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March 2019 Portfolio Review

So March 29th has come and gone, and whilst Brexit has been postponed at least temporarily, the market's quarter end marker was non-postponeable and the results tally delivered a remarkable reversal of the last quarter of 2018.

Global markets ended the first quarter of 2019 in re-assuring fashion thanks to encouraging reports from Beijing, which raised hopes of a constructive outcome to US and China trade discussions. This follows an earlier wobble, as markets reacted to a couple of indications of a possible US recession. While the US Federal Reserve has supported markets by pausing its rate hike cycle (the Federal Reserve (Fed) statement was even more 'dovish' than markets expected suggesting an interest rate hike in 2019 is now all but off the table), it's uncertain as to whether this will be enough to spur further equity gains. Global growth is slowing and although Chinese manufacturing indicators showed some helpful momentum, the overall trend has been a slow deceleration.

The market mood was not helped by comments from the deputy director of the International Monetary Fund (IMF) when he stated that central banks and governments do not have the tools to combat another sharp economic shock. However, some countries are undertaking stimulus measures such as China, while in the UK the Chancellor has amassed a Brexit 'war chest' for infrastructure projects. In the US, were President Trump to be re-elected, then looking beyond 2020, he may well seek to implement his plan to upgrade America's ageing public infrastructure.

In the UK, the Brexit impasse looks set to continue with Theresa May's offer of sacrificing her premiership in return for the backing of her deal failing to unite her party and the DUP. We have had indicative votes in the House of Commons with a runoff between the most popular suggestions but still no clear way forward as we write. Even if there was a majority for a course of action it remains unclear whether the government would adopt it, particularly if the customs union option receives the most backing. Such an addendum to the Withdrawal Bill could tear the Conservative party apart, so lots of moving parts as we enter April! Sterling remains around $1.31, as global currency traders attempted to work out the implications of these developments with a general election or hard Brexit still a possibility. Away from Brexit, the CBI reported retail sales volumes dropped sharply in March, the fastest contraction in seventeen-months, but did say the figures had been possibly distorted by the later timing of Easter this year. Typical council tax bills in England are set to rise by 4.7% in April, the second biggest increase in a decade.

Europe looks to be weakened by a triumvirate of political risk (both internal politics and global trade), slowing Chinese growth (particularly impacting Germany) and high levels of debt (Italy being the most prominent example).However, despite weak manufacturing activity data, Germany's key business sentiment survey finally broke a run of six-monthly declines with an unexpected increase in the March

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reading, albeit highlighting the ongoing risk to the German economy from Brexit. The cautious mood of the previous week was reflected by Germany issuing new government Bunds at a negative yield for the first time since 2016.

In Japan, minutes from the central bank's latest meeting showed members increasingly discussing the need to introduce additional policy stimulus in the face of a weaker global economy.

It seems likely that positive political outcomes should cause a catch-up in demand. The political outcomes of Trump's trade war and Brexit are one set of crucial variables. On the credit market side, there are potential vulnerabilities to the world economy from the next credit default cycle. These are much larger than they have been historically as a consequence of the higher levels of debt that the past decade of ultra-low interest rates has led to. Central banks were and are aware that their extraordinary monetary measures would cause this negative side effect.

Unfortunately, the over-selling in markets last year shows they are scared of the size of the credit market and the risks it brings too. This means that while central banks are determined to defuse the credit market risk over time through gradual normalisation of their monetary policy, they will from time to time overshoot their targets as they manoeuvre in uncharted territory – as happened last year. Volatility episodes like the last two quarters are therefore likely to repeat.

Portfolios

After a poor 2018 for emerging markets and fears of the US slowing further, the former benefitted from a short-term recovery and in particular, India (see graph below). The resultant gross return of c15% from the Alquity Indian Subcontinent fund helped to recover a significant amount of the fall from August.

Amongst the larger holdings in portfolios, the UK Inflation-Linked Gilt exposure rose just over 6% and the Lindsell Train UK Equity exposure also generated c4.4%. With a broad range of positive returns for March, all portfolios saw reasonable upside of between 1.06% gross for the income portfolio, to 2.67% gross for the ethical portfolio.