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# 2021: year in review

**Like every year, 2021 can be defined by a few key words. Although newsflow in recent weeks has been dominated by debate around Covid variants and supply chain disruption, 2021 hasn't all been about the pandemic.**



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We also had meme stocks that grabbed the headlines for a brief period, COP26 was an important milestone, Tesla became the latest entrant to the \$1 trillion market-cap club, and, of course, inflation remains a worry. In this year's review, we will look at each of these topics, their impact on markets, and the Marlborough multi-asset team's view as to how they might influence the investment landscape in the months ahead.

## Covid variants

Omicron has spread faster than just about anyone expected. Yet, thankfully, so far, it has proven much less harmful than previous variants, as vaccinations have helped limit its impact. Countries have learned how to keep the economic wheels turning despite public health measures. Many businesses have thrived in the back-to-work spending spree that we've seen (and participated in). But as increasing numbers of countries introduce more stringent measures - and even lockdowns - there is potential for economic growth projections to disappoint.

Unfortunately, we don't have a crystal ball, and we don't yet know how this will play out; if Omicron is brought under control relatively soon, and those measures can be eased quickly, then 2022's economic backdrop could still offer excellent opportunities for companies to grow their earnings. But it could also go the other way. Or new, more dangerous variants may emerge. With uncertainty like this, we revert to our mantra: stay invested, stay diversified, and maintain appropriate levels of risk.

## Supply chain disruption

When the Ever Given cargo ship got stuck in the Suez Canal in March, it highlighted the fragility of the global supply chain network. While globalisation has brought many benefits, it means that even slight delays in one area can send ripples around the world. Improvements in technology and efficiencies in logistics have meant companies have been able to run with much lower inventories. Just-in-time processes track goods through the whole supply chain, and order books are updated as stocks come off the shelf.

But while these processes are generally efficient, they are also fragile. Unexpected demand spikes can lead to empty shelves - sometimes, more people may want to buy a specific item than the computer has predicted! The same is true for supply disruptions.

We came across an interesting statistic during our research into supply chains: the Madrid Maersk holds the world record for an ultra-large container ship's fastest loading and unloading. It took nearly 3,000 workers 59 hours to move 6,500 containers. Truck drivers made up 2,351 of those workers. The important number here is the number of truck drivers. This has been an area which has seen declining numbers of workers for many years, due largely to poor wages and working conditions. But when the pandemic saw supply chains grind to a halt, this exacerbated the situation, as many truck drivers sought work elsewhere. Where did they go? Amazon's workforce increased by 628,000 to more than 1.4 million from March 2020 to September 2021.

So now we are left with an imbalance in the system. Supply problems have led to delayed deliveries, higher prices, gaps on supermarket shelves and petrol stations without fuel. The worst effects of these problems were fairly short-lived and did not heavily impact company earnings in the short term; in the longer term, companies will probably adjust their processes to keep more stock on hand and reduce their reliance on longer delivery networks. This may well have an impact on profitability. Closer to home, these issues have had a significant and lingering effect on inflation. Switching these complex networks back on is no simple task. They will clear in time – and some already have – but some, like shipping, will take longer than others. To ease supply chain disruptions, workers – who are in short supply – need to be hired, and companies will need to pay up. And with more money in our collective pockets, we generally buy more stuff, and are prepared to pay more. So we have lower supply, and higher demand; higher inflation will probably be with us for some time to come.

## Inflation

This is arguably the factor which investors care about most, as it affects just about everything. The big question is whether the higher levels of inflation we experienced in the second half of 2021 will be transitory or persistent. The follow-up question is what central banks are going to do about it. For much of 2021, central banks took a patient approach, expecting inflation to subside as the initial Covid-reopening trade surge fed through the system. But as supply disruptions rolled through the system, energy and fuel prices increased sharply and wage growth started to rise, it became clear that inflation was likely to be around for longer than initially

anticipated. US Fed chair Jerome Powell has now stated that it is no longer appropriate to call inflation transitory.

On the positive side, inflation gives many companies higher pricing power; they can charge more for their goods or services and earn higher profits. But if these profits are eaten away by the higher input and wage costs they are forced to pay, they could be back to square one. So investors – and the managers of the funds we hold in our portfolios – need to pay careful attention to the fundamentals.

On the negative side, inflation eats away at the value of the fixed future cash payouts that you get when holding a bond. So higher inflation equals lower bond prices in the short term. We have maintained slightly lower-than-benchmark exposure to changes in interest rates for some time, as it is entirely normal to see increased inflation in a post-recession environment. But, at some point, we will change this posture. Inflation has been well above central banks' inflation targets for some time now. As an example, US inflation has risen from 1.4% in January this year and stands at 6.8% as of December. As mentioned above, inflation may persist, and central banks' willingness to let inflation run above their target levels is waning. We've already seen the Bank of England increase rates, and the Fed is expected to raise rates soon. As interest rates rise, they limit growth and can usher in a recession. At that point, bonds become a great

investment. Towards the end of the year, we have seen yields on long-dated bonds falling, indicating a rising risk of this scenario. For now, though, our base case is for stronger economic growth to persist for a while, though we are constantly reassessing this view.


## Meme stocks

Meme stocks first came to prominence in January 2021, when US video game retailer GameStop soared 1,900% in under a month, propelled by Reddit forum r/wallstreetbets and other online retail investor communities. Retail investors collectively targeted stocks that were heavily shorted, recognising that if they invested collectively and managed to push the price up a bit, they might force the shorts to buy back the stocks to cover their losses. Several high-profile hedge funds positioned aggressively for share prices to fall suffered heavy losses as a result. This highlighted the short-term impact that social media can have on investing.

Eventually, though, share prices must reflect fundamental realities, and GameStop's share price subsequently fell 90%, almost as quickly as it rose, as retail investors moved on to other stocks.

The meme stock phenomenon was concentrated in a handful of shares to which the funds making up the Marlborough portfolios had no exposure. Like many market participants, we concluded that there was no broader cause for concern, as we had no exposure to these companies and an impact on broader markets was





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unlikely, given the unique profile of companies being targeted. However, we make sure that the funds we invest in have investment and risk processes in place to avoid the fallout from such episodes.

### **Tesla - active managers underweight tech**

Tesla is a leader in electric vehicle manufacturing. Whatever your view is on Elon Musk, the CEO, he has a long history of initiating multiple disruptive start-ups and driving them to success. PayPal, SpaceX, The Boring Company, Neuralink, OpenAI, and, of course, Tesla are just a few of the companies Musk has played a key role in launching. Tesla is a true pioneer in its field. On November 17, 2020, the S&P US Index Committee announced that Tesla would be added to the S&P 500 Index. Its entry was remarkable for several reasons: on the day Tesla entered the S&P 500, it was the sixth-largest US company by market capitalisation. In the index's history, Tesla was the largest addition to the S&P 500, both by market capitalisation and rank. Since then, the company has rarely been out of the headlines. Tesla has joined the \$1 trillion club and is one of only a handful of publicly listed US companies to surpass a \$1 trillion market cap. It joins five large tech companies with much higher revenue and profit totals: Google parent company Alphabet, Amazon, Apple, Microsoft and Facebook parent company Meta. Additionally, Elon Musk is expected to have sold a total of \$18 billion worth of Tesla shares in 2021, which is being

dubbed the best trade in history.

From an investment perspective, the concern centres around the valuation of Tesla, which is astronomical and implies global dominance in the electric vehicle market. However, there are several reasons to counter this view. One is competition, as due to increased regulation, there were a raft of new electric vehicles launched in 2021, with an ever-increasing number to follow in 2022 and beyond. A second is consumer choice, as people, by nature, will buy different products (this is already visible with Volkswagen's ID.3 selling well). A third reason is the price point, which will be a driver of consumer decisions on which car to buy, leading to more price competition in this space.

The share price rise of Tesla and a handful of other big-name companies has contributed significantly to the overall performance of the S&P 500 in 2021. However, the valuations of some of these companies have been a concern for many investors. It's important to highlight that many active fund managers are underweight some of these companies on valuation concerns. Additionally, hundreds of other companies in the index can contribute to performance should any of the big names fall out of favour.

### **COP26**

COP26, or Conference of Parties 26, was the 26th United Nations climate change conference, held at the SEC Centre in

Glasgow, Scotland, from October 31 to November 13 2021. The participating 197 countries agreed on a new deal, known as the Glasgow Climate Pact. This was the first climate deal to commit explicitly to reducing coal use. Coal is the most carbon-intensive fossil fuel; therefore, phasing it out is critical to limiting climate change and keeping global warming to 1.5 °C. Countries including South Africa, Chile, Poland, Ukraine, South Korea, Indonesia and Vietnam agreed to phase out coal. These nations include some of the world's most intensive users of the fuel.

In addition, Japan is to invest \$100 million in transforming fossil-fired plants into ones based on ammonia and hydrogen fuel. However, the world's most significant coal users - China, India, and the United States of America - were not among those pledging to phase out coal-fired power.

The conference was a reminder that the transition to a more sustainable world is happening now, not at some distant point in the future. First, surging fossil fuel prices in 2021 exposed a lopsided transition toward low-carbon power. We still see an orderly transition in the medium term, but with bumps on the way leading to growth and inflation volatility. Developed market societies are beginning to show their acceptance that moving to carbon-neutral will have a cost; people are increasingly willing to pay up for cleaner, less harmful products and services. This will mean some companies will be able to increase their customer base, which in turn will allow them to ramp up production and drive down costs. Hopefully, this becomes a virtuous cycle - just as we've seen with solar panels: as price declines attract more customers, costs continue to fall, bringing in ever more customers. Changing attitudes will create opportunities, and as always, there will be winners



and losers. We'll strive to find the fund managers who can successfully identify the winners and avoid the losers.

Despite the difficulties we've faced this year, investors have enjoyed another year of strong returns, driven by the rebound in equity markets. As always, there were bumps in the road, but in periods when share prices were volatile, bonds offset some of those losses, reminding us of their value in

portfolios. We don't know what the future will bring\*, but we're pretty sure there will be more surprises in store for us. And so we'll continue to ensure that the portfolios we manage are diversified across asset classes, regions and styles, and populated with risk-appropriate, best-in-class underlying funds.

*\*See our '2022: Outlook and Positioning' document for some of our views on what might happen.*

### Risk Warnings

Capital is at risk. The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest. Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our funds invest for the long-term and may not be appropriate for investors who plan to take money out within five years. The funds may have exposure to bonds, the prices of which will be impacted by factors including; changes in interest rates, inflation expectations and perceived credit quality. When interest rates rise, bond values generally fall. This risk is generally greater for longer term bonds and for bonds with higher credit quality. The funds invest in other currencies. Changes in exchange rates will therefore affect the value of your investment. The funds may invest a large part of its assets in other funds for which investment decisions are made independently of the fund. If these investment managers perform poorly, the value of your investment is likely to be adversely affected. Investment in other funds may also lead to duplication of fees and commissions. In certain market conditions some assets may be less predictable than usual. This may make it harder to sell at a desired price and/or in a timely manner. All or part of the fees and expenses may be charged to the capital of the funds rather than being deducted from income. Future capital growth may be constrained as a result of this.

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