Q4 2021 Overview – Countrywide Assured plc Balanced Managed Pension / Life Investing Funds

This report is provided by our Fund Manager Schroders and covers the portfolio activity on our main investing funds the Countrywide Balanced Managed Pension/Life Investing Funds, together with their short-term economic outlook. The report describes the current economic background and Schroders' perspective of this and how it impacts their management of the Countrywide Balanced Managed Pension/Life Investing Fund. It also covers all individual asset class sectors (UK & Global Equities; fixed interest; Property and cash).

Your policy will be invested in a specific customer fund of your choice which has its own fund objectives (see fund list and specific fund objectives) www.countrywideassured.co.uk/fund-centre/understanding-my-funds/fund-objectives/. All customer managed funds are invested in the Countrywide Balanced Managed Pension/Life Investing Funds, to a greater or lesser extent depending on the nature of the fund objective. If you're invested in an individual asset class sector fund, although no specific commentary is provided for these funds, the report does cover individual markets and other asset classes, which is consistent with the fund managers reasoning.

Portfolio Activity

The portfolio remained overweight equities over the quarter. We had maintained a modest overweight in European equities as part of an overall overweight equity view, however the position was closed in November. It was decided that of the overweight US and European equity positions we held, the European position was more exposed to a synchronised global growth slowdown following the outbreak of the Omicron variant. In contrast, the portfolio continues to hold the tilt in favour of US equities given the strength of the economic recovery there.

Turning to fixed income assets, the portfolio remained underweight bonds, however the composition of this underweight position changed throughout the quarter. Within the government bond universe, the portfolio closed the overweight UK vs underweight German government bonds position. This was predicated on our expectation of a more hawkish Bank of England (BoE) versus the European Central Bank (ECB), and the potential headwinds stemming from a European energy crisis. We believed that ECB market pricing would likely catch up due to ongoing inflation fears, or BoE hawkishness would result in headwind fears bringing gilt yields lower (and bond prices higher). We took profits on the trade following a sharp rally in November. In December, the reverse trade was implemented and an underweight UK government bonds position was added at a better entry point. An overweight Australian and Canadian vs US government bonds position was added in November to reflect the significant rate hikes that had already been priced into the Australian and Canadian yield curves.

In currencies, we maintained our position in the US dollar against the euro in order to hedge against the risks posed by tightening liquidity from the Federal Reserve. In December, an overweight Canadian dollar vs US dollar position was added to the portfolio. This position provided exposure to the upside potential in energy markets given the strong outlook for oil.

Outlook

Last year, the Covid vaccine program inspired confidence in a "re-opening trade" which offered high returns with limited risks. We are now, however, in a more mature and nuanced phase of the cycle. Economic activity and consumer demand remain healthy, but prices are elevated and there is uncertainty around inflation, the process of monetary policy normalisation and, of course, further Covid-19 outbreaks. Against this backdrop, we expect equity returns to be more muted but still positive, supported by solid corporate earnings. Within equities, we continue to favour the US, given the strength of the recovery there, and are starting to re-enter emerging markets.

Inflation is a popular theme, and we would agree that, over the medium term, we are likely to be in a more inflationary environment compared to the last decade driven by rising wages, deglobalisation and decarbonisation. In the shorter term, we expect inflation momentum to peak as year-on-year comparisons improve and supply bottlenecks ease; however, central banks are starting to raise rates and this will impose a speed limit on equity returns.

We expect the withdrawal of emergency levels of support by central banks and governments to play an important role in shaping economic activity in 2022. Although government spending will remain strong, overall fiscal policy will be less supportive. This should not be a surprise after the “shock and awe” fiscal largesse of 2021. With regards to monetary support, we also see a move in a less positive direction. Here central banks are ending pandemic-related quantitative easing (QE) programmes which have been used to inject money directly into the financial system.

Covid-19 continues to cause volatility, with the latest variant, Omicron, renewing these concerns. It is important to step back and acknowledge that we've come a long way since the first quarter of 2020. Levels of immunity are considerably higher, even in the face of mutations; governments have become more experienced and react more quickly; and the processes of developing new vaccines are increasingly efficient and streamlined. Market participants have also developed a framework to consider the virus.

Looking at the bond market, a combination of fading global growth momentum, even if still strong in absolute terms, and a more hawkish Federal Reserve should see curves continue to flatten (and support the US dollar against a broad basket of currencies). As a consequence, we have moved to a more neutral view on longer maturity US bonds and negative on shorter maturity instruments. Given our view that bond pricing is fair, we are also now taking advantage of opportunities to earn carry (income) from Italian bonds.

One area in which supply constraints look set to persist is in commodities, particularly the energy sector. At the same time, with the economic cycle moving into the expansion phase, demand for commodities is strong. Consequently, we remain positive on commodities.

In recent years, we have compared the global economy to a "wobbly bicycle", where a lack of economic momentum left us vulnerable to being blown off course by any gust of wind. The pandemic forced governments to put stabilisers on the wobbly bicycle, allowing us some reprieve from cyclical volatility. Those stabilisers will be coming off in 2022 and the private sector will have to take on the baton of growth. We believe that this is not a time for big bets and we have a much more diversified stance than we did last year.

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