3 June 2021 – Monthly update

Omnis Managed Portfolio Service

US inflation has seen its biggest jump since 2008, fuelling concerns that rising consumer prices may become a problem for the economy. Any hint that central banks, particularly the Federal Reserve (Fed), are genuinely concerned about inflation – or less convinced that it will be transitionary – could spook markets.

The positive outlook for equities relies on higher inflation being temporary, central banks keeping monetary policy easy and governments not implementing austerity measures. The louder the noise on inflation, the greater the pressure for central banks to taper their quantitative easing or raise interest rates.

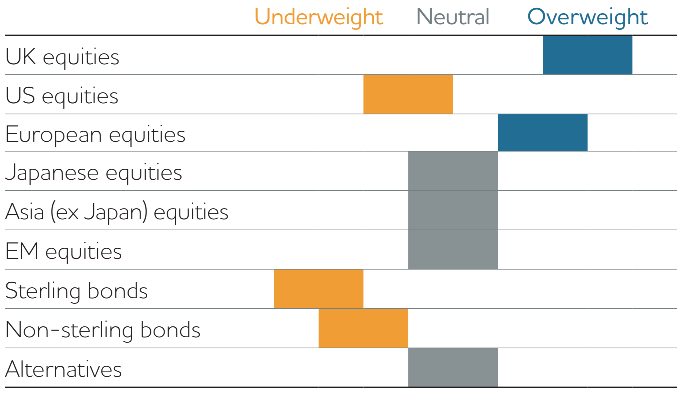
We think the outlook is pretty positive, but we recognise it's fairly fragile because a lot hinges on what central banks do. As inflationary pressure grows over the next couple of months, expect to hear tough words from central bankers. This might be enough to create some volatility in equity markets and push bond yields higher. However, the Fed and the Bank of England are unlikely to hit the panic button just yet.

We don't expect the Fed to raise interest rates until its quantitative easing programme has been wound down, which is not likely to happen until the end of the year. While we continue to see isolated evidence of inflationary pressures, we believe they are part of supply chain bottlenecks that come with reopening the economy and they will be temporary. Over time these bottlenecks will ease and inflationary pressure will diminish.

The UK economic recovery is pretty much on par with the US thanks to the vaccine rollout. The country is almost in lockstep with the US, albeit without the arsenal of the fiscal stimulus that Biden's unleashed. The public sector net borrowing in the UK is much lower than had been forecast, so the expectation is that the Budget in the autumn will not have to be as severe as many commentators had previously thought.

Everything's pointing towards Europe following the UK and the US with a sharp recovery once the vaccine allows its economies to reopen. The success of Asian countries in controlling the virus meant that there wasn't a huge amount of political pressure to get a vaccine rolled out. Elsewhere in emerging markets, Latin America and Brazil continue to be to be severely affected by the pandemic.

Asset allocation



Investment strategy

We could see inflation in some developed regions peak above 2% in the next few months, and possibly as high as 4% before dialling back down. High inflation is a real concern because bonds don't offer any protection against it and equities would fall. As the global economic recovery continues, alongside policy tightening in China and the prospect of a stronger US dollar, we remain overweight in our allocation to equities.

There are growing concerns that the US stock market is overvalued, with fears the bubble could burst. We remain underweight US large caps, not because we think the companies are bad, but because we think the valuations are excessive. We like US smaller companies as they will likely benefit from the current economic environment.

Our allocation to fixed income remains underweight because of the potentially slim returns. Despite this, we're maintaining some exposure in portfolios due to the protection they offer in the event of unexpected stock market swings.

We have an overweight allocation to the UK, where the outlook continues to improve and valuations still look attractive. While Europe has paid the price for the slow vaccine rollout, we remain confident in the regions' recovery and remain overweight, largely through the Omnis European Equity Leaders fund.

For more information on your Omnis Managed Portfolio, please contact your financial adviser.

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