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August 2018 Portfolio Review

August saw some upheaval over Turkey's currency nosedive, followed by a period of calm in markets. Political uncertainty and concerns surrounding Turkey's reliance on foreign capital, as the US Federal Reserve gradually reduces global liquidity, have seen the Turkish lira plunge this year.

Despite this, we should remain cognisant of the fact that Turkey represents just 0.6% of the MSCI Emerging Markets (EM) index and contributes less than 2% of global GDP. The issues in Turkey are not representative of all emerging markets, as many EM countries have seen their external debts and current account balances improve in recent years. The exposures of European banks to Turkish counterparties do not appear to be a systemic risk. Spain and France, which have exposures of $82 billion and $38 billion respectively, are the most exposed. However, capital and reserves for eurozone financial institutions are close to $3 trillion, suggesting that the European banking system can withstand any losses resulting from Turkey's troubles.

Various economic data releases this month show that, in terms of positive economic surprises, Europe has now overtaken the US, which has begun to slow in this regard – just like China. This observation, paired with the much more elevated relative valuations of US stocks, is leading to an increasing number of investment research sources to expect, not only economic growth leadership, but also stock market return leadership to pass from the US to Europe and Japan.

On that basis, the UK should be expected to move ahead positively. UK valuations are some of the lowest around the western world. However, the release of the government's business guidance for a no-deal Brexit scenario brought home what is holding the UK back. Not knowing whether to prepare for a significant change in our terms of trade with our largest trading partners in March next year, is creating a significant dampener for all other medium-term business plans. Any form of change always brings opportunities as well and they might indeed even outweigh the initial costs of adjustment. But they are just as uncertain at the moment as the final outcome of the Brexit divorce process. Calling for preparations for, and assessments of, the costs for a UK outside a customs union is a rehash of 'project fear'. We feel that the likelihood of a total no-deal Brexit next March is very slim, but, it is quite likely that the period of uncertainty for British businesses will stretch far beyond March 2019. However, the economic drag this will create should be already priced in to UK stock markets, whilst the economic upside we are experiencing (despite the prevailing uncertain conditions) has yet to materialise in capital valuations. The pleasing flip side of this situation is, once again, attractive dividend yield levels for investors in the UK stock market.

The broad recovery and the US' S&P 500 stock market index even hit an all-time high, which supposedly also now constitutes the longest bull market period. In the US, President Trump complained in a Reuters interview that he expected the US Federal Reserve (Fed) Chair Jerome Powell to be more dovish and not raise interest rates. This shows that the President is willing to put public pressure on the Fed to keep interest rates lower than anticipated in order to support economic growth. In the same interview, Trump also claimed that both China and the EU were manipulating their currencies to benefit their exporters. Ironically, the Dollar weakened on Trump's comments!

Trump came under more pressure at home as his former campaign chairman Paul Manafort, was convicted on eight counts of bank fraud while his long time ‘fixer’ Michael Cohen, pleaded guilty to eight charges, including campaign violations. The guilty plea implicates the President but Trump called it a ‘Russian witch hunt’. If the level-headed politicians prevail, then judging President Trump will be left to the US electorate, rather than the courts. The relative calm of stock markets tells us that the ‘wisdom of the masses’ represented in capital market action, sees it similar.

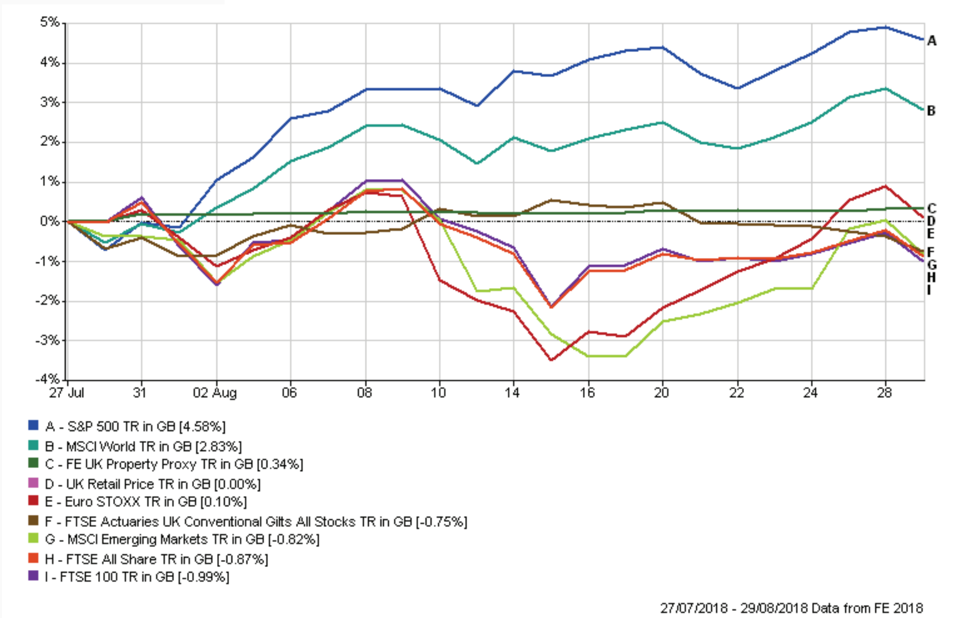
Portfolio Commentary

With US markets surging, the runaway victors throughout August were the US equity funds. The Vanguard index funds pushed through 5.15% gross return, leading the Old Mutual active fund which returned 3.35% for the month. Again, the Jupiter European fund generated healthy growth returning the second highest figures for the month of 5.11%.

Interestingly, the ethical equity fund contingent played a dominant role in the leading funds for August fulfilling five of the top fourteen funds.

Whilst ‘risk-on’ fed healthy returns to the higher risk portfolios in the main, UK exposure served to portfolio detriment over the month. The All-Share and the FTSE-100 fell overall by approximately 1%, weighed on by Brexit concerns and the looming deadline (see below).

As a result, the lower international exposure of the lower risk portfolios and the increased weighting in gilts and absolute returns funds led to small negative monthly returns for growth portfolios 3, 4 ,5 and 6 and the Income and Income & Growth portfolios.



The value of units can fall as well as rise.
Past performance should not be seen as an indication of future performance