Quarterly Report

Fourth Quarter **2021**

moneyfarm

A letter to our investors

by Richard Flax
Chief Investment Officer at Moneyfarm

Dear investor,

The fourth quarter of 2021 continued the pattern we saw over the first nine months of the year. Developed Market equities put in a strong performance in the last three months of the year, driven by the US. Emerging Market equities continued to lag, while global bonds did relatively little. But behind a very strong headline performance in Developed Market equities (north of 20% for the year), the picture was a bit more mixed, with some beneficiaries of the pandemic giving up some of their 2020 performance as the global economy took its first steps towards normalisation.

Our recent discussions have really focused on inflation and monetary policy. Inflation has continued to exceed expectations, reflecting strong demand and continued supply chain issues. We also see that imbalance in labour markets, notably in the US, where many firms continue to struggle to recruit workers, even if the total number of employed remains below pre-pandemic levels. We expect these imbalances to remain a challenge for much of 2022.

Faced with some of the highest inflation rates in a generation, policy-makers are preparing to act. The Bank of England raised its base rate in December and we will likely see interest rates in the US rise as early as March. We believe that Central Bankers will be cautious about how quickly they normalise monetary policy, even if “higher-for-longer” inflation has forced a reassessment on the speed and timing of higher rates.

At the end of 2022, it seems quite uncontroversial to say that a) policy rates in Developed Markets will be higher than they are today and b) policy rates will still be very low compared to history - especially in real terms.

In that context, the key question remains - how will the global economy and financial markets digest the removal of some of the policy stimulus we’ve seen over the past two years?

We continue to have a generally constructive view. We think that policy-makers will proceed cautiously, wary of choking off the global recovery and that financial markets will be able to digest the interest rate hikes we’re currently expecting. We’d guess that Central Bankers might be pleased to see some differentiation in the performance of risky assets - for instance in the

recent underperformance of loss-making equities.

In the equity space, we continue to debate whether the valuation premium of US equities is warranted or whether more lowly-rated markets like the UK or Emerging markets will outperform. The premium that US equities enjoy has steadily increased in recent years, driven partly by stronger earnings from US companies, notably some of the large technology platforms. US corporate profitability is at an all-time high on some measures - and has proven very resilient. But after a challenging 2021, we may see some more opportunities in the Emerging Market equities this year.

On the fixed income side, low bond yields remain a challenge, particularly in the context of high inflation. The prospect of higher policy rates also raises some interesting questions about long-term interest rates. We expect long-term rates to remain relatively low - at least compared to history, but we continue to prefer short-dated credit rather than long-dated government bonds.

2021 saw stronger returns than we might have expected at the start of the year. And we'd be surprised to see another year of 20% returns in Developed Market equities. But we believe that the global economy will continue to heal. We see a wide range of expectations across different parts of financial markets and that should create opportunities over the course of 2022 and beyond.

Richard Flax
Chief Investment Officer

The final quarter of 2021 encouraged investors to look both forwards and backwards. The year was bookended by two strains of Covid-19, with the progression from Delta to Omicron serving as a reminder of the efficacy of vaccines and the potential for the virus to become endemic in time.

Having said that, Q4 highlighted many of the global economic issues that may well persist well into 2022. High inflation, supply chain bottlenecks and a labour shortage are some of them, and the tune being played by central bankers was markedly different at the end of the quarter than it was at the beginning.

Even so, economic growth has largely been positive and there are signs that we're entering a new phase of Covid-19, one in which society can begin to function under more normal conditions despite notably high case numbers. So, let's take a moment to look at the key themes from the Q4 of 2021 and what they mean for the year ahead.

Economic growth has remained strong

The fourth and final quarter of 2021 rewarded those that stuck with risky asset classes. Faced with a number of factors causing uncertainty, markets continued to react strongly, which led to positive equity performances. The trends of the quarter also laid the foundations for a 2022 that looks set to be quite different from 2021.

The last two years have seen the global economy show remarkable resilience, maintaining an infrastructure to keep operating even in truly exceptional circumstances. In 2021 as a whole, real growth is estimated to be (net of inflation) 6%, with 2022 predicted to be around 5%. Earnings are expected to grow 20% in some of the key geographies, as the future threatens to become more 'precedented'.

This environment will set the stage for market momentum in the coming year. We expect to see geographies and sectors regain lost ground and offer plenty of opportunities for investors who can take a forward-looking approach to equity performance.

Q4 of 2021 turned around a negative trend seen in the preceding quarter, leading to positive economic growth in some key geographies; a sign of strength after what was a volatile September.

Omicron ushers in a new phase of Covid-19

The emergence of the Omicron variant in the quarter represented two distinct aspects of the development of Covid-19. We appear to be at something of a turning point in the course of the pandemic, with governments looking at not just the immediate crisis but also a future in which we learn to live with the virus.

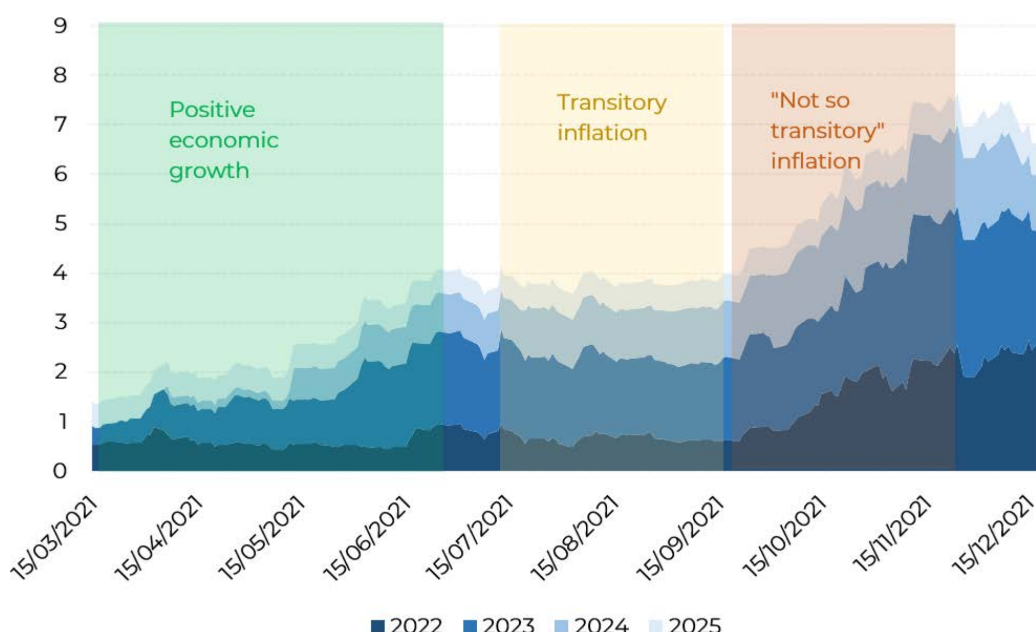
On the one hand, case numbers in the UK have been exceptionally high for weeks, a trend that started in early December. The country exceeded 200,000 new cases at the start of January and it's unclear when the peak of the wave will come. Hospitalisations have risen sharply, but are still significantly below the equivalent rates during less vaccinated peaks.

On the other hand, the Omicron variant represents a step forward in the fight against the disease. Of course, high case numbers have necessitated some rethinking in terms of healthcare protocols, but the variant could be the start of the 'normalisation' of living with Covid-19. Effective vaccines and less severe symptoms are promising signs and could lead to a 2022 that is less affected by Covid-19 than 2021. The word 'endemic' started getting used in Q4; you'll probably hear it a lot in the coming weeks and months.

Inflation was a key theme for the quarter

For much of 2021, inflation had been kept under control. When it did become an issue, it was predicted that it would be 'transitory', that the factors causing higher figures would pass and relative normality would resume.

This theory ran aground in the face of supply chain bottlenecks that proved more persistent than expected. The price of raw materials and energy have skyrocketed, there's a broad shortage of workers and materials, logistical complications persisted throughout the quarter and central bankers were perhaps slow to react to a situation that was less transitory than we'd hoped.



As a result, monetary policy was once again under the microscope. With that, we saw a marked U-turn in the rhetoric coming from central bankers. Investors, economists and institutions alike now forecast as many as four interest rate hikes for 2022, a significant acceleration when compared to the indications we had before Q4.

What we can say, however, is that we ended the quarter with much more clarity than when it began. Now that all the major players are aligned, we believe 2022 will see central banks catch up with rapidly developing economic trends and act accordingly.

Looking ahead to 2022

Here are the key topics to watch out for as 2022 gets up and running. From Omicron to inflation, it's a complex picture but some themes are emerging.

1- Inflation should gradually reduce

Global supply chain bottlenecks, rising commodities prices and rampant demand following the gloom of 2020 led to an excessive increase in prices in the final quarter of 2021. For the new year, markets expect inflation to gradually normalise and for nominal rates to get closer to long-term policy targets. Our expectation is one of a gradual reduction of the inflation rate. In fact, we're already seeing improvements on the supply chain side and we should see less of a ripple effect from national lockdowns.

Key questions: the first key question here is whether or not, and to what extent, inflation-linked bonds and gold will keep contributing to performance. Gold continues to have good prospects, both as an inflation hedge and as a diversifier. As for linkers, the room for further growth looks limited. This is because these products perform well when there are inflationary shocks, which seems far less likely in 2022. Is this a good time to cut back on linkers?

The second key topic is whether or not "value" stocks will outperform "growth" stocks. As we've previously discussed, the latter tend to suffer more during periods of high rates, due to their relatively high leverage and because their forecasted revenues are less certain and further away. As a result, it will be important to monitor the relative performances and the impact of inflation in the first weeks of 2022. Is it time to bet on value again?

2 - Will the US stock market be a frontrunner?

After months of negotiations, Joe Biden has been unable to convince enough senators to back his ~$2 trillion fiscal plan. The package has already been reduced to $1.75 trillion in an effort to convince the requisite Democratic senators to vote in favour. What would the consequences for markets be if it is indeed cut any further? For now, it seems the lack of a majority has actually reduced the risk of inflation, strengthening the case for a rate normalisation in 2022. However, we'll be closely monitoring the US political situation and its impact on the steepness of the US yield curve.

Key questions: the main issue to watch here is whether the US stock market will outperform the rest of the Developed Markets. Even if our models have identified a higher equity risk premium in Europe for 2022, it's not easy to quantify the impact of the potential approval of Biden's fiscal plan. Is there a chance that markets are underestimating the potential for that to happen? Or, on the contrary, is US equity expensive, particularly after the Christmas rally? Should we favour European equity

over the US in 2022?

3 - Will Omicron cause much significant disruption?

As we've discussed, Omicron spread rapidly throughout Europe and the US in December. It did initially cause market volatility before ultimately losing some of its initial ominousness. Higher transmission rates are being offset by a significantly lower mortality rate and much lighter symptoms than other waves. As a consequence, it seems unlikely that severe containment measures will be necessary, particularly in countries with high vaccination rates. It's too early to declare Covid-19 'endemic' but markets seem to be betting on a happy ending. It will, of course, be something we'll be closely monitoring in the coming months, particularly in Developing Countries.

Key questions: the important factor here is whether or not Omicron proves powerful enough to lead to new lockdown measures. In Developed Markets, the key risk to monitor is the potential impact of Omicron on demand and inflation. As for Emerging Markets, the focus should be on quantifying the risk of further bottlenecks and rising commodity prices. Should we increase our allocation to raw material to hedge against the risk of a strong Omicron?

Your Portfolio 4

Quarterly Report

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Your model portfolio

P4

Your Moneyfarm portfolio is designed to replicate one of our seven model portfolios. A model portfolio comprises a diversified group of ETFs that target an expected return for a specified amount of risk, corresponding to your Investor Profile. Note that your portfolio and performance may differ from the model portfolio, depending on the amount invested in your portfolio and the timing of your cash flow.

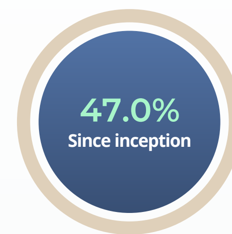
These performance charts were made using a monthly index from ARC, or using a cash proxy, against which we have compared our model portfolios (after Moneyfarm's fees). This is compiled data from wealth managers and is net of fees. It includes data from large asset managers, private banks and wealth managers including close competitors of ours. It is submitted on a voluntary basis. These indexes show actual client returns for a given level of risk.

More information can be found here.

Performance

Peer comparator
Competitor** 2.5%

Peer comparator
Competitor** 7.9%



Peer comparator
Competitor** 38.3%

Model portfolio performance

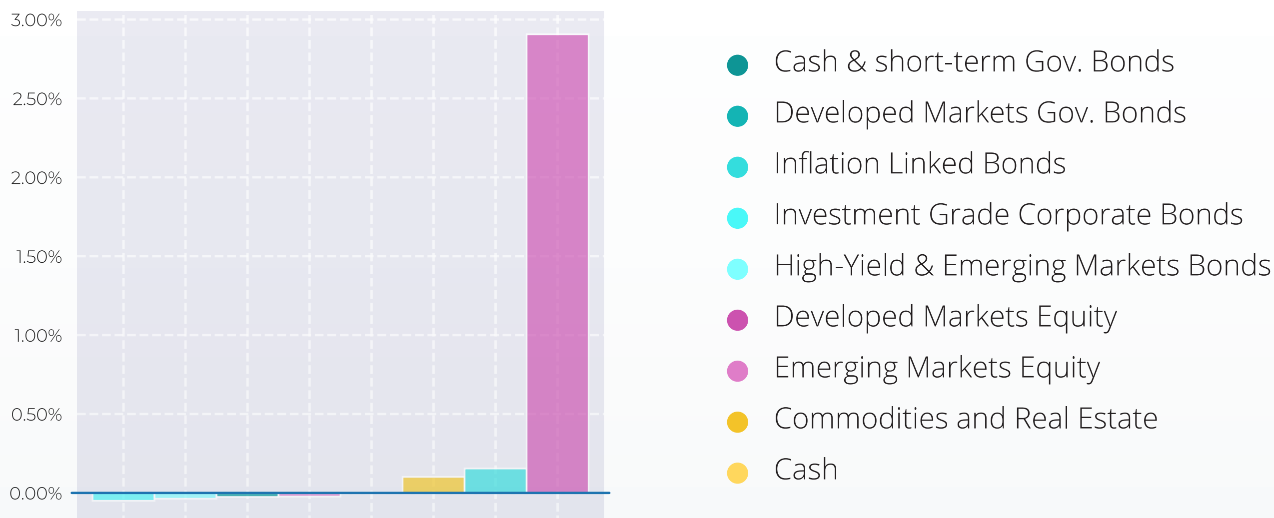
In the fourth quarter of 2021, the performance of the model portfolio was positive.

On the fixed income side, both government and corporate bonds posted a small negative return, having a minor impact on the portfolio performance.Inflation-linked bonds, on the other hand, appreciated significantly, contributing positively to performance and demonstrating their ability to diversify in a market environment characterised by inflationary pressures and global supply chain bottlenecks.

Equities were once again the largest contributor to performance in the fourth quarter. Specifically, Developed Markets Equities outperformed Emerging Market ones, largely due to Chinese regulatory pressures and the uncertainty around Evergrande.

In this context, gold rallied and contributed positively to the performance of the portfolios, showing its nature of hedge against inflation.

Performance attribution



Volatility

Here you'll find a breakdown of your portfolio's volatility over the last year, the last three years, and since its inception. The Sharpe ratio helps us to understand the returns of the portfolio relative to its risk.

*Sharpe Ratio assuming a 0-1 year GILT as risk free

Portfolio allocation

P4

Portfolio allocation

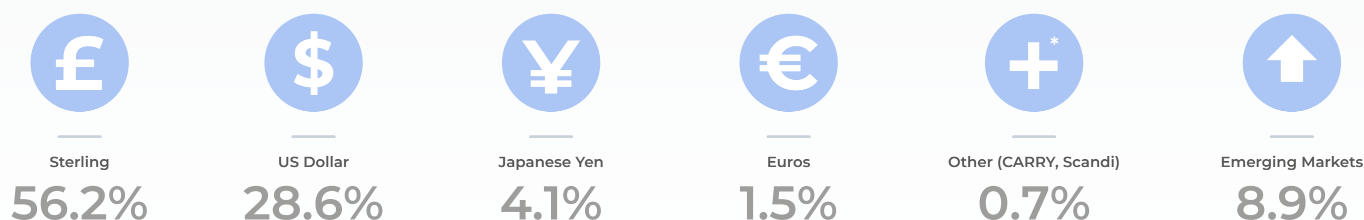
Cash & short-term Gov. Bonds	7.3%
Developed Markets Gov. Bonds	9.0%
Inflation Linked Bonds	5.0%
Investment Grade Corporate Bonds	15.2%
High-Yield & Emerging Markets Bonds	9.5%
Developed Markets Equity	42.5%
Emerging Markets Equity	6.5%
Commodities and Real Estate	3.0%
Cash	2.0%

Geographic exposure

United Kingdom	20.7%
United States	44.1%
Eurozone	13.8%
Japan	6.1%
Other developed countries	2.0%
Emerging Market (excluding China)	8.5%
China	4.7%

Currency exposure

P4



Sterling	US Dollar	Japanese Yen	Euros	Other (CARRY, Scandi)	Emerging Markets
56.2%	28.6%	4.1%	1.5%	0.7%	8.9%

ETF breakdown

Name	ISIN	Weight	TER	Currency Hedged
Chinese Sovereign Bonds in Local Currency	IE00BYPC1H27	2.5%	0.35%	N
Emerging Markets Equities local currencies	IE00BKM4GZ66	6.5%	0.18%	N
UK Sovereign Bonds Short Maturities	IE00B4WXJK79	7.3%	0.07%	N
UK Investment Grade Corporate Bonds 0-5 years	IE00B5L65R35	8.3%	0.20%	N
Developed Market Equity (MSCI World Value)	IE00BP3QZB59	3.0%	0.30%	N
Emerging Markets Sovereign Bond in US Dollar	IE00B2NPKV68	4.0%	0.45%	N
Gold	IE00B579F325	3.0%	0.19%	N
US High Yield Credit	IE00B4PY7Y77	3.0%	0.50%	N
Japan Equities (MSCI JAPAN)	IE00B4L5YX21	3.4%	0.15%	N
US Investment Grade Credit	IE00BZ163K21	6.9%	0.09%	N
UK Equities (FTSE100)	IE00B810Q511	6.2%	0.09%	N
US Equities (S&P500)	IE00B3XXRP09	10.7%	0.07%	N
Euro Equities (MSCI EMU) Sterling hedged	LU1127516455	5.7%	0.17%	Y
US Equities (S&P500) Sterling hedged	IE00BM67HX07	13.5%	0.09%	Y
Global Inflation Linkers Sterling hedged	LU0641007264	5.0%	0.20%	Y
Global Sovereign Bonds Sterling hedged	LU0641006290	9.0%	0.25%	Y
Cash		2.0%		

Peer Comparison Data: Asset Risk Consultants ARC collects the monthly returns of a collection of discretionary investment managers including large Asset managers, private banks and Wealth Managers to create an index of the average returns for a given level of risk. **ARC benchmarks are as follows. Private Client Index Relative: Risk to World Equities: ARC Cautious PCI: 0 – 40% / ARC Balanced Asset PCI: 40 – 60% / ARC Steady Growth PCI: 60 – 80% / ARC Equity Risk PCI: 80 – 110%. Where the relative risk to World Equities means you are taking approximately that percentage of the risk global stock markets. Moneyfarm's Risk level 2 is compared to the ARC Cautious Private Client Index (PCI), our risk levels 3 and 4 use the ARC Balanced Asset Private Client Index (PCI), levels 5 and 6 are both compared to ARC Steady Growth Private Client Index (PCI) and our risk level 7 is matched to ARC Equity Risk Private Client Index PCI.

ARC compiles indexes using the average competitor returns, including Barclays Wealth, HSBC, Investec Wealth and Investment and Blackrock, as well as many others.
The last 3 months of data are ARC's estimates. ARC does not produce an index that is a suitable comparison for P1, as it does not contain any equity. We use monthly GBP Libor + 0.5%, as this is a cash proxy, which Moneyfarm believes is a fair comparison.

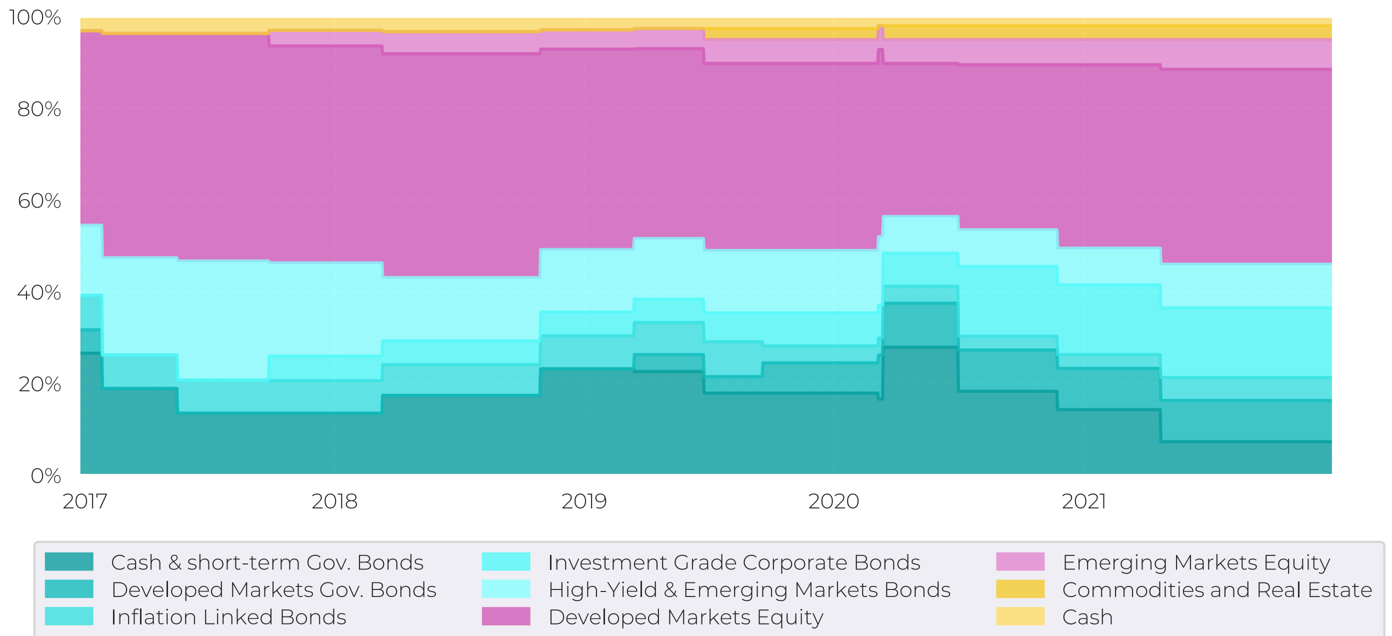
Asset allocation changes

The allocation was adjusted once in October. The repositioning was limited in scope and based on some tactical views, with the fundamental structure of the portfolio remaining very similar to that which has served us well over the rest of 2021.

Despite the spread of Omicron and some ostensible signs of slowing global growth following the significant post-pandemic rebound, we believe the outlook for next year is positive and that corporate earnings will stay resilient against the new variant and keep on growing. As for the risk of inflation, which rose significantly in the last months of 2021, we expect a normalisation in 2022 with rates closer to the long-term policy targets. Our base case remains one of a gradual reduction of the inflation rate.

From an equity perspective, we partially cut the exposure to UK small cap and reallocated to global equities. We believe the attractive valuations are less relevant now given the uncertain scenario surrounding the UK economy and the fact that a large portion of the rebound in revenue and earnings from cyclical segments is now behind us.

Your portfolio's allocation over time



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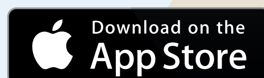

Risk warning, as with all investing, your capital is at risk. The value of your pension can fall as well as rise and you may get back less than you invest. Eligibility to invest in a pension depends upon your circumstances. Tax rules may change in the future. If you need help with pensions, seek independent financial advice. Note that you can't withdraw money from a personal pension until you're 55.

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