October 2017 Portfolio Review

It has been an eventful start to November, following an October that generated positive returns for investors in global markets. The synchronised global recovery continued as the Global Manufacturing Purchasing Managers' Index (PMI) for September ticked up a fraction to 53.2 ahead of August's 53.1 figure. Global corporate earnings per share (EPS) also rose while developed market equities, emerging market (EM) equities and commodities gained in the month with an upward pull from Brent Crude oil.

The UK will have focused on the first interest rate rise for more than a decade, rising by 0.25% and reversing the cut of last August. The UK's developing inflation and interest rate dynamics strongly suggested that this rate rise would happen so markets were unsurprised, with the only market reaction being a small but still counter intuitive decline in short term yields and £-Sterling.

Despite the rise, the Bank of England's accompanying comments focused on the weaknesses of the UK's economic situation. Not the ideal backdrop for further rate rises next year, even with the rate setting committee indicating that another two 0.25% rate rises over the next 24 months were likely. It may still be sufficient to prevent a deterioration of £-Sterling's value beyond the recent lows and could indeed be the best medicine of the UK's central bank against further inflationary pressures which thus far have not been caused by rising wages, but increasing prices of imported goods. Citing reasons for the rise in its minutes, the MPC noted that unemployment has fallen to a 42-year low, 'domestic financial conditions are highly accommodative and consumer confidence has remained resilient'. There is limited risk of increasing pressure on the mortgage laden UK public, which could undermine the UK consumers' propensity to spend.

The MPC stated 'All members agree that any future increases in Bank Rate would be expected to be at a gradual pace and to a limited extent'. As a consequence, there should be minimal impact on the discretionary spending power of the UK consumer. However, unless the UK falls into a Brexit induced recession, the direction of travel of interest rates and bond yields has been reversed and points upwards from here.

Other notable developments were president Trump's announcement (finally) that he would replace Fed chair Janet Yellen by appointing Jay Powell. Again, this had been widely expected as of late and since – as we recently wrote here - his policy views have been very similar to Yellen's, markets took it as another non-event. On the more market and economy relevant subject of the tax reform, far less progress was forthcoming and with the Trump administration coming under increasing investigative pressure over the Russian influence affair, many expect that very little will happen this side of Christmas.

In Europe, the big monetary policy event of the month was the European Central Bank's (ECB's) meeting, at which Mario Draghi announced an extension of the bank's quantitative easing (QE) programme for nine months with monthly purchases of EUR 30 billion from January to September

2018. This was an acknowledgement of the solid growth apparent in the region, but also keeps the door open for a further extension to be announced. Despite the impending reduction in monthly bond purchases, euro area sovereign bonds gained 1.1% over the month. The announcement was in line with consensus expectations for the ECB. Inflation readings in the Eurozone will be crucial for the QE outlook, given the unexpectedly cooler headline inflation release in October of 1.4% for September's year on year figure.

More unnervingly, Catalonia held a referendum on independence on 1 October, which caused Spanish equities to weaken moderately and Spanish yields to spread further out from the German Bund. As increasing political uncertainty unfolded over the month, the Catalan regional parliament unilaterally declared independence from Spain after a secret vote. This move led the Spanish authorities to trigger Article 155 of the Constitution and assume direct control of the region. Despite the volatility, Spanish government bonds actually gained 0.9% on the month.

This may have had to do with the fact that the Spanish government also announced that it would call for early regional elections in Catalonia. This would return the conflict resolution onto a democratically legitimised political path. This remains a watch and wait situation, but for the time being it feels that the risk of immediate escalation has been defused.

Finally, the more speculatively inclined investors were enthralled by the renewed meteoric rise of the trade value of the crypto-currency Bitcoin. Reaching $7,000 per coin over the week, its perceived value has now increased 7-fold since the beginning of the year and all virtual coins in circulation are equivalent to more than 100 billion US$. There are plenty of voices around warning that this pseudo currency is backed by not much more than speculative interest and the hope of internet finance enthusiasts that global crypto currencies may one day replace traditional national currencies. At the very least however, it should be noted that the recent value development has all the hallmarks of a market bubble which inevitably will end in a value collapse at some point in the not so distant future.

Portfolios

On the back of the news above, Portfolios experienced significant upside over October driven once again by the risk-on appetite. The India funds showed stellar performance rising in excess of 8% for the month.

In all, only two funds out of the 58 portfolio constituents showed small negative returns in October.

Maintaining first quartile performance against their peers, the consistent 'suspects' being Jupiter European, Old Mutual North American and Lindsell Train UK Equity helped to drive the highest risk portfolio (10 V12) to a gross return over 3% whilst the lowest risk 3 V12 returned just over 1% gross.

For investors with a leaning towards an ethical stance, the gross return was 2.8% which also took the ethical portfolio to the top of the 12 month figures having delivered a gross return of 15.27%.