Whitechurch Asset Views
Award Winning Wealth Managers

Whitechurch Securities Ltd
WEALTH MANAGERS

Monthly Round Up - May 2018

Strategic Overview

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Having been seemingly universally shunned by global investors, monies flowed back into the UK stockmarket in April. UK shares rose to the top of the leaderboard of major developed stockmarket indices, posting a return in excess of 6%, more than double the MSCI World index. This was pleasing to see as we had recently reduced overseas exposure to increase allocation to the UK stockmarket.

It was also pleasing to see that from a style perspective 'Value' showed outperformance whilst expensive 'Quality' areas of global stockmarkets lagged. It is our view that many leading defensive quality stocks are trading on demanding valuations and that there is more scope for shrewd stock-pickers to hunt for value in unloved, cheaper stocks.

Although global stockmarkets broadly moved back to positive territory, the elevated level of volatility of the first quarter persisted through much of April. After exceptional low levels of volatility in 2017 it is realistic to expect volatility to be more in line with longer-term levels going forward. Geopolitical headlines continued to play a significant role in unsettling investors, particularly the prospect of a "trade war" between the US and China alongside an escalation of tensions between the US and Russia over the situation in Syria.

Currency also continued to influence market returns and, as we have mentioned previously, has become a key focus for us when assessing global markets. In April, weaker UK economic news (reducing expectations of a rise in UK interest rates) saw a fall in the pound versus other major currencies. There was also a recovery in the value of the dollar during the second half of the month. We continue to extol the virtues of holding well-diversified international exposure given the political uncertainty that threatens the domestic economy.

Away from stockmarkets, commodities rallied strongly fuelled (no pun intended) by the oil price hitting $75 a barrel for the first time in four years. The increase in the price of the black stuff contributed to renewed concerns of inflationary pressures. Such concerns, together with more optimistic investor sentiment, also saw a fall in the price of 'defensive' Government bonds. Meanwhile, commercial property has continued to be a good diversifier and our exposure produced a steady gain in April.

Looking ahead, we still believe that interest rate policies at home and overseas will be key drivers of asset prices. Our view is that any interest rate increases are likely to be cursory due to a lack of sustained inflationary pressure and fragile economic growth. This is reinforced by sluggish UK economic data reducing the likelihood of an imminent UK interest rate rise.

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.

Sell In May & Go Away?

It is the time of year for this old adage to be trotted out again and for clients to ask:

"Should I sell my stockmarket investments and hold cash for the summer?"

In response, we will once again refer to our default position which is that we don't believe that looking at a calendar provides a good way to formulate investment strategy. The table below details the performance of the UK stockmarket during the period of 1st May to St Leger Day over the past ten years and it shows that whilst investors may have avoided periods of volatility they would also have missed out on periods of material gains.

St Leger Day Return from 1st May	
16/09/2017	+1.7%
10/09/2016	+9.9%
12/09/2015	-9.2%
13/09/2014	+1.3%
14/09/2013	+4.7%
15/09/2012	+4.0%
10/09/2011	-12.9%
11/09/2010	+0.6%
12/09/2009	+20.8%
13/09/2008	-9.6%

Source: Financial Express

Following the recent rally, historically high market levels may concern people, given the continued global economic and political uncertainty. Political uncertainty may well continue to weigh on short-term sentiment, what 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 a catalyst for market jitters.

However, whilst we are not advocates of market timing to guess short-term market trend's, investors worried about short-term volatility could consider drip feeding monies into the market. 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. 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.

£ UK Equities

In a reversal of recent market trends the UK stockmarket was at the forefront of global stockmarket performance. The catch-up was driven by a strong rally in resource stocks and enhanced by takeover activity, whilst a weakening of sterling boosted UK exporting blue chips shares. There was also some recovery in oversold UK domestic stocks and smaller companies outperformed.

From a sector perspective Food and Drug retailers were the stand out performers, driven by Sainsbury's detailed merger plans with Asda. Oil and Gas producers and Oil Equipment also performed strongly as the oil price increased sharply. All UK sectors except Tobacco and Household goods posted positive returns over the month.

In terms of economic data, the UK's first quarter GDP Growth was a disappointing 0.1%. Anecdotal evidence suggests that parts of the UK economy ground to a weather driven halt in March. As a result the Bank of England is likely to delay the next base rate rise for a while until the growth trajectory is clearer due to weak growth and inflation.

The strong month for UK shares is pleasing to see given that 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 has been 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, we expect the 'lower for longer' rate environment to continue which is supportive for dividend producing shares.

$ US Equities

Although the US first-quarter earnings season showed strong momentum over the past month (more than three quarters of companies that reported have exceeded expectations) the S&P 500 index ended the month up only 0.35% lagging most major global stockmarkets.

The failure of the US stockmarket to rally on the positive earnings appears to be an indication that US equities are quite highly priced and that short-term performance driven by the corporate tax cuts has already been priced into the markets.

Investors appear to be more interested in monetary policy rather than corporate earnings. The Federal Reserve is expected to announce two more 0.25% interest rate increases over the remainder of 2018 and a further three rate rises next year.

Fundamentally, our underweight position to the US stockmarket has been fairly neutral in terms of performance year to date. On valuation terms our favour for other markets versus the US remains intact. Trump's tax reform bill could see one final push for a 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 markets returned a positive performance in April. The FTSE Europe ex UK index returned 4.1% in local currency although gains were slightly eroded due to the strength in sterling, bringing returns for UK investors down to around 3.7%.

The global synchronised recovery, which proved so fertile for asset markets in 2017, has been showing signs of faltering in recent months as surveys of business activity pointed to a slowdown in many parts of Europe. Temporary factors, such as bad weather and the spike in the euro at the start of the year, played a role in depressing sentiment.

There is little sign of an imminent increase in the outlook for prices in the Eurozone, with CPI inflation running at 1.3%. This suggests that the European Central Bank will continue its accommodative policy throughout the year and Mario Draghi emphasised a need for "patience and persistence". This should be supportive for European stockmarkets.

With signs that the strong performance of 2017 could be losing momentum and the fact that investing in European equities has also become more consensus over the past year, we are a little more cautious and 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 and with more stimulatory monetary policies.

Japanese Equities

Japanese equities joined in the global recovery with the TSE TOPIX returning around 4% in local currency. There was some weakening of the yen against sterling which diluted returns for UK investors.

Political concerns heightened in April. Prime Minister Shinzo Abe is facing his biggest crisis since coming to power in 2012, with a resurfacing of the scandal relating to his wife and the sale of state owned land at discounts. Abe has denied accusations that he and his wife were involved in the sale. Despite this, nearly half of the country wants Abe to resign. This short-term uncertainty could prove a headwind.

Meanwhile, the Japanese economy continues to grow at a steady pace and with little inflationary pressure the B ank of Japan is likely to continue quantitative and qualitative monetary easing which 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. However, corporate earnings within Japan remain volatile as the value of the yen fluctuates.

Asia Pacific & Emerging Market Equities

April illustrated the significant divergence in the nature of performance of different Asian and Emerging markets and currencies. This was highlighted by the strong performance in India which increased by 6.7% and Russia which fell heavily by 14.1% for sterling investors.

The overall effect was that the FTSE Asia Ex Japan Index rallied by 1.9% and MSCI Emerging Markets index was up by 1.2%. Currency provided a small boost for UK investors with the sterling index returns translating to 2.9% and 1.4% respectively.

India was at the top of the performance table as the World Bank provided positive growth forecasts for the Indian economy. Chinese stockmarkets gave up returns made early in the month to finish flat.

At the end of the month we saw the historical meeting between the leaders of North and South Korea. The easing geopolitical risk is undoubtedly positive for the region but unlikely to be a major catalyst for stockmarket gains (especially given how markets ignored the 2017 sabre rattling).

Russia was easily the worst performing stockmarket (-7.6%) with losses doubled for UK investors with a weakening of the rouble. This has been precipitated by the imposition of new US sanctions on oligarchs and companies linked to Putin. However, Russia has faced sanctions for years and it is unlikely this is a game changer for the Russian market.

Despite the significant divergence in Asian and Emerging Markets 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 it is a timely reminder that we should 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 fell back in April as fears of inflation reared their head and investors regained an appetite for higher risk assets. UK Government bonds fell by 1%. Overseas Government bond markets also fell back as April proved to be a 'risk-on' month across the globe as investors showed renewed confidence. As a result it was a relatively better month for higher risk areas of bond markets. The IA High Yield Bond sector was the best performing bond sector increasing by 0.6%.

In the United States, the Federal Reserve maintained interest rates in May as widely expected. The renewed inflationary concerns saw 10 year US Treasury yields breach the 3% level, before ending the month at 2.95%. At this level we believe that there is value in US treasuries, providing defensive exposure to high quality fixed interest assets.

Whilst we have moved 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 the recently added US treasuries provide insurance during risk-off periods. Overall, we continue to favour fixed interest exposure in corporate bonds and less interest rate sensitive areas of bond markets. Exposure ranges from defensive investment grade to 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

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 and also some capital growth. We have 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 increase in volatility that we have seen in 2018 has proven to be a timely test for our alternatives exposure, and the Absolute Return funds held have continued to prove broadly positive 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. Although it is important to be selective and have a strong understanding of such fund, they are true diversifiers within our portfolios and offer different opportunities versus traditional 'safe haven' asset classes, which appear expensive.

Commodities

Over the month there was a strong rally in the oil price which increased by 7% reaching $75 a barrel for the first time in four years. This was driven by ongoing political uncertainty. In particular the worsening of relations between the US and Russia regarding the Syria conflict and, towards the end of the month, the increased risk of US sanctions on Iran caused a further spike.

A rising oil price has been a key theme so far this year and it was announced during the month that the excess oil inventory that has kept the oil price low has run dry due to OPEC cuts on production and robust global growth boosting demand. Consensus estimates the oil price will rise further and whilst such short-term predictions are notoriously unreliable there are many factors supporting a high oil price in the near future.

Gold lost around 0.5% during the month as risk assets returned to favour. For UK investors a strengthening dollar towards the end of the month would have provided a positive return of 1%.

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 fell from 2.7% to 2.5% in April as measured by the Consumer Price Index. 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.

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