September 2018
Portfolio Review

As we head into October, we are noticing an increased amount of “chatter” about what is the right positioning for a “Brexit” portfolio. With the outcome of the Article 50 negotiations increasingly unclear, as you might imagine, commentators’ opinions on what constitutes good “Brexit positioning”, is also equally unclear. There are however a few points that should be borne in mind, whatever the final outcome.

The first is that we are already beginning to see some increased volatility in markets which we will discuss later. This is by no means all Brexit linked but UK based investors should bear this potential for increased volatility in mind over the next 12-18 months. This leads onto the second key point. If you rely on your portfolio for income and are taking a natural yield from dividends, the capital volatility should not prove an immediate concern. If, however, you need access to capital or other lump sums, the attendant volatility may mean you are having to encash a proportion whilst markets are lower, which may be disadvantageous. Therefore, some liquidity planning with your adviser is an important thing to consider if you are planning any withdrawals in the next 12-18 months.

Looking at September’s markets, the month ended overshadowed by US interest rate policy, global trade tariffs, soft Chinese manufacturing data, Brexit, Italy and a United Nations summit. However, there was some positive trade news.

Canada and the US reached a new trade agreement, the United States-Mexico-Canada Agreement (USMCA) which replaces the previous NAFTA deal. Canada has made some concessions on its dairy industry, there is a side-agreement on auto tariffs while a dispute settlement mechanism will remain in place. Trump’s fiscal stimulus fireworks are however, beginning to shine less brightly, while the potential for collateral damage from his trade disputes with China are beginning to hold back business investment. The free trade agreements his administration reached this week with both South Korea and Japan make it seem less likely that the US will descend into a global trade war, but there are various rational arguments that suggest that Trump’s America First dispute with China is not ending any time soon.

In the UK, the volume of the domestic Brexit debate is gradually rising to a crescendo, particularly as it is Party season! Political representatives of the traditional appear incapable of providing the stability of framework economies require to thrive, fearful that their electorates will succumb to the calls of populist politicians if they dare to support slightly more complex and cooperative routes to collective benefit.

In the absence of constructive political debate, it is left to journalists, business and trade representatives to take hold of the debate. It seems very unorthodox that it is the non-political leaders of society who feel obliged to create a sense of urgency by pointing out uncomfortable truths and inevitable

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consequences of politicians' current course of action but also identify the more constructive paths towards solving the looming 'impasse'.

No wonder the British public is becoming increasingly alarmed as the press no longer merely reports and comments, but seemingly exaggerates deliberately in order to force politicians to take constructive action. It is a sad fact that in the first 2 years of Brexit negotiations very little progress has been made towards establishing mutually acceptable and constructive terms of an exit. While this can be partly blamed on traditional negotiating stratagem, it is equally blamed on the vast majority of the political and administrative leadership of the UK being unconvinced of the necessary direction of Brexit.

In such an environment of political indecisiveness there is a danger that the proverbial 'can' is kicked further down the road or a muddle through around some compromise relatively close to the status quo is pursued. Neither would be ideal, but certainly far less dramatic than the dichotomous outcomes, influencers are trying to portray April 2019 to be. There is some comfort that capital markets appear to see it similar, with the value of £-Sterling recovering towards its pre-Salzburg levels rather than taking much note of the rising crescendo of the no-deal Brexit scaremongering that took hold of the public debate over the end of the month.

In Europe much focus was once again on Italy, with fears for its bond market dragging down equities as the populist government hiked the budget deficit to 2.4%, much to the disapproval of the EU's leadership. We would note that 2.4% remains substantially below the EU's imposed 3% of GDP deficit limit while also still constituting a primary budget surplus – before interest payments. There is comment that Italy should be permitted some fiscal slack given its economic reform burdens and the fact it shoulders much of Europe's immigration pressures from Africa. Germany's politicians would do well to remember that they exceeded the EU's budget guidelines far more substantially in the early 2000's when they had become 'the sick man of Europe'. From this perspective the pressure on Italian bonds appears somewhat an overreaction, although admittedly it should serve as a warning shot to the populists in government that if they take their fiscal initiative any further, then every additional Euro of stimulus may lead to an equal or higher debt servicing burden for Italian businesses, households and the government itself.

Indeed, the global economy and capital markets appear remarkably robust in terms of consistent but not exuberant growth.

Portfolios

September highlighted an increase in volatility for UK investors. Trade wars and the strength of the US Dollar impacted heavily on emerging markets, whilst momentum and the expected benefits from corporate tax cuts continued to drive US markets, and Brexit negotiation fears impinged on the UK and European major indices (see the following graph).

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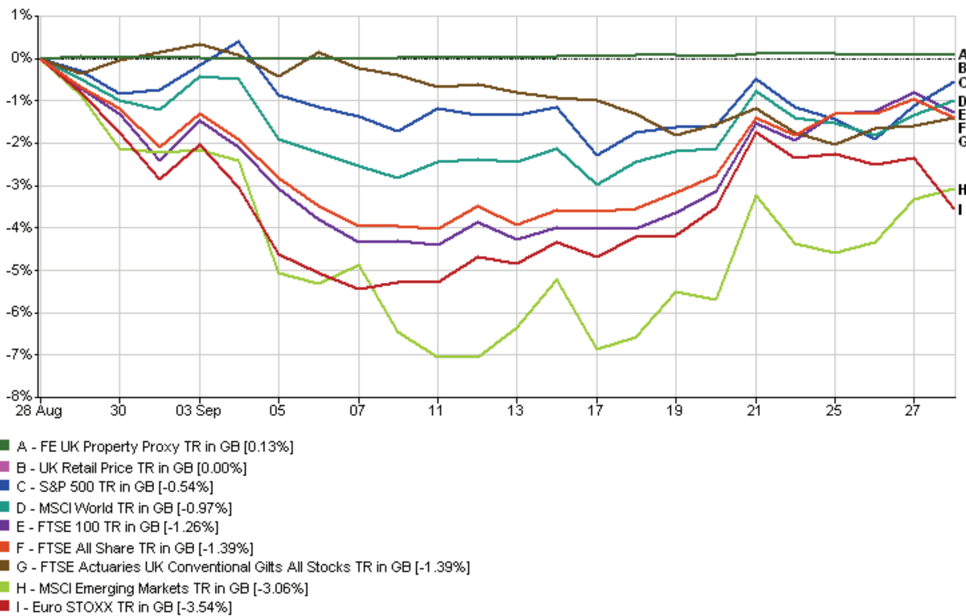

The non-correlated, currency based H2O Multi-Returns fund delivered a positive result of +4.69% for the month. This is a constituent of the absolute return segment of portfolios where the aim is to dampen portfolio volatility whilst seeking positive returns over the longer term. Over the month, this element helped to soften some of the 'downturn'.

Against this backdrop, the higher risk ATR10 portfolio suffered the greater decline amongst the growth portfolios falling approximately -1.52% over the month. Unsurprisingly, the major detractors to performance being the European and Emerging Markets funds with HSBC, Jupiter and Fidelity falling between approximately 3% and 5% over the month. Indian funds fell by almost 20% over the month, but with direct exposure limited to approximately 2% in even the higher risk portfolio, this did not have a significant impact.

Conversely, the more defensive portfolio R3 dropped only a little under 0.5% over the month through reduced exposure to riskier assets.

Whilst comment abounds around bulletin boards and direct marketing documents about the best stocks or funds to buy in the case of a 'no deal,' 'soft' or 'hard' Brexit, the reality is that no one knows the outcome so any suggestion about the 'best' place to be is pure speculation.

If you do have any questions about the risk profile of your portfolio, please contact your Beckford James adviser.

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