Close Brothers Asset Management

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Close Sustainable Balanced Portfolio Fund

Monthly fund manager update

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MONTH IN FOCUS

The Close Sustainable Balanced Portfolio Fund returned +2.1% in June. This compared favourably with the Investment Association 40%-85% Shares sector, which returned 1.9% over the month. The year-to-end of May return for the Fund stands at +5.3%.

US LABOUR MARKET

In June, we created a US labour market dashboard to monitor changes in employment, hours worked and wages. There are two key reasons for this project. First, we know that the US Federal Reserve (Fed) closely monitors employment and wage data given that it forms one of its two key objectives (maximum employment and price stability), and therefore is an important part of policy decisions. The second reason for the project is to monitor the financial health of the consumer, which can help to inform investment ideas. Our key findings are as follows:

The pandemic and resultant recession is unique in comparison to previous economic downturns in terms of the concentrated impact on lower-wage service sector jobs. Job losses occurring mostly in the lower-paid roles had an obscure impact on wage data, with the Bureau of Labor Statistics (BLS) showing the average hourly earnings figure spiking by 8.2% year-on-year (YoY) in April 2020, and remaining above 4% until April 2021. However, with over 80% of the 9.6m net job losses among workers in the bottom 25% of the wage distribution, and approximately 7.9m low-wage workers leaving the workforce - while 1.5m jobs were added in the top half of the wage distribution – average wages were skewed upward. Clearly these wage growth figures were not reflective of a strong economy, nor severe inflationary pressures from the cost of labour, but rather the shift in composition in the workforce – with lower-paid workers dropping out of the calculation of average earnings in a meaningful way.

A more representative, but less frequent, figure is the Employment Cost Index (ECI). This adjusts for the changes in composition in the labour force, meaning that it strips out the impact of lower-paid workers leaving the workforce. This shows a much more muted impact on wages resulting from the pandemic, with ECI growth of 2.4%-2.6% (YoY) between 2Q 2020 – 1Q 2021, which are the lowest growth rates since 4Q 2017. However, sequentially, the 0.9% growth in 1Q 2021 was the biggest move since 2Q 2006.

This is being driven by lower-paid roles in the services sector, more specifically in leisure and hospitality. Over the past four months, on average leisure & hospitality has accounted for c.70% of the net change in non-farm payrolls. This is also the sector in which there have been consistent sequential wage increases, with readings of +1.3%, +1.5% and +1.3% over the past three months respectively. This is a notable point when taken in combination with the payroll data, given that the onset of Covid-19 led to an artificial boost in wage growth data, but as these lower-paid workers return to the workforce there hasn't been an equivalent weakening of average wages data. This implies that these workers are returning to the workforce on higher wages than before, as a swathe of companies in the retail, hotel, leisure, restaurant and warehouse sectors raise the minimum wage paid to employees. This is also taking place at the state level, with Delaware being the first state to approve a $15 minimum wage by 2025 (the Federal minimum wage is currently $7.25).

Until then, when testing the historical relationship between the ECI (wage) growth and the unemployment rate, we can see that a 1% decrease in the unemployment rate leads to an approximate 0.25% increase in wage growth. Therefore, a return to an unemployment rate of c.4% would approximately be associated with wage growth of 3% which, when using today's 10 year breakeven rate of 2.3%, would represent real wage growth. The Fed's projections show that US unemployment is expected to dip below 4% by the end of 2022.

There could be upside to wage growth figures considering that the rate of job resignations are the highest in at least 20 years, alongside record US job openings of 9.3m in April. Taken together, this implies that workers are growing increasingly confident of their ability to find other (more favourable) employment. This has facilitated 26 states (as of21st June) cutting off federal unemployment benefits, despite the benefit programme being fully funded through to early September. Iowa's governor, Kim Reynolds, said the payments are 'discouraging people from returning to work'.

STOCK OF THE MONTH: NVIDIA

- +23% in June.
- Nvidia designs and manufactures graphics and video processing chips for PCs, games consoles and other devices.
- The share price rose in June on the back of sell-side target price upgrades following a results announcement in late May. Nvidia achieved record revenues in Gaming, Datacentre and Professional Design Visualisation, as well as guiding above consensus for the next quarter.
- There was further positive news flow in June when the company's $40bn proposed acquisition of Arm Ltd received endorsement from three of the world's largest chipmakers.
- Nvidia has an exemplary record , with the company partaking in Conflict Free Sourcing Initiatives. Nvidia stands out among its peers due to its due diligence on its supply chain, receiving a 100% response rate in 2019 on its responsible mineral reporting template.