VT Astute Funds

Quarterly Commentary

Q3 2021

Introduction

Thank you for taking the time to read our Q3 commentary. As the last quarter marked the one-year anniversary of the Astute funds launch, in July 2020, we are now able to share performance data within our commentary. You will find dedicated sections for each of our three funds later in this update for investors who wish to see specific detail on their chosen portfolio. While the level of risk within each portfolio varies, the Astute view and philosophy that drives our positioning is consistent throughout. We remain focused on our long-term investment objectives and delivering these while minimising downside risk.

What are we discussing this quarter? With “freedom day” behind us and schools returned, many of the restrictions of the past 18 months are behind us. The long-term effects of the pandemic are still uncertain, however. Despite a strong economic recovery, growth is beginning to slow, and that has led to increasing worries about persistent inflation and a sluggish economy. This so called “stagflation” trap is the topic of our CIO letter this quarter.

In our **Astute Overview** section, we will look at how fragile global supply chains are creaking under demand pressures, and at China, where the high-profile problems at the country’s largest property developer added to the wall of worry in emerging markets.

Our regular **Astute Perspective** shows our current conviction views, while **Astute Positioning** covers how those views translate into the portfolios, and what changes we have made in the past three months.

Finally, **Astute Observations** highlights some of the more interesting research, data, or charts we have encountered recently with a few short and, hopefully, enlightening comments.

As always, we take a long-term approach to investing our clients’ assets, but success is a journey, not a destination, and the short-term views expressed herein are aimed at managing risk and making your investment journey as smooth as possible. By taking a risk-adjusted approach to your investments, we aim to deliver reliable growth in line with our stated risk profiles and provide you, and your financial planner, the consistency and security to plan for your long-term financial future.
Thank you for your continued support. If you have any further questions or require any additional information, please do not hesitate to contact your usual financial planner.

Fund Management Team

Scott Osborne
Chief Investment Officer

Toby Hulse
Investment Analyst

Mark Houghton
Investment Analyst

ASTUTE INVESTMENT MANAGEMENT LTD

Stagflation Frustration

Happy Birthday to the VT Astute fund range! We passed our one-year milestone in July, which eases the regulatory restrictions on performance reporting, something the eagle-eyed among you may have noticed from our factsheets already (as they now include performance statistics). You will also find a dedicated performance breakdown for each of the funds at the back of this commentary. I also want to personally thank you for your support since launch and hope this last year is just the first of many on the way to achieving your financial goals. In case you’re wondering, there was no cake. My daughter's second birthday is shortly after, and my wife didn’t appreciate me drawing comparisons, although if I could guarantee good behaviour from financial markets by promising them a trampoline for Christmas, life would be much easier.

Apologies for mentioning Christmas in October but we are well and truly through the summer holidays now and getting to the business end of the year. Easy growth comparisons to pandemic affected numbers will wash through, both in terms of economic numbers like GDP growth and inflation but also in earnings numbers for individual companies. Essentially the dust is beginning to settle and, as some semblance of “normal” life resumes, we can take stock of how well the economy weathered the crisis.

Some things I have discussed in the past still look a little worrying. Labour markets certainly look tighter and supply chain issues seem to be persisting longer than expected (see **Astute Overview**). Both of which feed into inflation expectations. On balance it seems the risk that inflation stays higher for longer has increased, and that may lead to central banks tightening more quickly than anticipated. This has been one of our principal concerns for most of the year and while we don’t think the pace of policy tightening will accelerate all that much, we have insulated the portfolios from this risk as much as we think we can. This worked in our favour this quarter as bond markets, a key underweight for the funds, started to price-in interest rate increases and higher yields, pushing bond prices lower. So, we are comfortable with the risk around inflation expectations but what about growth?

An elevated rate of inflation was always seen as an acceptable, ideally temporary, consequence of a strong economic recovery, but what if inflation sticks around and the growth does not? Rising price pressures, transitory or not, are placing significant costs on consumers in all sorts of areas. The hard data show household and company balances sheets are in rude health, but you might not feel like splashing out on Christmas or a new high-tech production line if your energy bill just doubled or your gross margin is under pressure. Without the animal spirits to support spending it won’t matter how much “dry powder “there is, it just won't get spent.

This stagflation trap is what is occupying markets at the moment and it’s a hard scenario to defend against. It puts policymakers in a tricky position because central banks should really continue tightening to control inflation, but higher rates will only pour more cold water onto growth. Fiscal intervention is also unlikely as governments have limited room to borrow more, particularly as interest rates increase. The simple reason this looks so gloomy is why we don’t think it will materialise. Governments are designing policies, like the UK’s super deduction or the mooted tax on share buybacks in the US, to encourage real capital investment and unlock that spending.

In summary, we are getting more worried about slowing growth and the potential for stagflation but not enough to adjust our risk-on positioning. We will increase our efforts to defend against this outcome and search for ways to protect the portfolios from this downside scenario should it materialise. More generally we continue to be positive on the outlook for risky assets, albeit China is raising some questions (see **Astute overview**). As yields rise, we may be able to tip-toe back into bond markets, and that will help portfolio diversification, but until then we remain underweight fixed income. As always, we remain disciplined in our approach to managing risk, but maintain our focus on achieving our long-term growth objectives.

Scott Osborne PhD CFA
Chief Investment Officer

Astute Overview

GLOBAL SUPPLY CHAINS– THROWING PETROL ON THE FLAMES

One aspect of the recovery from the pandemic we are all seeing in our daily lives is the disruption to global supply chains. From a shortage of semiconductor chips to a shortage of HGV drivers, both materials and the methods for moving them around the globe remain disordered. Short and long-term trends in supply chains, labour shortages across that chain, and end demand (in some cases panic buying) are all converging to stress a fragile system to breaking point. Some of these bottlenecks will work out over time, but how long will temporary impacts last, and are some changes more permanent in nature?

First, let's examine a case study supply shortage that emerged during the pandemic: semiconductors. The basic commodity of computing power and increasingly ubiquitous in everyday devices. Already a structural growth story as trends around AI, “smart” devices, and 5G technology accelerated, the pandemic saw a spike in demand as consumers upgraded home PCs and other personal devices during lockdowns. Much of this immediate demand was met by falling orders from cyclical areas, like car manufacturers. As activity recovered these manufacturers now find themselves out in the cold, with a chip shortage so severe it is halting production and slowing their recovery. Any other business feeding into that supply chain will also be affected, demonstrated by the recent negative guidance from Melrose. The UK-based engineer doesn’t use chips itself but supplies drivetrains for new cars and reported “in month cancellations” had risen to over 20% compared to a normal rate of around 1%. Meanwhile, ASML, the Dutch company which supplies the complex printers needed to produce the most advanced chips, is flourishing. One of those companies is still well below its pre-pandemic valuation, the other is two to three times above it.

These dynamics may work out over the next year as additional chip fabricating capacity enters the market but issues like the US/China innovation war and China’s “made in China 2025” policy could influence market dynamics for the foreseeable future. This is just one complex example, but there are many more where growth is being limited or redistributed due to supply chains issues, some of which were temporary but have resulted in permanent change. The real question is what is the overall impact on growth and the consumer?

Here we can look at the recent petrol “shortage” for clues about consumer behaviour. The perception that something may not be available leads to a run on supply, and the shortage becomes self-fulfilling. Panic buying, higher prices, and more buying to beat future price increases, is a classic inflationary spiral. What’s more worrying, however, is that this behaviour defers consumption elsewhere. Despite the very healthy appearance of many household balance sheets, nobody likes the feeling they are being ripped off, even if they can afford it.

Bottlenecks in supply chains, either because there aren’t enough chips to go around or because your tanker driver now delivers for Tesco, creates additional costs in the value chain and that has to be absorbed or passed on. Many company's feel they have the “pricing power” to squeeze consumers, but push too hard, or at the wrong time, and you might lose a customer forever. Worse still, they may not go shopping at all.

Astute Response:

We see this as a key driver of consumer behaviour and “animal spirits”. While changing supply chain dynamics can create winners and losers to be exploited by talented active managers, if the net effect is to dampen overall demand that could be negative for growth and the market as a whole. We retain our bias to active in key areas and step up our efforts to hedge against slowing growth, although it is not our base case expectation.

CHINA PROPERTY – UNDERPINNING REQUIRED

China has been one area of the markets generating a lot of headlines this year due to the Communists party’s continued interventions in markets. Many of these policies are directed at political priorities like population growth or closing wealth inequality (“common prosperity for all”), but others are sensible economic measures designed to reduce financial risk in markets. The worry is that the ultimate cost of these reforms is borne by investors. The best example of this dynamic is the “Three Red Lines” implemented in 2020 to reduce excessive leverage in China’s real estate market. Ultimately this has led to the partial default and now suspension of dealing in the country’s biggest developer, Evergrande, but could have wider implications for the economy.

The three red lines were designed in response to booming prices, sales, and worrying increases in borrowing by developers. If a speculative property bubble built on leverage sounds familiar to you, then you can understand why China is acting now to try and prevent a 2008 style bubble burst. Even controlled deflation is painful however, and the restrictions on additional lending were so severe that only a tiny fraction of the market could comply. This forced developers like Evergrande to aggressively de-lever, essentially selling assets to pay back debt. As it transpired, and perhaps not unexpectedly, the deleveraging could not happen quick enough and so Evergrande found themselves locked out of debt markets and unable to refinance existing debt as it came due.

If this sounds bad, it is, but the outcome was almost inevitable, and some would say desirable from China’s perspective. The public travails of Evergrande sends a strong message to the sector to get their house in order and shares at least some of the pain with equity and bond investors, who are unlikely to be compensated for their risk-taking… or will they? Offshore investors may struggle, but a far larger portion of Evergrande's liabilities are onshore, and here the belief is that China’s pockets are deep enough to provide bailouts where necessary. They won't allow any company to become “too big to fail”, but they won't allow any failure to become too big to bail out. They can fine-tune the economic pain by the scale of their response. Of course, not everyone agrees.

The bear case centres not on China’s financial firepower but on the so-called “real economy”. Real estate is a huge industry, some estimate construction and related services contribute as much as 29% of GDP and employs almost 20% of the urban workforce. Over 90% of urban households already own their home and over 80% of new sales are to existing owners. Clearly, a drop-off in activity and a fall in prices is bad for workers and their sense of wealth. Finally, the debt owed permeates all parts of the economy, all the way to regional authorities who rely on lucrative land sales to fund investment. Firepower is one thing, directing it effectively is another.

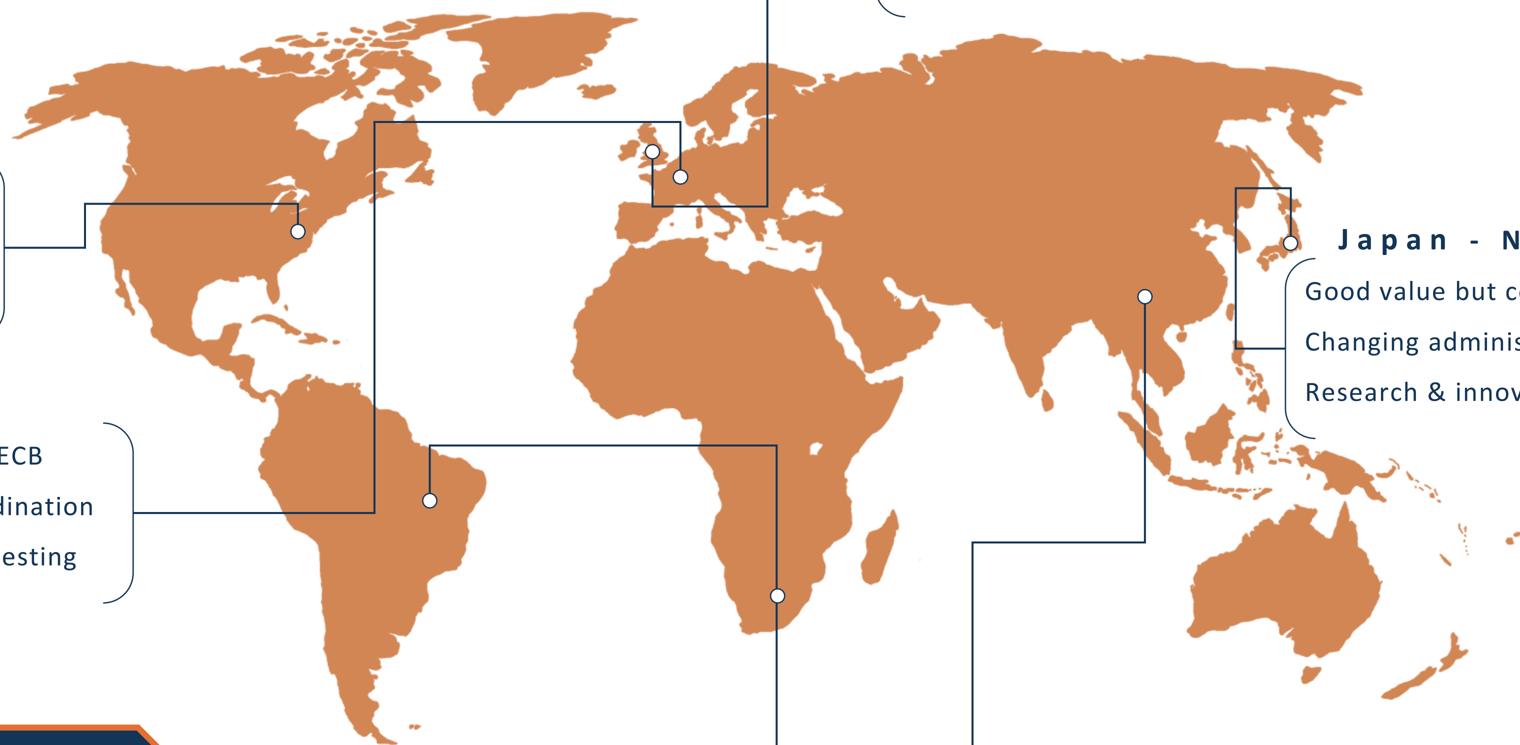
The bull case is simply that China will meet this challenge with a wall of stimulus and easing measures. There are good companies outside of the problem sectors, on cheap valuations, that will do well regardless (managed decline or bubble burst and blockbuster stimulus). Furthermore, the pricking of the property bubble will force a reallocation of wealth away from real estate and into markets. Being too early an investor could be painful in the short term but may still be a better outcome than missing the rally if and when it comes.

Astute Response:

We have and continue to place faith in both China’s ability to deflate this potentially damaging property bubble and our selected managers' ability to navigate the related market volatility. However, the potential for contagion into the real economy is larger than anticipated and the downside risk to the position is growing. As a result, we will review our positioning and reduce our risk-taking accordingly either directly via China or elsewhere in EM.

Sources: Refinitiv; Capital Economics; Financial Times; Rogoff, Kenneth, and Yuanchen Yang. 2021. “Has China’s Housing Production Peaked?” China and the World Economy 21 (1): 1-31.

Astute Perspective



UK – Neutral/Overweight
- Larger companies remain structurally challenged
- Prefer smaller companies with growth opportunities
- Labour/goods shortages likely exacerbated by Brexit

N. America - Neutral
- Expect strong recovery led by record stimulus
- Rising inflation putting pressure on growth names
- Debt ceiling & mid-terms already looming

Japan - Neutral/Overweight
- Good value but corporate nationalism persists
- Changing administration very much status quo
- Research & innovation remains strong suit

Europe - Neutral
- Fiscal co-operation emerging, supportive ECB
- Elections to have limited impact on co-ordination
- Global leader in green and sustainable investing

Asia & Emerging - Overweight
- Long-term growth from demographics & development
- China tightening policy will slow growth versus peers
- Vaccination catch-up a short-term hurdle to growth

Conviction Views

A key part of our process is building conviction ideas which are then expressed across each of the portfolios. While asset class and regional views are an important input into this process, the opinions outlined below will be the driving force behind any potential future returns.

1. Pivot to Cyclical
   - Economic rebound will broaden growth opportunities, benefiting cyclical sectors most
   - Valuations more attractive for growth linked to economic rebound but cautious on long-term outlook and avoiding value traps

2. Overweight Technology
   - Technological revolution will continue, lean into disruptive areas, the strong get stronger
   - Look beyond current global leaders and use specialists to stay ahead of the curve

3. Invest Sustainably
   - ESG will become the default option, and the market will shift accordingly
   - If sustainable investing is the future, invest with those who have ESG way into their past

Asset Class Views

Fixed Income	Negative						Positive
Sovereign Bonds							
Corporate Bonds							
High-yield bonds							
EM Debt							

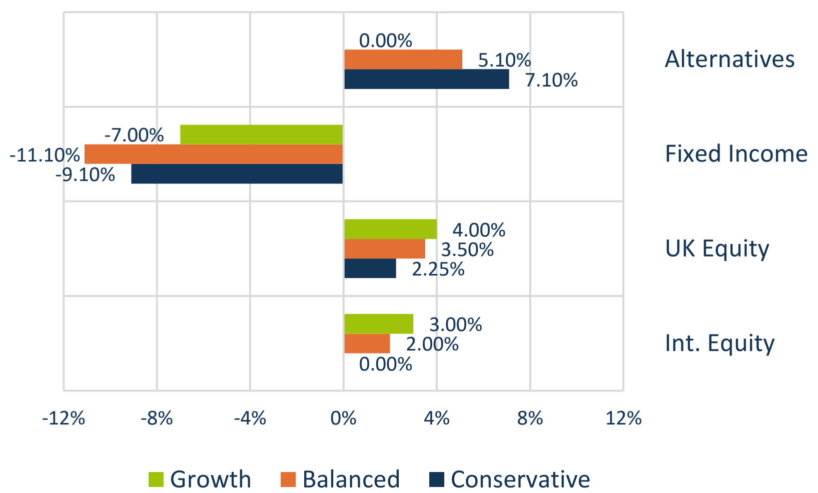
Alternatives	Negative						Positive

Equities	Negative						Positive
UK							
Europe							
Asia & Emerging							
Japan							
US							

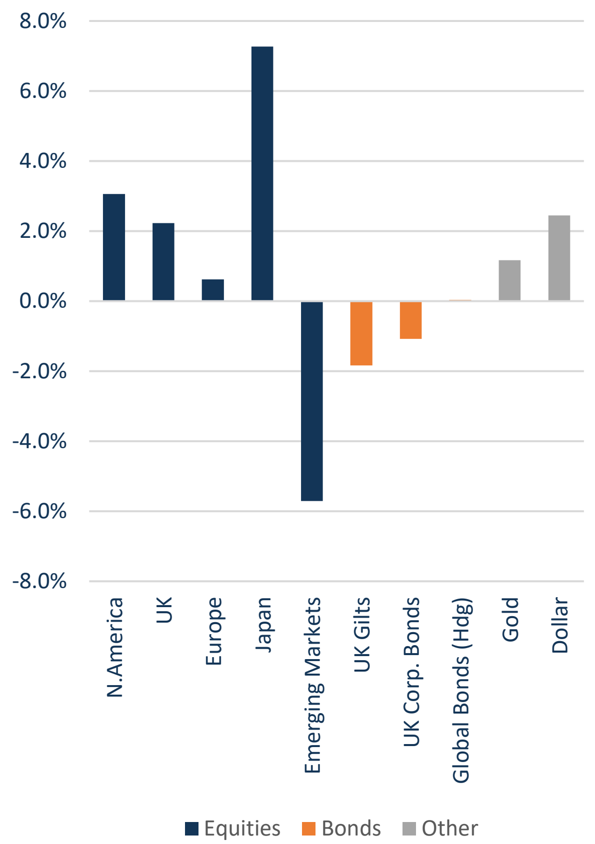
ASTUTE INVESTMENT MANAGEMENT LTD

Astute Positioning

Tactical Asset Allocation[1]



Asset Class Returns[2]



Fund Activity

	Fund	Funds
New Purchase	Invesco S&P 500 ETF	Con, Bal, Gro
New Purchase	Tritax EuroBox PLC	Con & Bal
New Purchase	Aberdeen European Logistics Income	Con & Bal
Top Up	Gresham House Energy Storage	Con & Bal
Top Up	ES R&M European	Bal & Gro
Top Up	Jupiter Japan	Bal & Gro
Top Up	JPM UK Equity	Con, Bal, Gro
Trim	Invesco Physical Gold ETC	Con & Bal
Trim	Granahan US Smid Select	Bal & Gro
Trim	VT Gravis Clean Energy Income	Con & Bal
Trim	SPDR® MSCI USA Small Cap ETF	Bal & Gro
Trim	L&G US Equity ETF	Con, Bal, Gro
Trim	Baillie Gifford American	Con, Bal, Gro

The last quarter was relatively quiet in terms of portfolio activity. We did trim our US exposure early in the period following a strong Q2, rotating capital into Europe and Japan. Our long-term growth bias continued to benefit performance, whilst the inflation hedges we put in place during the second quarter helped to dampen volatility, particularly in September as yields started to increase. We also opportunistically entered some European logistics positions following a takeover bid for our student property portfolio.

Performance over the period was positive. Equity markets generally made progress, despite fading over the course of the quarter. The obvious exception being Emerging markets where further intervention from the Chinese government and a stronger US Dollar more generally, saw markets give back the gains of Q2. As the summer ended and some clarity developed on both inflation and central banks' tightening schedules, yields ticked higher. This pushed fixed-income assets into the red but fell short of the steep losses seen when yields spiked earlier in the year. The biggest winner was Japan. With progress made towards re-opening following a successful Olympics, the performance gap to western markets looked incongruous and the resignation of Prime Minister Yoshihide Suga triggered a sharp catch-up rally.

The biggest driver of performance for the Astute funds was the continued bias for equities over fixed income. Selection in our alternatives was a strong contributor as our real estate assets performed particularly well. Bond returns were flat but this contributed positively as most benchmarks were negative in Q3. Our corporate bond managers suffered most as they struggled to offset the headwind of rising yields through credit selection. All our equity components outperformed their benchmarks this quarter, the only exception being the US, where our inflation hedges held back returns early in the period. Despite outperforming the broader index, the overweight to EM was the obvious drag on performance. This is a position we are carefully reviewing in light of developments in China (see Astute Overview).

There were essentially two trades made this quarter, one at the beginning and one at the end. Early in the period, we moved to trim our US exposure and reallocate over UK, Japan, and Europe. We felt the bounce back for high-growth names had gone a little too far and would underperform if yields started to rise again. While we saw the risk mostly to our growth names, we trimmed broadly to maintain a balanced exposure within our US equity component and gained cyclicality by virtue of the markets we moved into.

The other trade is somewhat forced following the bumper cash offer for GCP Student Living in July. We first purchased this investment trust in December 2020 as we saw good potential for capital growth that would eventually turn into a quality income play, as students returned to university. While our small shareholding had little influence on the final decision, the 30% premium on offer matched the all-time high price and was enough compensation for most investors to sell up. As a result, we will reluctantly part company with a quality asset when the deal closes in December. Since those shares will be swapped for cash in the future, we effectively were overweight cash from this point and so began the search for suitable alternatives. With a flurry of capital raising activity from investment trusts throughout September we took advantage of a discounted equity raise from two prime European logistics managers, Tritax EuroBox, focused on larger warehouses and development assets, and Aberdeen Standard's European Logistics income, focused more on mature midsize warehouses with strong rent profiles. With Europe lagging the UK in terms of online retail adoption we think the broader logistics story has room to run and assets in prime logistics locations like Rotterdam will benefit.

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2021. Past Performance is not a reliable indicator of future results.
[1] – Relative positioning is expressed versus Astute's long-term strategic weights. [2] – Total returns in GBP. Broad market indices are used to represent the performance of different regions over the period

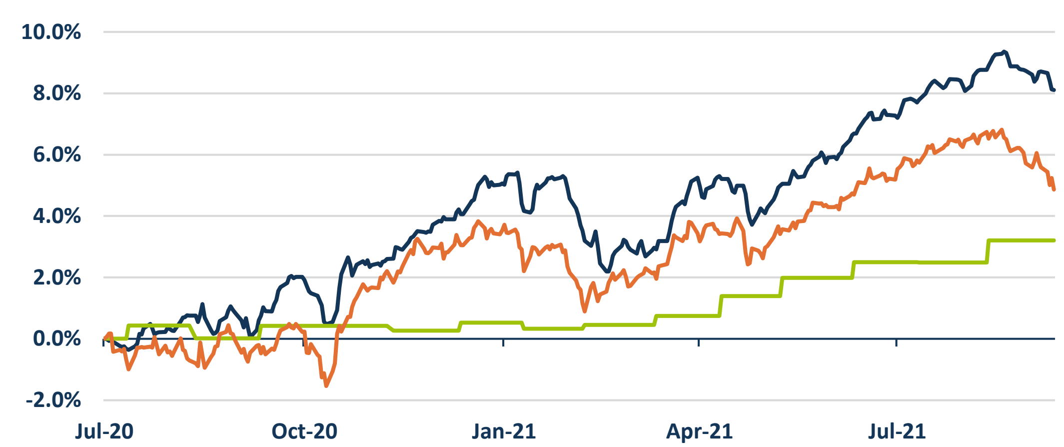
VT Astute
Conservative

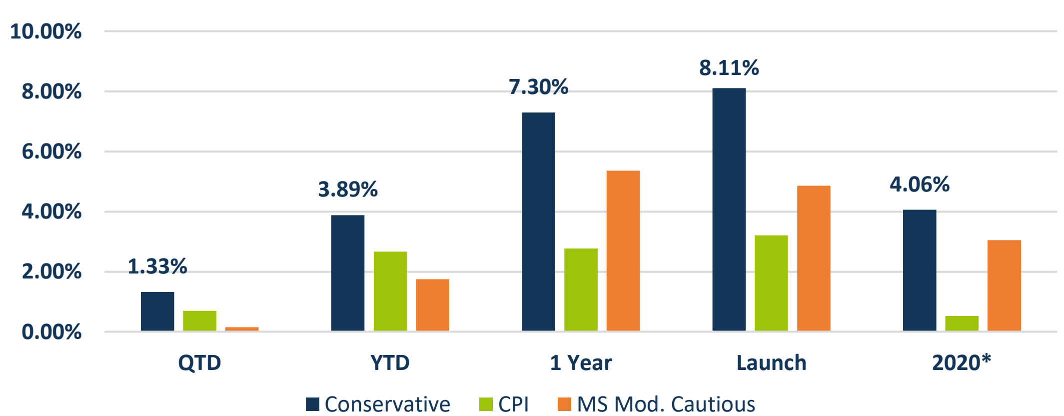
The Conservative fund had a strong quarter against the backdrop of difficult conditions for traditional fixed income assets. Minimising the sensitivity to interest rates within our fixed income component helped limit losses and contribute a small positive performance.

The underweight position in bonds also allows for higher allocations to equity and alternatives, both of which delivered strong returns through the quarter. Japan, where the Jupiter Japan Income is our only holding, particularly helped to offset losses in Asia and Emerging markets despite being a much smaller position.

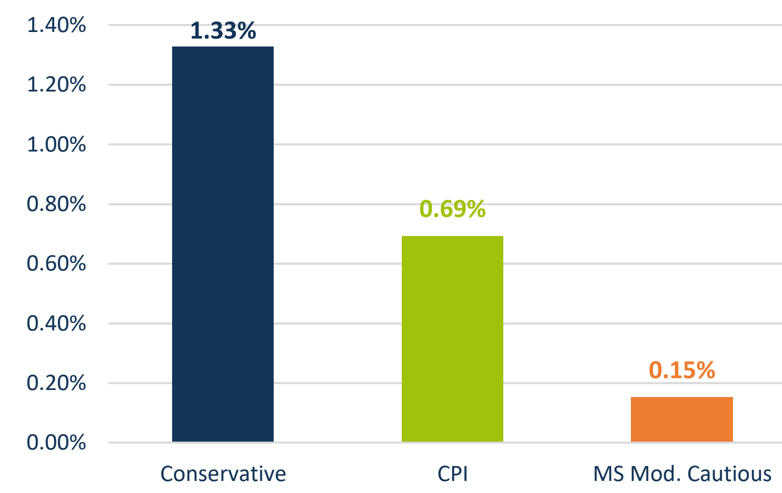
The top contributing fund was GCP Student living which was bid for at a 30% premium, contributing around half of the total return for that part of the portfolio. While we are reluctant sellers, we have already recycled the capital into other opportunities within real estate through two new European logistics positions. Also providing solid returns in Q3 was our core absolute return manager Blackrock European Absolute Alpha. Despite giving back some returns late in September, this quality-biased strategy continues to benefit from excellent stock selection in both their long and short books.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	12.2%	0.40%	0.05%
Government	7.20%	1.45%	0.10%
Credit	20.4%	-0.42%	-0.09%
UK	6.0%	2.95%	0.17%
N.America	11.6%	1.51%	0.25%
Europe	3.6%	3.73%	0.13%
Japan	2.1%	9.35%	0.19%
Asia & Emerging	4.6%	-4.15%	-0.20%
Alternatives	32.4%	2.53%	0.78%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
GCP Student Living	1.36%	31.37%	0.38%
L&G US Equity ETF	5.34%	3.85%	0.23%
Jupiter Japan Income	2.08%	9.35%	0.19%
BlackRock European Absolute Alpha	6.18%	2.05%	0.13%
JPM UK Equity Core	3.97%	3.03%	0.12%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2021. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] data for the period 20/07/2020 to the 30/09/2021.. [2] data for the period 30/06/2021 to the 30/09/2021, * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding.

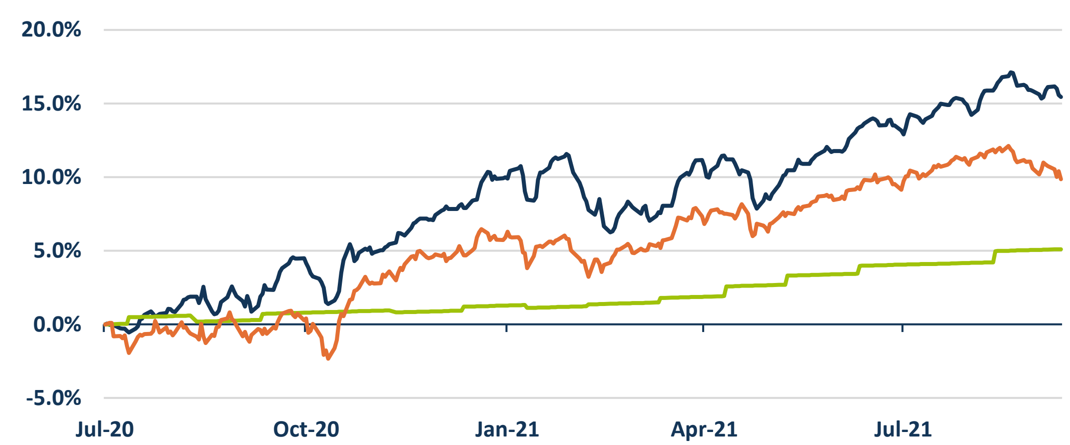
VT Astute
Balanced

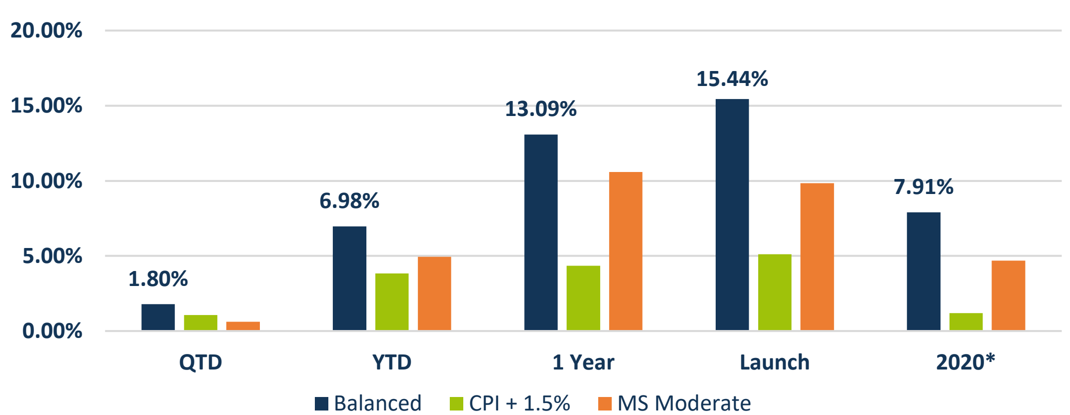
The Balanced fund had a strong quarter both compared to our peer comparator and our CPI+ benchmark, despite UK inflation continuing to accelerate through the quarter. Minimising the sensitivity to interest rates within our fixed income component helped avoid losses seen in the wider market. The smaller allocation to credit also helped as corporate bond managers generally struggled to compensate for rising yields through credit selection.

Within equities, we saw strong performance from Europe and Japan. The Jupiter Japan Income fund particularly helped to offset losses in Asia and Emerging markets despite being a much smaller position. Although our US equity exposure lagged the market, the largest contribution outside our core tracker position was the USA Financials ETF, a key part of our inflation and interest rate hedging strategy. This demonstrates the benefit of hedging some of our longer-term growth conviction while rate speculation drives up volatility.

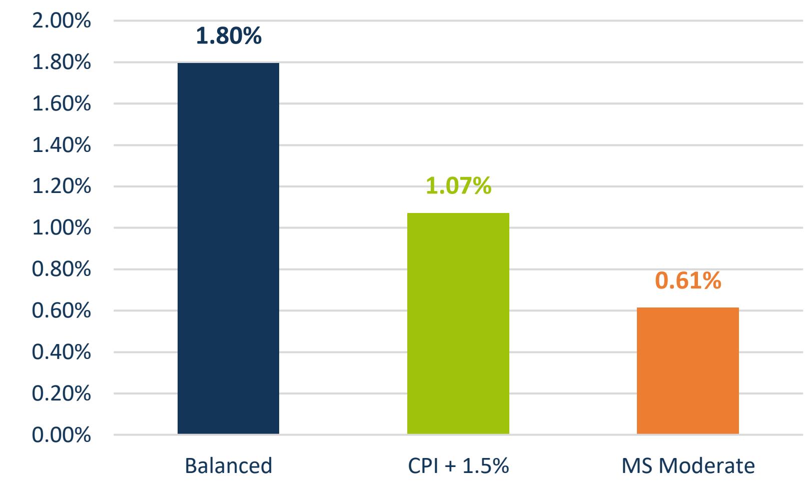
GCP Student living was also a top performer, after receiving a bid at a 30% premium. This contributed around half of the total return from our alternatives. While we are reluctant sellers, we have already recycled the capital into other opportunities within real estate through two new European logistics positions.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	6.1%	0.55%	0.03%
Government	3.1%	1.45%	0.04%
Credit	8.2%	0.20%	0.02%
UK	11.2%	3.09%	0.35%
N.America	25.2%	1.39%	0.42%
Europe	7.7%	3.71%	0.29%
Japan	4.6%	8.14%	0.38%
Asia & Emerging	9.3%	-4.37%	-0.39%
Alternatives	24.8%	2.86%	0.69%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity ETF	7.68%	3.85%	0.37%
GCP Student Living	1.26%	31.37%	0.36%
Jupiter Japan Income	3.05%	9.35%	0.29%
Xtrackers MSCI USA Financials ETF	3.09%	6.68%	0.20%
JPM UK Equity Core	6.04%	3.03%	0.18%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2021. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] data for the period 20/07/2020 to the 30/09/2021.. [2] data for the period 30/06/2021 to the 30/09/2021, * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding.

VT Astute
Growth

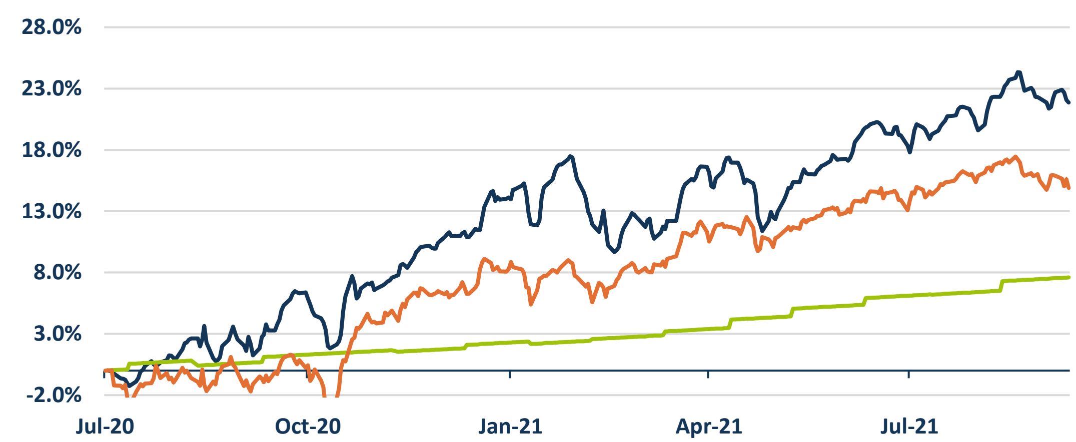
A solid quarter for the growth fund despite giving up some earlier gains through September as interest rate speculation and fears around growth began to influence sentiment. We continue to hold zero weight to fixed income in this portfolio and prefer to seek diversification via our alternatives. Given the negative returns seen in bond markets this quarter a zero return is relative outperformance.

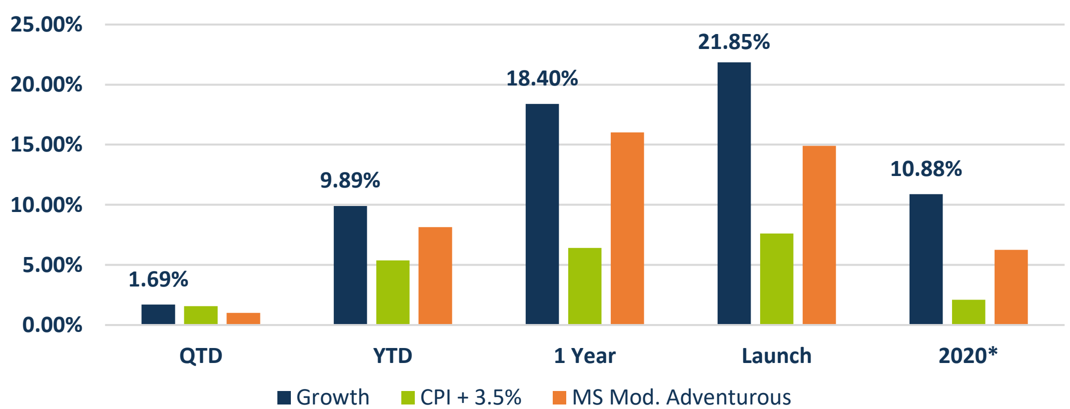
Within equities, we saw strong performance from Europe and Japan. The Jupiter Japan Income fund particularly helped to offset losses in Asia and Emerging markets despite being a much smaller position.

Our more cyclical European manager also made a strong contribution despite the headwind to his style early in the quarter. This more pragmatic approach to cyclicality and value in Europe continues to provide good upside to value rallies without giving away performance when the style falls out of favour.

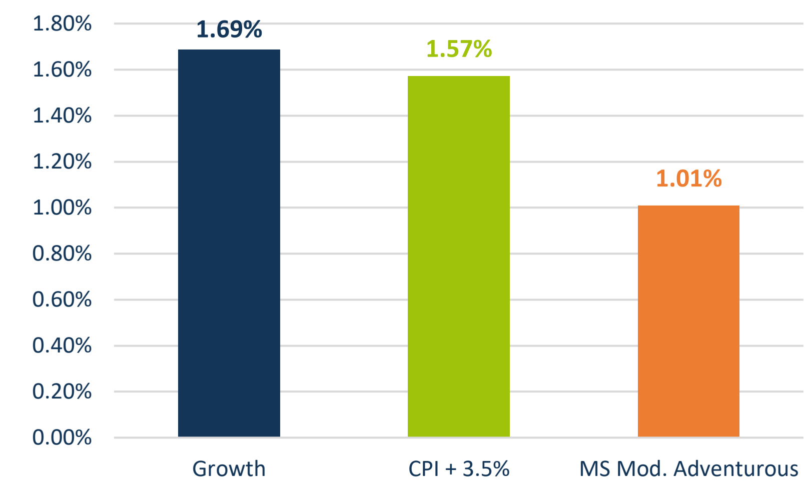
Although our US equity exposure lagged the market, the largest contribution outside our core tracker position was the USA Financials ETF, a key part of our inflation and interest rate hedging strategy. This demonstrates the benefit of hedging some of our longer-term growth conviction while rate speculation drives up volatility.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	0%	0%	0%
Government	0%	0%	0%
Credit	0%	0%	0%
UK	16.4%	3.75%	0.51%
N.America	39.6%	1.29%	0.56%
Europe	12.2%	3.69%	0.46%
Japan	7.1%	8.31%	0.60%
Asia & Emerging	14.3%	-4.39%	-0.61%
Alternatives	10.3%	1.82%	0.19%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity ETF	11.95%	3.85%	0.54%
Jupiter Japan Income	5.06%	9.35%	0.48%
Xtrackers MSCI USA Financials ETF	5.13%	6.68%	0.34%
JPM UK Equity Core	8.08%	3.03%	0.24%
ES R&M European	5.45%	3.55%	0.22%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2021. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] data for the period 20/07/2020 to the 30/09/2021.. [2] data for the period 30/06/2021 to the 30/09/2021, * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding.

Astute Observations

ENERGY PRICES - GAS EXPLOSION

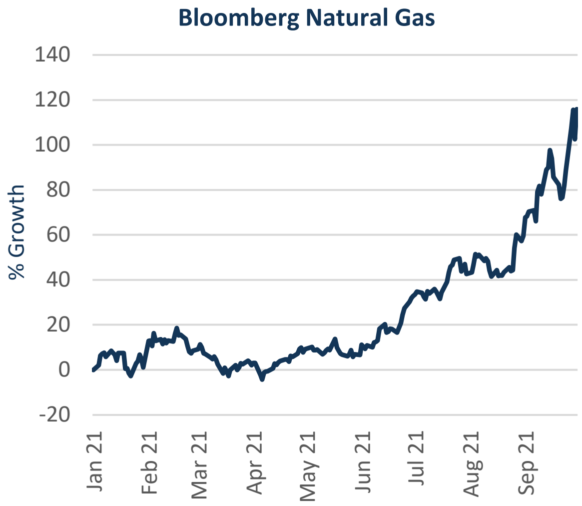
One area grabbing headlines at the moment is the soaring cost of natural gas, and the implications it has for wider energy prices. The phenomenal rise in prices this year, as shown by the first chart, is adding more fuel to speculation around stagflation. The simple idea being that spiralling costs impact both households and industry, impeding growth. What is causing this spike and is it temporary?

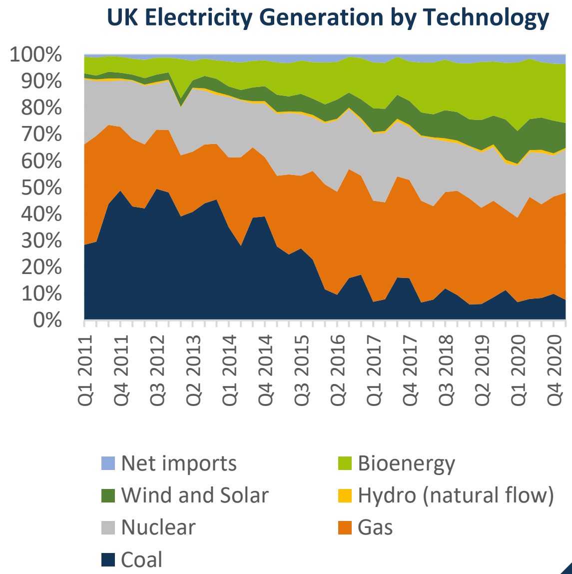
There are undoubtedly structural drivers that are leading to greater price volatility in energy markets, the transition to renewable energy the biggest among them. The second chart below shows UK electricity generation by power source, and the progress towards renewable energy (and away from coal) that has occurred over the last 10 years. While this is positive and, in isolation, has not led to spikes in prices, it has increased the fragility of the system as renewable energy sources can't be easily be stored. This creates feast or famine production dynamics.

Since gas can be stored and switched on when needed, it can be relied upon when the sun doesn't shine, if you'll forgive the pun. This makes it the marginal price setter for energy in the UK energy. Without more security on long-term energy storage to help even out the irregular generation from renewables it is likely energy prices will remain exposed to exogenous shocks.

This year we have demand spiking, as activity picks up, poor generation from renewables, and supply shortages from major suppliers like Russia. Given the controversy surrounding the Nordstream II pipeline, it is perhaps unsurprising that Russia might exploit its relative strength in this area for its own gain.

Sources: Refinitiv & BEIS





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