

What's your tipple? It's on the Central Bank

Many have said central banks are the punch bowl for markets. Loosely speaking this means central banks have been pumping money into markets in such volume that the equity rally is almost entirely propped up by that cash injection and, much like a huge bowl of punch at a party, it is the key factor in keeping the party going.

This narrative has amusingly twisted of late to reflect that central banks are no longer seen as the punch bowl of the party (AKA the equity rally), they are now the bartender of the party.

This alludes to the fact that unlike a punch bowl which holds a finite amount of liquid, a bartender will, in effect, never run out of booze. This view has largely formed from the repeated reassurances from central bankers that, regardless of how aggressive the economic recovery is, stimulus won't stop for a very, very long time.

With this unprecedented level of central bank stimulus in play, stock markets and other sectors like housing, meme stocks, crypto currencies and even some luxury goods like watches, have been propelled

forward at a blistering pace. And when you think about it, pumping billions of capital into the market will only cause that cash to be spent because investors and consumers who suddenly have an excess of cash, will look to do something with it. The laws of economics dictate that prices will rise in such an environment and before you know it, here we are - in a world where a company's earnings can halve and the stock price doubles, or something like "Dogecoin", a crypto currency which was started as a joke a few months ago, is now worth as much as BP… Crazy. To say this smells a lot like the .com crash is an understatement.

Yes, the environment has made investors millions and TAM's clients are included in this but, if investors can stop popping champagne for two seconds, it is clear markets are at a "Sword of Damocles" moment where record-breaking market highs are almost certainly at the mercy of central banks announcing that stimulus will, at some point, be tapered.

So, if there is the potential for more volatility on the horizon, just buy more bonds, right? Sadly, this time around it's not that simple. Bonds are currently being held ransom by the potential for interest rate rises to supress inflation. More inflation means lower real incomes from bond coupon payments, more inflation also means central banks raise interest rates to control it which again drives the price of a bond down causing further selling pressure.

Ok, well how about we just look through all this short-term volatility and buy high quality growth stocks and hold them for the long-term? Well, it's certainly worked before.

But, contrary to the last decade, with inflation on the rise, those attractive growth stocks which investors have been buying for the last 10 years look much less attractive with a sustained 2%++ rise in inflation. Let's not forget, the more investors pay today for those potentially deteriorating forward earnings, the less your investment is going to yield in the future. These factors are at the core of why growth stocks are trailing value stocks in this blistering rally, and why ESG stocks which largely remain untested in a recession are suffering this year.

So where from here?

Given inflation looks like it's going to be here for the remainder of the year, it makes sense to keep one's fixed income exposure inflation protected but endeavour, where appropriate, to take as little duration risk as possible. TAM's current approach is to blend inflation protected government debt with short duration investment grade credit which is providing a lot of protection to client portfolios.

Sticking with inflation, it also makes sense to continue to diversify away from high growth stocks and instead look to companies with more of their earnings in the present rather than far off in the distance. That doesn't have to mean buying equities with bombed out share prices, they can still be high quality businesses, just high quality now and not high quality in 10 years (AKA growth investing).

Even more compelling right now is the concept of income. Given how expensive everything is, TAM is looking at companies starting to pay a dividend. Yes, a word in 2020 which was taboo. However, dividend paying stocks are now looking like a great source of income yield from fantastic companies in

great shape with very attractive share prices courtesy of the COVID sell-off.

The final pillar of 2021 asset allocation is active management. With COVID causing every sector to be littered with winners and losers it's critical that active management gets fully utilised as both a defensive strategy to protect clients from investing in companies going under and an offensive strategy to own those companies gunning for double digit growth in 2021.

To conclude, yes there are black clouds on the horizon and a reckoning is beckoning with all this free money, but good quality businesses are still all around us and for those willing to move away from the decade-long growth trade, there remain plenty of good stores of value to invest client capital but as always, this market is about two things, and two things which TAM excels at… diversification and active management.

Stay safe and remember, when the central bank is serving the drinks, drink them responsibly.

Kind regards,

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