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November 2018 Portfolio Review

As November draws to a close, global stock markets have provided a positive last week to an otherwise bleak month for investors. Global equities rose, with US stocks achieving their largest weekly gain for the year. Risk assets were supported by dovish comments from Federal Reserve (Fed) Chairman Powell, who noted that the Fed Funds Rate may already be close to the bottom of the range of neutral rate estimates, thus indicating that a pause in the hiking cycle may occur sooner than previously expected. This comment was a notable shift in stance from October, when he said "we're a long way from neutral at this point." He also cautioned that the Fed would become more data dependent from here.

The correction to lower valuation levels means that stocks no longer look expensive relative to earnings or in historic context. It can be argued that they are now pricing in a considerable amount of economic slowdown for 2019, which is by no means a given. However, compared to the end of 2017, the outlook to next year is fraught with more uncertainties.

Economic growth momentum has slowed everywhere, even in the US where Trump's fiscal stimulus continues to boost the economy at the expense of creating public debt burdens for future generations. The trade uncertainties from Trump's 'America First' trade wars and a still unclear shape of Brexit can no longer be expected to be neutralised by elevated business activity levels. To top it all off, central banks have begun to end the extended period of extraordinarily cheap credit, which creates the risk of a credit crunch as higher financing costs lead to increasing default rates amongst weak businesses.

At the G20 summit over the weekend, Trump confirmed a 90-day trade ceasefire between the US and China that will leave the US tariffs on $200 billion worth of Chinese imports unchanged at 10%. Prior to this, the tariffs were due to be raised to 25% on 1st January. This outcome should support markets until there is clarity over the relationship at the end of the 90-day period. China has agreed to immediately increase its purchases of US goods, notably in agriculture. This is welcome news for markets, but the threat of higher tariffs remains, if agreements are not reached.

The recent fall in the oil price and the persistently strong US dollar are expected to remain headwinds against inflation next year, supporting the case for a pause in the Fed's tightening cycle.

In the eurozone, European Central Bank (ECB) economist Peter Praet stressed that there has been very limited spill-over from a tightening of financial conditions in Italy to the broader euro area, but that conditions in Italy are "unsustainable". Praet suggested quantitative easing would end, as scheduled, in December, unless more substantial tightening of the financial conditions was seen. The expected new Chief Economist of the ECB, Philip Lane, added that potential rate increases next year will be data dependent, but also that the ECB is starting to see more strength in the labour market. Growth and inflation are expected to progress sufficiently to allow for an interest rate hike in September 2019, although leading indicators continue to point to a slowing of economic momentum.

On the Brexit front, the days until parliament votes on 11 December are strewn with familiar predicaments for the UK's MPs. Approve the bill for May's Withdrawal Treaty, which would respect the referendum outcome for a Brexit as they promised, in return for being given a meaningful vote in the matter or reject it as it is neither economically beneficial nor sovereignty-restoring. If MPs opted for the latter, they would thereby risk even more political instability and either an even worse economic/dependency outcome or an end to Brexit altogether.

Before the details get picked apart by MPs however, the Bank of England (BoE) has released its own assessment of the different Brexit outcomes and what they could mean for the economy. The headline-grabbing figures point to an 8% drop in British GDP in the worst-case scenario following a crash Brexit, and a 30% fall in house prices. If no deal is agreed and no transition period put in place, the BoE predicts the worst fall in national income since the second world war.

Political interference by Mr Carney and suspect timing for an "independent" BoE? Or a considered response to the question the governor was asked by the Treasury select committee; to imagine the worst-case scenario for no-deal Brexit Britain. Arguably, the muted market reaction to the BoE's assessment suggests Carney has spent a large amount of political capital already, and has lost quite a lot of credibility, at least in the eyes of the markets.

It is understandable that non-political observers will be increasingly concerned that the UK is heading straight towards a disorderly no-deal Brexit, which for the economy would likely be the worst of all possible outcomes. It will, no doubt, be quite scary as we approach decision time but, in the end, we trust politicians will chose the least risky outcome for themselves and the country. This might not happen in the first vote on 11 December as MPs may feel obliged to demonstrate their principles towards their constituencies, but there is a high likelihood that the vote will go differently if the bill is returned for a second reading. It should also be comforting for investors that the one notion that has an overwhelming majority in parliament is the prevention of a no-deal exit.

Portfolios

Fund returns over November highlighted how quickly market sentiment can turn on its 'heels.' The above-mentioned reassuring comment from Chair of the US fed gave markets a 'tailwind' aided by the news of the easing situation in the US/China trade wars, which has led to surge in the UK and European equity markets by around 2%. This is obviously welcome news after September and October months of negative returns.

We saw how sentiment against the Indian and Japanese markets had moved into negative territory a few months ago. Although some of the smaller holdings in the portfolios, the Alquity and Baillie Gifford funds were up 11.69% and 10.8% respectively in November. *

Of the larger holdings across portfolios, Merian North American Equity outperformed the Vanguard US Index fund returning 2.3% against 2.11%.

Within domestic market (UK) returns, the stalwart Lindsell Train UK Equity fund led the contingent returning 1.2% against the backdrop of the FOOTSIE and the All-Share each falling c0.3%.

At the more cautious end of portfolios, downward pressure on the fixed interest market led to slight negative returns and some uncharacteristic volatility, much of it in the UK bond space. Throughout a difficult 2018, however, these portfolios have provided resilience to investors by maintaining lower volatility and keeping shocks to a minimum.

As a result of the negative pressure in the fixed income markets and the negative sentiment around UK equities resulting from Brexit, the greater detractors from performance mostly sat within the UK.

To that end, portfolio performance varied between approximately -0.62% for the predominantly UK equity orientated Income portfolio, to c+1.35% for the ethical portfolio.

*all figures quoted gross.