frame in which we measure two variables or the time period over which we take our measurements. The time period over which we measure performance is often standardised, but this may either amplify or diminish the impact of absolute movements and as markets tend to go up over time I'm still a fan of using a logarithmic scale to show percentage movements when showing data with a wide range between high and low values.

But what we tend to lose sight of is whether or not the likely long term growth rate on our portfolios is enough to deliver our expected spending needs when we begin to consume instead of build capital and whether we should adjust the amount of risk we are taking in our portfolios in order to earn our expected return. Instead, we often tend to focus on short term returns relative to a benchmark which may or may not be the most appropriate comparator against which to measure how much we need to meet our future plans. For example, many investors have a portfolio that is broadly diversified by geographic and asset class exposure but will tend to note how well (or badly) their portfolio is doing relative to the FTSE 100 index. Often this is simply because this is the index that is most often quoted in the UK media whenever market performance is discussed, but it tells us little about whether we will have enough to live on comfortably in retirement.

In the last two years or so the massive volatility in stock markets has led us all (to a greater or lesser extent) to seesaw between bouts of extreme fear and greed and to lose focus on our long term objectives. Because of this I thought it may be useful for me to set out, from the perspective of a dispassionate observer of global markets who is looking from a distant planet, what may be the reasonable expectations of real and absolute investment returns in the next year or so.

But to help us better understand what the future may bring let's first look back in time. After three strong years for equity market returns there were double digit returns (of mid-teens to high twenties) from most major equity markets in 2021 while inflation of 6.8% in the US in November was the highest for 40 years. This compares with 4.6% in the UK (but with more to come when energy price rises are factored in). Such market returns are probably too good to last, even if much of the rise shows the recovery from the Covid induced lows of the early pandemic, so we have taken action and plan gradually to introduce some changes to client portfolios to increase diversification and reduce the risk per unit of return.

Recent policy actions around the world have been focussed on controlling inflation which, after the big bounce in prices in the initial recovery period, ran the risk of becoming permanent rather than transitory. Our view remains that much of the inflation impact from supply and demand dislocation will be transitory and when the year on year impact of, for example, the rise in the oil price has worked through, inflation will fall back to less concerning levels. However, labour markets remain tight and if wages rise to reflect the difficulty in recruiting skilled staff as well as to offset the higher gas and electricity prices and tax and national insurance rises, it is likely that inflation will remain at a rate higher than we have been used to for a decade or more. Central banks have recently signalled to the markets that they are ready to take action on inflation, with the Bank of England breaking ranks first by raising its base rate by 0.15% to take it to 0.25%. Further 0.25% moves have been signalled if inflation does not start to fall, but in truth it takes a long time for interest rates to have an effect in the real economy and as the increases are well below current inflation stock markets, which tend not to like high interest rates as they push up the cost of capital and squeeze out growth, have been largely unperturbed by the change in policy. In the US the confirmation of Jay Powell to a second term as Chairman of the Federal Reserve is seen as being moderately hawkish on rates but markets have been sanguine on the rapid tapering of the Fed's bond buying programme, with an end to the stimulus from bond buying expected by the end of Q1. After that US interest rates are expected to rise. However, contrary to the taper tantrum of 2013 the bond market has taken this outlook in its stride.

Negative real bond yields imply that markets think inflation will be transitory, but earning anything close to an above inflation return from government bonds in the foreseeable future appears extremely unlikely. Because of this we are going to restructure the bond portion of our portfolios. Having now had the opportunity to meet Rebecca Young in her new role at Artemis, we will retain exposure to the Artemis Strategic Bond fund but with a reduced weighting. We will also reduce exposure to the Allianz Strategic Bond fund and will introduce Dickie Hodges' Nomura Global Dynamic Bond fund, this has a manager who believes that much of the inflation we are seeing is structural rather than transitory, which means that our portfolios will have a broad spread of dynamically managed global fixed income exposure. UK fixed income exposure to corporate bonds and gilts, including index linked (which are now expensive relative to the expected inflation rate), will be reduced slightly.

In our drive to increase the diversification of risk and return in we are also introducing exposure to two global multi asset funds, the Legal and General Multi Asset Target Return fund and the BNY Mellon Multi Asset Diversified Return fund. Both these funds earn a return from cash flows that are lowly correlated to the UK equity market. And we are also broadening the spread of returns in the property portion by introducing a holding in the Schroder Global Cities fund. This fund has a good record of exploiting opportunities from developments in land use across the globe in areas including distribution infrastructure, data centres and domestic accommodation for specific groups such as pensioners or students. The managers are pragmatic and do not expect a return this year as high as that earned in 2021, but the increased diversification and lower volatility compared with equity markets is a valuable consideration.

These changes will slightly reduce our equity exposure in order to help protect against the increased volatility in stock markets that we expect to see as interest rates rise and government economic stimulus is withdrawn. The Omicron variant of Covid 19 is also a concern to markets as, although potentially less deadly than earlier variants, the need to protect against the highly transmissible nature of the virus may still cause interruptions to normal business, particularly in the travel and hospitality industries. No changes are being made to the equity funds held in the portfolio but in the US the exposure to the growth style (where many stocks are now very expensive) is being reduced in favour of the M&G North American Value fund.

When looked at from afar investor returns have been strong in the last year and for several years before this, but are probably unsustainable given that higher interest rates are clearly signalled as a means of controlling inflationary pressures. This means that the most likely outcome for investors in the near future will be one of modest absolute returns with the potential to beat inflation. Volatility may well be higher than we all would like as markets adjust to changes in policies implemented by governments to control a rapidly evolving virus control scenario. On a relative basis value as a style may well continue to outperform growth (this will favour the UK over the US) and, after some years of a rising trend floating all boats on a wave of momentum, 2022 is more likely to be a year in which active managers will earn their keep and we expect stock selection to be a major contributor to an above inflation total return.

As always when writing these newsletters, the deadline looms and thus I have been pressured into consuming an almost infinite amount of energy to write this at something approaching the speed of light. Please find the time to read it at a relatively more modest pace. Any questions on astrophysics will be better answered by the Max Planck Institute in Heidelberg and queries on Einstein's 1915 text and the 1920 translation of it should be addressed to the Hebrew University of Jerusalem (which holds the Einstein literary archive) but feel free to ask us about investment.

AIM / IHT Portfolio Service update

Oliver Brown
Investment Director
oliver.brown@rcbim.co.uk

During the last quarter the AIM market failed to keep pace with the gains made by the UK main market and other global markets as the prospect of rising interest rates acted as a headwind to growth company valuations, which are a mainstay of the AIM market. Nevertheless, the AIM market remains an attractive arena for growth companies looking to expand and we believe the quality of companies on the market has never been higher and we consider the AIM market to be a jewel in post Brexit Britain's crown.

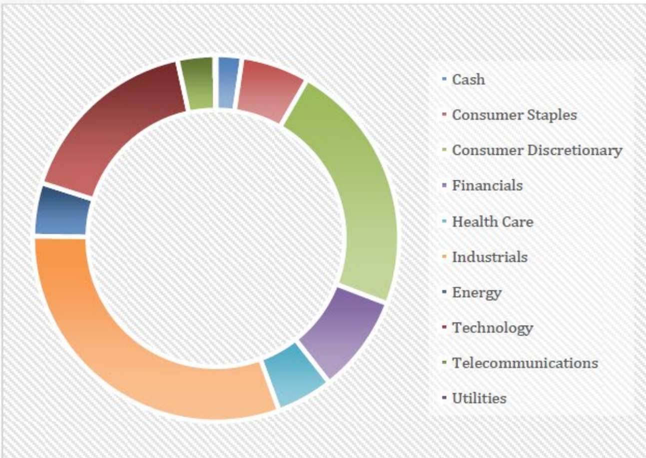
In an active period for equity raisings, ITM Power, an energy storage company, Springfield Properties, a Scottish housebuilder and Eckoh, a technology payments solutions company, were added to the portfolio. We also participated in the IPO of Devolver Digital, a computer games developer. Profits were taken in a number of holdings in order to raise cash for the new holdings. We anticipate plenty of further opportunities in 2022 as companies seek capital for expansion purposes.

This is an example of the holdings in a client portfolio as at 31st December 2021 (exact stock selection and sector weightings for a new client portfolio may be different from this illustration):

Anexo
Animalcare
ASOS
Artisanal Spirits
Breedon
Brooks Macdonald
CMO Group
Creo Medical
Devolver Digital
Eckoh
Jet2 Group
Elixirr Consulting
Essensys
Gamma Communications
Hotel Chocolat
Impax Asset Management
Johnson Service Group
K3 Capital
Lords Trading Group
Marlowe
Mattioli Woods
Microlise
Midwich
MJ Hudson
Saietta
Strix Group
Springfield Properties
Sumo Digital
Supreme
Team17
TinyBuild
Watkin Jones
Young & Co Brewery

By sector:

Cash	2.3%
Consumer Staples	6.0%
Consumer Discretionary	22.5%
Financials	8.6%
Health Care	5.0%
Industrials	30.8%
Energy	4.7%
Technology	16.7%
Telecommunications	3.3%
Utilities	0.0%



The historic performance (after fees) of the **RCBIM AIM / IHT Investment Service** to 31st December 2021 was:

	Last Quarter	**1 Year**	**Since inception 1st May 2018**
RCBIM AIM / IHT Investment Service	-1.75%	9.45%	44.00%
FTSE AIM All Share TR Index	-1.92%	6.12%	19.84%

How we have performed (as at 31st December 2021)

The historic performance (after fees) of the RCBIM Core portfolios, across the 7 risk profiles, was:

Risk Category	Portfolio	Last Quarter	1 Year	3 Years	5 Years	7 Years	10 Years
Defensive*	RCBIM Managed Funds	0.6%	3.6%	18.8%	19.5%	n/a	68.7%
	RCBIM Direct Equity	n/a	n/a	n/a	n/a	n/a	n/a
	ARC £ Cautious	1.3%	4.1%	17.2%	18.0%	26.1%	n/a
Conservative*	RCBIM Managed Funds	0.8%	6.6%	21.4%	22.3%	n/a	81.2%
	RCBIM Direct Equity	n/a	n/a	n/a	n/a	n/a	n/a
	ARC £ Cautious	1.3%	4.1%	17.2%	18.0%	26.1%	n/a
Cautious	RCBIM Managed Funds	1.1%	7.0%	19.8%	20.4%	34.3%	n/a
	RCBIM Direct Equity	0.4%	6.6%	18.6%	18.8%	33.2%	n/a
	ARC £ Cautious	1.3%	4.1%	17.2%	18.0%	26.1%	n/a
Cautious Balanced	RCBIM Managed Funds	1.2%	9.4%	25.9%	28.1%	47.5%	103.7%
	RCBIM Direct Equity	1.2%	9.7%	25.6%	27.1%	48.5%	105.6%
	ARC £ Balanced	2.5%	7.9%	25.7%	27.3%	40.9%	73.3%
Balanced	RCBIM Managed Funds	1.3%	11.3%	30.8%	33.6%	56.8%	118.8%
	RCBIM Direct Equity	1.4%	11.7%	29.8%	32.0%	57.0%	118.7%
	ARC £ Steady Growth	3.2%	10.8%	33.2%	37.5%	56.8%	101.1%
Balanced Growth	RCBIM Managed Funds	1.4%	12.4%	34.3%	37.4%	62.8%	131.9%
	RCBIM Direct Equity	1.3%	12.8%	33.9%	36.6%	64.2%	130.1%
	ARC £ Steady Growth	3.2%	10.8%	33.2%	37.5%	56.8%	101.1%
Growth	RCBIM Managed Funds	1.4%	13.4%	37.6%	41.7%	70.5%	133.4%
	RCBIM Direct Equity	1.1%	12.9%	27.7%	n/a	n/a	n/a
	ARC £ Equity Risk	3.9%	13.3%	41.5%	47.4%	71.1%	127.7%

(* Data for Defensive & Conservative strategies is indicative only and was obtained from FE Analytics)

The historic performance (after fees) of the Portcullis Asset Management Overseas Focused portfolios, across the 7 risk profiles, was:

Risk Category	Portfolio	Last Quarter	1 Year	3 Years	5 Years	10 Years
Defensive	Portcullis AM Managed Funds	0.77%	1.24%	22.02%	21.66%	52.05%
	ARC £ Cautious	1.30%	4.10%	17.20%	18.00%	n/a
Conservative	Portcullis AM Managed Funds	1.02%	3.66%	27.32%	27.59%	68.73%
	ARC £ Cautious	1.30%	4.10%	17.20%	18.00%	n/a
Cautious	Portcullis AM Managed Funds	1.24%	5.59%	31.57%	32.40%	82.50%
	ARC £ Cautious	1.30%	4.10%	17.20%	18.00%	n/a
Cautious Balanced	Portcullis AM Managed Funds	1.47%	7.31%	36.03%	38.18%	102.34%
	ARC £ Balanced	2.50%	7.90%	25.70%	27.30%	73.30%
Balanced	Portcullis AM Managed Funds	1.57%	9.00%	40.50%	42.74%	113.63%
	ARC £ Steady Growth	3.20%	10.80%	33.20%	37.50%	101.10%
Balanced Growth	Portcullis AM Managed Funds	1.78%	10.39%	42.22%	44.50%	125.92%
	ARC £ Steady Growth	3.20%	10.80%	33.20%	37.50%	101.10%
Growth	Portcullis AM Managed Funds	1.87%	11.21%	44.13%	47.45%	131.33%
	ARC £ Equity Risk	3.90%	13.30%	41.50%	47.40%	127.70%

(All data for Portcullis Asset Management Overseas Focused strategies is indicative only and was obtained from FE Analytics)

Portcullis Asset Management is a trading name of RC Brown Investment Management, and has been created to manage the Overseas Focused Portfolio range, following a specific request from a Financial Adviser firm wanting a more global bias.

RC Brown Investment Management Plc, 1 The Square, Temple Quay, Bristol BS1 6DG

Tel: 0117 925 6073 Email: enquiries@rcbim.co.uk www.rcbim.co.uk