Whitechurch Asset Views
Award Winning Wealth Managers

Whitechurch Securities Ltd
WEALTH MANAGERS

Monthly Round Up - September 2018

Strategic Overview
The Only Game in Town

Below are the key factors that have influenced investment markets in recent weeks, followed by our current position.

The US stockmarkets were the only game in town in August.
US stockmarkets provided the only positives in August posting another month of strong gains due to robust economic news-flow. However, all other major global regions showed negative returns, with geopolitical issues and trade war concerns weighing on investor sentiment. The overall result was a rise in the US heavy MSCI World Index of 1.3%.

Looking at fund performance in August, IA North American Smaller Companies was the best performing sector, returning 6.9%. The technology sector also rallied strongly, returning 4.8%. At the other end of the spectrum, it was Emerging Markets focused sectors that were hit hardest. IA China and Greater China had another tough month -3.4% but the IA Global Emerging Markets Bond -3.7% was bottom of the pile with many Emerging Market currencies seeing heavy falls.

Mixed sentiment across the globe
Investors in the US were in a relaxed mood and stockmarket volatility in August (as measured by the VIX index) was very subdued. However, markets in Europe and Asia were not as calm and there was significant volatility in Emerging Markets, with Latin America and Turkey seeing heavy sell-offs.

Summer doldrums for UK investors
The UK stockmarket fell back during the month, but it was a reversal of recent months as medium and smaller companies held up better than Blue chip larger companies. Although Brexit noise remained a feature, it was weak performance from oil and mining sectors which were key detractors to the UK markets.

The longest US bull market since World War II
The rally in August resulted in a record breaking month for US stockmarkets, with the major benchmarks hitting new peaks. During the month, the US bull market became the longest on record since World War II having avoided a 20% or more decline since March 2009. During which time the S&P 500 has risen more than 300%. This was the cue for lots of commentators to trot out the adage that bull markets do not die of old age.

Currency diversification remains a positive
Although currency movements have proved more muted recently, strong US economic data saw an extension of the rally in the dollar and Brexit fears pushed the pound lower versus the yen and the euro. The overall currency effect saw the 1.3% return from the MSCI World Index over the month translate into a gain of 2.2% for UK investors. We continue to extol the virtues of holding well-diversified international exposure given the political uncertainty that threatens the domestic economy.

A better month for bond investors
Away from stockmarkets, increased nervousness amongst investors (outside of the United States) saw a better month for most areas of bond markets. US and German Government bonds rallied as investors sought safe havens. However, the buoyant US economy meant that High Yield bonds were favoured in America. As a result the IA £ High Yield sector was the best performing area of bond markets and returned +0.3%. The IA Gilts sector was broadly flat over the month, whilst Emerging Market debt was hit hard by falling currencies.

Best of the Rest
Commercial property had a steady month and is proving a good bedrock within our cautious and balanced portfolios. We have stuck with our favoured three funds from F&C, Henderson and Kames. The asset class is again displaying the two attributes we seek – attractive yields compared to government bonds; and a lack of correlation with equity and bond markets.

Looking Ahead
This month highlighted the disparity we have seen between US stockmarkets and the rest of the world this year. Whereas the S&P 500 has provided double digit returns in sterling year to date, other major stockmarkets (UK, Europe, Japan, Asia and Emerging Markets) have seen no gains in 2018.

Strong US economic data and global political turbulence are polarising investor sentiment. Whether the US stockmarket can continue to outperform so strongly is questionable, but the lack of progress of other global stockmarkets is seeing more value emerge. As a result, our strategic view remains focused on the belief that there is value to be had in several areas of global stockmarkets.

Political uncertainty at home and abroad will remain a feature but it is largely background noise, in our view, and does not alter our investment outlook. We remain more focused on central bankers and believe that interest rate policies will be key drivers of asset prices. Our view remains that interest rate increases are likely and that holding money in cash, will continue to erode the value of savings in real terms for the foreseeable future.

We believe that a well-diversified portfolio can continue to provide cash beating opportunities in a number of areas for those prepared to ignore short-term noise, focus on valuations and take a longer-term perspective.

Our investment focus remains upon generating attractive risk-adjusted returns (the amount of return we can generate based upon the level of risk being taken) on a rolling three-year period. It is on these measures that Whitechurch has earned a wide range of industry awards in recent years.

On the following pages we provide a more detailed review of the markets and touch on how we are positioning our portfolios.

UK Equities

UK stockmarkets fell back over the month with concerns over Brexit remaining at the forefront of investors' minds. However, with the falls in commodity stocks and concerns of a trade war hitting global multi-nationals it was large cap stocks which were the worst performers over the month. The benchmarks for medium sized companies and small cap stocks showed only a modest negative return.

Barely any sectors were in positive territory over the month with big underperformance seen in some sectors. Key underperformance over the month came from Mobile Telecoms as Vodafone fell a further 11% over the month. Tobacco fell back over the month with brokers cutting targets on tobacco stocks as they continue to face pressure from next generation products such as vaping devices. Miners were also key underperformers as they took a hit from lower metal prices.

In terms of economic data, figures were reasonably positive. Whilst PMI survey data was mixed over the period the UK's public finances continue to outperform expectations due to strong tax receipts, helped by low unemployment.

The Bank of England increased the base rate at the start of August from 0.5% to 0.75% the highest level in almost a decade; but it is unlikely that we will see further rises until there is more clarity upon the Brexit outcome.

Despite the political uncertainty creating negative sentiment we remain sanguine on our view of UK equities. Although we expect to see the noise increase over Brexit over the coming weeks our belief is that UK shares with high overseas earnings benefit from a weaker pound and those with more of a domestic focus are deeply unloved and undervalued by investors, thus representing a contrarian opportunity. Furthermore, we expect a lower for longer rate environment to continue which is supportive for dividend producing shares and with the UK stockmarket yielding close to 4% this is a very attractive feature.

US Equities

US investors shook off concerns over rising interest rates and threats from Trump over a trade war and focused on the strong domestic economic data. The S&P 500 was up 3.2% whilst the small cap focused Russell 2000 increased by 4.3%. Returns for UK investors were enhanced by the rally in the dollar translating the S&P and Russell returns to 4.1% and 5.2% respectively.

The rally in August resulted in a record breaking month for US stockmarkets, with the major benchmarks hitting new peaks. August saw the longest bull market on record since World War II having avoided a 20% or more decline since March 2009 – during which time the S&P 500 has risen more than 300%. This was the cue for lots of commentators to trot out the adage that 'bull markets do not die of old age.'

What tends to kill them off is a fear of recession, but economic data releases over the month continued to point towards a very healthy US economy. Unemployment fell to the lowest level since 2001 and US consumer confidence hit an 18 year high.

From a corporate point of view, the technology sector bounced back strongly. Apple became the first $1 trillion company. At the other end of the spectrum, energy stocks were the worst performers despite the high oil price.

Although having an underweight position to the US stockmarket has been a drag on performance year to date, our favour for US smaller companies has been a major positive. Trump's tax reform bill could see one final push for the extended US bull market run. However, we are seeing a number of fund managers starting to question the sustainability of the US economic strength. On this basis, the strong run of corporate earnings could begin to falter and high valuations, rising interest rates, and the political uncertainty over Trump are key reasons that make us cautious on the wider US market.

European Equities

European stockmarkets fell back in August as investors were preoccupied by political issues, with concerns that Italy will announce a high government spending budget which could affect the credit rating. The benchmark index fell by -2.0% in local currency terms although a strengthening euro against the pound saw the impact softened to -1.4% in sterling.

In terms of economic news flow it was broadly good news. Q2 GDP growth of the Eurozone economy was upgraded to 0.4%. Eurozone inflation was stable and jobless figures were at the lowest level since 2008. PMI surveys continued to provide an optimistic outlook that some of the recent weakness is not leading to a sustained downturn.

Whilst other central bankers have been tightening monetary policy, the European Central Bank proved to be more supportive and confirmed that interest rates will remain unchanged until the autumn of 2019 at the earliest.

On a corporate level, it was a reversal of July performance with value areas such as financials, telecoms and energy underperforming whilst consumer staples and technology outperformed. Technology was the only sector to provide a positive return.

European markets have lagged wider developed markets year to date and our reduction in European exposure has been prudent. The strong recovery of 2017 has lost momentum this year. We have been trimming our overweight exposure to bring monies back home to the out-of-favour UK stockmarket. However, we continue to believe that Europe looks more attractive than the US on valuation measures with more stimulatory monetary policies likely to remain in place for some time.

Japanese Equities

Whilst it was an uninspiring month for the Japanese stockmarket and the benchmark Topix index decreased by 1%, a stronger yen vs the pound resulted in an index gain of 0.8% in sterling terms. In the year to date Japan has underperformed global markets but the strength of the yen has generated positive returns for UK investors.

Economic news-flow was steady but from a corporate perspective the recent earnings season has been more positive than the economic news suggests. The upturn in profitability is making the Japanese market appear relatively attractive compared with other Developed Markets (even cheaper than the UK).

In politics, Shinzo Abe is likely to win the leadership election on 20th September, which will see him become the longest serving Japanese Prime Minister and continue his Abenomics push past 2020.

Investing in Japan is unexciting at present but, despite recent underperformance, holding yen has been supportive for UK investors during times of risk aversion. The economy is growing at a steady pace and the Bank of Japan is likely to continue quantitative and qualitative monetary easing and this should provide a supportive backdrop.

Valuations appear relatively attractive compared with other developed markets (cheaper than the UK) given the potential for dividend policy reform, the ability to return cash to shareholders, and scope to improve return on equity. However, corporate earnings within Japan will remain volatile as the value of the yen fluctuates.

Asia Pacific & Emerging Market Equities

August proved to be a more difficult month for Asian and Emerging Market indices which continued to lag Developed Markets. The MSCI Emerging Markets and FTSE Asian Pacific Ex UK Indices fell by 2.9% and 0.5% respectively during August and the Emerging Markets benchmark is now in bear market territory having fallen more than 20% since January.

Emerging Markets were hit by Turkey's economic troubles. The Turkish lira hit an all-time low against the dollar in early August, and there are growing concerns that the issues could spread to the Eurozone. Trade tensions and a strong dollar also dominated the headlines in Emerging Markets. At the start of August trade relations between the US and China deteriorated further.

The MSCI China Index declined in August losing 3.8% during the month. Economic growth figures were positive but investors seemed more focused on ongoing trade tensions and a continued slowdown in the territory.

In contrast to China, India managed to outperform the wider Emerging Market indices with the MSCI Indian Index climbing 4.4% during the month.

Russia had a torrid month in sterling terms with the RTS Index declining 14.2% during August. Russia's economic outlook deteriorated after the ruble hit more than two-year lows against the dollar in August following Washington's move to apply fresh sanctions. Brazil also fell sharply during the month declining more than 10%. Brazil's economic recovery got little traction in the second quarter amid industrial action and growing political uncertainty.

Emerging Market valuations have been driven down with the August sell off and given that there is scope for earnings recovery across many Asian and Emerging Markets, they are beginning to look relatively attractive. But a watchful eye needs to be kept on economic indicators coming out of China and also the potential of Turkish contagion.

It will remain important to be selective when investing in these higher risk markets. As we have seen with concerns of a trade war, the optimism over China can be checked very suddenly. Furthermore, a continuance in the recent rally in the dollar will prove to be a headwind for many of these markets.

However, overall fundamentals across Asia and Emerging Markets still look attractive with structural reforms, better corporate governance, greater consumerism and cheaper valuations, providing good opportunities for investors seeking long-term growth.

Fixed Interest

Fixed interest proved broadly positive during August, although there were mixed signals driving bond markets. An increase in nervousness amongst investors (outside of the United States) saw an increase in demand for more defensive assets. US and German Government bonds rallied as investors sought safe havens. UK Government bonds were not as sought after but The IA Gilts sector was broadly flat over the month.

The buoyant US economy meant that High Yield bonds were favoured in America. As a result the IA £ High Yield sector was the best performing area of bond markets and returned +0.3%.

In contrast, Emerging Market debt was hit hard by the fallout from Turkey and Argentina. Currencies of both countries fell heavily during the month and investors became increasingly nervous of contagion to other emerging markets. As a result the IA Global Emerging Markets Bond sector fell by 3.7%.

Although the overall trend in global bond markets is towards a monetary tightening phase, with interest rates heading up, it is going to be a slow process with central banks telegraphing their intentions to markets along the way. Even though many bond markets are historically overvalued, this approach by the central banks leads us to believe that there will be no collapse in bond prices.

Our exposure to fixed interest is through a basket of complementary and diverse bond funds for cautious and balanced income orientated portfolios. We will continue to avoid UK Government bonds, although we have a material position in US treasuries to provide insurance during risk-off periods. Overall we continue to favour our fixed interest exposure in corporate bonds and less interest rate sensitive areas of bond markets. Exposure ranges from defensive investment grade corporate bond funds and strategic bond exposure right up to financial bonds. We also hold Emerging Market Debt where we believe attractive yields provide adequate reward for risk, despite recent turbulence.

Commercial Property

UK commercial property funds once again remained solid, providing marginal, income driven gains.

It has been rewarding for investors since we returned to investing in UK commercial property last summer. The major UK commercial property funds have reverted to type and produced steady returns from income generation but also some capital growth. We have recently increased our exposure to property as the asset class is again displaying the two attributes we seek – attractive yields compared to Government bonds; and a lack of correlation with equity and bond markets.

Alternatives

It was a difficult month for Absolute Return strategies with most funds struggling to make headway and there has been negative news-flow on high profile funds recently. Fund Manager GAM liquidated their £9 billion Absolute Return Bond fund due to irregularities, whilst Standard Life's flagship Global Absolute Return Strategies has continued to underperform and seen significant outflows.

These are not funds we hold and with increasing interest rates weighing on returns from bond markets and stockmarkets displaying a higher level of volatility our belief remains that selective alternative strategies are necessary to provide an added level of diversification.

We have a preference for equity long/short strategies and we continue to be frustrated by the (lack of) performance from the popular multi-asset strategies. Although it is important to be selective and have a strong understanding of long/short funds, they are true diversifiers within our portfolios, and offer different opportunities versus traditional 'safe haven' asset classes, which appear expensive.

Commodities

Oil prices increased during the month with Brent Crude increasing by 4.4%. A strong rise in oil prices has been a key feature this year along with sanctions imposed by Trump.

The dry weather that we have seen in the UK has been replicated across many regions worldwide and this is having upward pressure on food prices which will also be inflationary in the short-term.

Despite increasing investor nervousness, Gold fell for the sixth month in a row with the gold price ending down 2.0%. We only hold gold indirectly through a small amount in alternative strategies. Gold is a diversifier but we find it hard to value and its lack of yield provides a headwind as interest rates rise. Elsewhere we do not have direct exposure to commodities within our portfolios, although mining and energy will feature within UK and overseas equity exposure.

Cash

UK inflation increased to 2.5% in July as measured by the Consumer Price Index (CPI) helping to vindicate the increase in interest rates by the Bank of England. It is likely to remain at these levels due to inflationary commodity prices and a renewed weakening of sterling. Despite the recent 0.25% interest rate rise the best instant access Cash ISA deals are still offering around 1.3% it remains likely that a Cash ISA will provide a negative return in 2018.

For investors taking a medium / long term view we continue to believe that there are more attractive opportunities across other asset classes to beat cash. We are not going to see interest rates reverting to their long-term average for a long time. Therefore, cash is only held at present for tactical reasons or within lower risk strategies to enable us to counterpoint this with higher risk assets.

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