Whitechurch Asset Views
Award Winning Wealth Managers

Whitechurch Securities Ltd
WEALTH MANAGERS

Monthly Round Up - April 2018

Strategic Overview
War of Words

Global stockmarkets suffered another month of losses in March, with investors becoming unnerved by the potential fallout of an impending trade war. This has been instigated by President Trump expressing an intention to impose tariffs across a wide range of imports, with China the prime target. Given there tends to be no winners in a trade war, this was universally seen as bad news for global markets.

Although the potential of a trade dispute is unsettling; to put it in context the initial proposals for tariffs on Chinese goods make up around 0.1% of Chinese GDP with even less impact on the US economy from Chinese retaliation measures. Furthermore, like many of Trump's initiatives, investors will question to what extent it is a war of words and another case of all mouth and no action.

Although we have not seen the levels of market turbulence seen early in February, global equities are showing more elevated levels than witnessed last year. The VIX index, which is the most widely used measure of stockmarket volatility, showed a reading of 20 at the end of the month, which is in line with the long-term historical trend level. Nonetheless, with US policies fuelling investor concerns it is reasonable to expect that 2018 is not going to be a repeat of the smooth rising markets witnessed last year.

Currency continues to influence market returns and, as we have mentioned previously, has become a key focus for us when assessing global markets. In March, the news of a potential Brexit transition agreement saw a rally in the pound versus other major currencies, which saw local currency losses exaggerated in these stockmarkets for UK investors. Despite the recent strengthening of the pound, we continue to extol the virtues of holding well-diversified international exposure given the political uncertainty that threatens the domestic economy.

Away from stockmarkets, reduced concerns of inflationary pressures saw fixed interest prove to be a good defensive hedge from the stockmarket volatility. Defensive Government bonds were sought after as investors quelled their appetite for risk. Commercial property has also proved to be a good diversifier and one of the few areas of asset allocation to generate positive returns so far this year.

Looking ahead, we still believe that interest rate policies at home and overseas will be key drivers of asset prices, whilst currency movements are also going to be key determinants for investor returns as we move through 2018. We continue to believe that, at home and abroad, any interest rate increases are likely to be cursory due to a lack of sustained inflationary pressure and fragile economic growth.

Political uncertainty will continue to weigh on sentiment, with less than 12 months until Brexit, the potential escalation of a global trade war and conflict in the Middle East. Such factors could prove another catalyst for more market jitters. The recent increase in the level of stockmarket volatility is hardly surprising following a prolonged period of unusually steady market rises. Although, we have seen short-term losses across many areas, looking ahead, a correction could prove healthy for long-term investors, in terms of bringing valuations to less optimistic levels. It also provides a timely reminder that stockmarkets fall as well as rise and for investors not to become complacent or be tempted to take on more risk than they are comfortable with.

Our top down view remains focused on the belief that there is value to be had in equities versus cash and bonds, with a number of areas offering long-term growth prospects and attractive dividends. Whilst 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.

On the following pages we discuss our approach across global stockmarkets and other asset classes, as we look to extend our award winning performance in 2018.

UK Equities

In line with all major stockmarkets, UK shares fell back in March, falling nearly 5% at one point on the back of investor concerns over the effect of potential tariffs on global trade. A strengthening of sterling also weighed on UK exporting blue chips shares. There was some recovery towards month end, although the index still finished nearly 2% lower.

With some more positive news-flow around Brexit regarding a potential transition agreement, it was the UK mid-caps with a more domestic focus that held up better than UK large cap overseas earners. Although, the increase in nervousness across global markets saw a move towards defensive stocks which led to strong performance from Utilities and Pharmaceuticals.

Overall, whilst it cannot be argued that the UK economy is booming, it is proving resolute despite the ubiquitous Brexit headlines forecasting doom and gloom. Wage growth is at its strongest since 2015 and although inflation fell below 3% during the month, the consensus view is that the next UK interest rate rise will come in May.

For investors in the UK stockmarket it seems it will remain a challenging environment as ongoing Brexit fallout continues to dominate investor sentiment. However, we have recently moved towards a more positive stance on UK equities. Although we are mindful of political risk, our belief is that UK shares are deeply unloved and undervalued by investors, thus representing a contrarian opportunity. It appears that there is excessive risk aversion and short-termism at play within the UK stockmarket. This is particularly true of domestic facing businesses, which have been hit the hardest and are trading at undemanding valuations. Furthermore, although we may see an interest rate hike in May, we expect a lower for longer rate environment to continue which is supportive for dividend producing shares.

US Equities

It was news-flow emanating from US that once again spooked global markets. Although, concerns over sharply rising US rates were calmed by more subdued wage growth figures, Trump's talk of sanctions saw a renewed sell off in the second half of the month. As a result, the S&P 500 was at the forefront of the market declines with heavy falls in large technology stocks also hurting US markets. Currency movements exaggerated losses for UK investors as the pound strengthened against the dollar resulting in a more than 4% fall when translated into sterling returns.

We still believe that monetary policy will be the key driver for US equities and, as widely expected, new Governor of the Federal Reserve (the Fed), Jerome Powell, announced an interest rate increase of 0.25%. He indicated another two rises would occur this year in line with market expectations and three more next year (above expectations).

On the corporate front, earnings have remained robust with consensus for Q1 profit growth now at 17% (increasing from 13% at the start of the year), fuelled by corporate tax reforms.

Fundamentally, our underweight position to the US stockmarket has been fairly neutral year to date. On valuation terms our favour for other markets versus the US remains intact, but Trump's tax reform bill could see one final push for the 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 about the wider US market.

European Equities

European equity market returns held up relatively well in the face of negative investor sentiment. UK equities were better within Developed Markets but a strengthening pound against the euro saw losses for UK investors, against the benchmark increase to more than 3%.

Economic news-flow this year has been disappointing and recovery appears to be losing some momentum. Economic growth remains steady (at around 2% for the Eurozone) whilst inflation was 1.4% (in line with expectations). The big concerns for the European Central Bank (ECB) and European exporters is the strength of the euro combined with weak inflation. Although Quantitative Easing is destined to run its course by the end of this year, it seems unlikely that the ECB will be looking to raise interest rates any time soon.

Corporate profits have been strong growing by 12% in 2017, making it the first time in ten years when profits have grown faster than US, but the figure is predicted to slow to 8% this year.

We have maintained a favour for European markets over US which was positive in 2017 but has proved more neutral over the month and year to date. Although Europe remains more attractive than the US on valuation measures there are signs that the strong recovery of 2017 could be losing momentum. The strength of the euro has proven to be a strong tailwind over the past year for UK investors but this could prove a headwind going forwards. The fact that investing in European equities has also become more of a consensus over the past year also makes us more cautious.

Japanese Equities

It was a relatively steady month for the Japanese stockmarket overall. The Topix fell by 2.0%, less than the MSCI World index, although currency was a negative with the pound strengthening against the yen, translating into an index fall of 3.4% for sterling investors. Year to date Japan has underperformed global markets but the strength of the yen has made it the best of overseas markets for UK investors.

Markets are receiving support from the Bank of Japan (BoJ) which has bought Y2 trillion ($7.8 billion) of ETFs (and plans to buy a further Y4 trillion before the end of 2018). In contrast, overseas investors have dumped Y8 trillion of Japanese equities so far this year spooked by the strong yen and effect of trade wars. However, the end of March saw evidence that investors were seeing oversold opportunities as the Japanese stockmarket saw the second largest weekly inflow on record.

Japan has been the best of the major Developed Markets over the past year and holding yen has been supportive for UK investors during the sell-off. The economy is growing at a steady pace and the Bank of Japan is likely to continue 'quantitative and qualitative monetary easing. This should provide a supportive backdrop (as well as buying equities when markets fall). Valuations appear relatively attractive compared with other Developed Markets 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 remain volatile as the value of the Yen fluctuates.

Asia Pacific & Emerging Market Equities

The performance of Asian and Emerging Market equities generally mirrored the falls in Developed Markets equities over the month. It is no surprise that Asian and Emerging Markets were affected by Trumps trade war sell-off, with China being the main target. There are fairly widespread views as to how this will conclude. Some are flagging an out and out trade war, others feel this is just an aggressive negotiation between the two super-powers.

Economic data so far this year suggests the Chinese economy's solid growth momentum of last year has carried over into the first quarter, with a government think tank forecasting gross domestic product will grow 6.9% in the first half of the year. While strength in China's economy will help underpin short-term global growth, economists are sticking to forecasts that momentum will slow later this year due to a cooling property market and rising borrowing costs.

Russia was back in the spotlight in March following the high-profile poisoning of Russian ex spies in Salisbury. Whilst the Russians deny any involvement, the unified expelling of diplomats globally indicates scepticism over Russia's stance. It is fair to say that relations between the West and Russia have reached their lowest level since the Cold War and we have seen a heavy sell-off early in April as US sanctions and concerns over conflict in Syria has seen investors shun Russia.

Despite recent risk aversion leading to some profit taking from Asian and Emerging Market equities, we believe that there are good opportunities to deliver strong performance from these areas. However, 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 and is a timely reminder that we do not become complacent over the longer-term risks of instability in the largest emerging market. However, overall fundamentals across Asia and Emerging Markets still look attractive with structural reforms, better corporate governance, greater consumerism and not least, relative valuations, providing good opportunities for investors seeking long-term growth

Fixed Interest

Bond markets staged a recovery in March as fears of inflation subsided and investors sought refuge from stockmarket volatility. Having struggled in recent months, UK Government bonds returned to favour and gilts posted a positive return of 2%. Overseas bond markets also rallied as March proved to be a "risk-off" month across the globe as investors grew more nervous of signs of slowing economic growth in China and Europe.

In the United States, the Fed raised interest rates in March by 0.25% to 1.5-1.75%. Whilst this was widely expected, estimates for future rate rises shifted higher and there was a more hawkish tone from the new Governor, Jerome Powell. However, whilst US interest rates went up, bond yields went down. It appears that the bond markets are prepared to "fight the Fed" and do not believe the Central Bank's perception of the strength of the US economy:

It wasn't a good month relatively for higher risk areas of bond markets. The IA Global Emerging Market Bond sector was the worst performing sector falling by 1.5%, with currency proving to be a headwind whilst the High Yield sector also fell by 0.6% over the month.

Although we are moving 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 recently added US treasuries as 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, and Emerging Market Debt where we believe that attractive yields provide adequate reward for risk.

Commercial Property

Despite the sell-off in equity and bond markets during March, 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

The falls in risk assets and the increase in volatility was a timely test for our alternatives exposure, and the Absolute Return funds held proved defensive over the month.

With increasing interest rates weighing on returns from bond markets and stockmarkets displaying a higher level of volatility, our belief remains that a basket of alternative strategies are necessary to provide an added level of diversification.

An upturn in the relative performance of our alternatives funds, year to date, has been welcome as the use of these funds has been called into question several times during the tandem bull-run for equities and bonds. However, it is important to be selective and have a strong understanding of such funds. They are true diversifiers within our portfolios and offer different opportunities versus traditional 'safe haven' asset classes, which appear expensive.

Commodities

Oil prices see-sawed during March jumping to a two year high on geopolitical concerns, before sliding back in the sell off at the end of March with Brent Crude trading close to $70 a barrel.

The gold price gained around 1.2%, although this translated into a loss of 1.4% for UK investors as sterling strengthened. There was some volatility in price around the time trade tariffs were announced. Even in these times of uncertainty we are not seeing any wholesale move into safe haven assets.

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. We do not have direct exposure to commodities elsewhere within our portfolios, although mining and energy will feature within UK and overseas equity exposure.

Cash

UK inflation fell from 3% to 2.7% in March as measured by the Consumer Price Index (CPI). Although UK inflation is expected to fall further over the coming months (as stronger sterling, and falling food and commodity prices kick in), cash remains unattractive. With the best instant access Cash ISA deals 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. 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.

Whitechurch Investment Team, April 2018

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