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November 2019 Portfolio Review

As we approach the end of 2019, we await the outcome in the UK of the election that should define our economic relations over the next decade. Britain heads to the polls in two weeks. Boris Johnson's Conservative party entered the election campaign with an average 11-point lead over Labour in opinion polls. Even if the Conservatives do not come out with a majority, the odds are that it will emerge as the largest party in parliament. However, that the Conservatives will definitely form the next government is far from a sure thing. There are several permutations to consider and it's interesting to note the odds of a Tory minority government compared with a Labour minority government – or coalition involving Labour – favour the Labour Party. This is because, while opposition parties are split across ideological and national lines, there is essentially now only one party on the right. Barring hugely unlikely number of Brexit party victories in Labour or Liberal Democrat seats, the Tories could struggle to find allies in parliament and the potential impact of a Labour led Government, is one the markets are watching. And looking coldly at the UK's public spending and not the politics it's clear that whatever the colours of the next government, public spending and the debt-to-GDP ratio are set to go up.

Away from Brexit, it has been a quiet to mildly positive month in capital markets, which may be a surprise given the political shouting about the General Election. The recent rally in risk assets is at odds with the still slowing global economy, leaving many uneasy about potentially overvalued asset prices. Bond markets have calmed down after a couple of weeks of volatility. Equities continue to edge higher and, in the US, have moved up to valuations not seen since the end of 2017 – when talk of 'irrational exuberance' was rife. This time around, markets are definitely getting ahead of the economy – investors are placing a lot of faith in global production and profits turning.

Normally the tactical view on asset allocation is rooted in looking through the "election noise" and assessing where we are in the economic cycle. Early in the cycle, valuations are cheap, policy accommodative and the economy has ample spare capacity to grow. It's often a good time to take risk. Conversely, late cycle is usually a good time to take chips off the table. When the economy is displaying signs of exuberance or overheating, higher interest rates usually put an end to the party.

It's proving much harder to navigate markets today based on an assessment of the cycle. The picture is far from clear. Unemployment rates are near record lows in most parts of the developed world, suggesting the economy is very late cycle. However, there are very few other signs of classic late-cycle economic exuberance. Neither business nor consumer spending looks toppy. Indeed, the US consumer is looking remarkably prudent: the savings rate, which often falls sharply late in the cycle, is pretty high.

And inflation is certainly not suggesting the global economy has reached its limits. In fact, central banks are preoccupied with the idea that inflation remains too low and may be getting stuck. Rather than trying to tame the expansion, the primary focus for central banks is how to get it moving up. This makes it very hard to say confidently how much time is left on the economic clock.

A resolution in the US-China trade conflict, a Brexit solution, and an easing of tensions in Hong Kong, Chile and Turkey could fuel a turnaround in business sentiment and a reacceleration in activity in 2020.

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Against a backdrop of muted inflation, interest rates could stay low. This would be a good environment for risk assets.

But there is a strong chance that geopolitical risk will linger. Surveys suggest the US electorate believes the president is right to address unfair trade practices, while on certain areas of the disagreement – such as China's state-led subsidies for its tech sector – there is seemingly no common ground. China believes in industrial policy, the US does not.

The US administration does seem to appreciate that it needs to get the balance right between keeping the agenda alive and not damaging the US expansion, hence the recent more conciliatory tones. We'll see in the coming months whether this more measured approach does much to boost corporate sentiment though the recent backing for Hong Kong democracy will have added another twist. If geopolitical tensions linger but don't re-escalate, we should be facing a slowing rather than a stalling economy. But that is beginning to look like a big 'if'.

Portfolios

A good month overall for portfolios generally with all producing positive returns, and with all except the very lowest risk portfolio outpacing the FTSE100 index. With renewed QE as the ECB and US Fed print between E20bn and $60bn per month, this has favoured risk assets.

Portfolio performance ranged from approximately 0.94% (gross of fees) to 2.39% for the ethical portfolio. Whether the drive for climate change is given a boost to sustainably minded companies, perhaps, though the great drive came from the US and UK Smaller companies stock-orientated funds as something of a recovery took hold.

Leading the bank of funds over November, the Unicorn UK Income fund produced a return of approximately 6.4% following several months of muted performance given the supressing pressure on value stocks. UK smaller company exposure through Amati gave the second highest return at a shade below 5.9%. However, given Trump's support to Hong Kong protestors and threats of further sanctions, stock rises came under pressure in the last few days of November and indices stepped back a little.

Of the 72 funds monitored on an ongoing basis, only 7 posted negative returns in November. Showing its non-correlation to major assets, the Natixis H2O multi-returns fund posted the tail-end performance at -1.86% as the underlying strengthening of sterling reversed a little of the previous months of very strong performance.

For the time being, portfolios remain resilient and in answer to the question, what are we doing to position for the upcoming election/Brexit? The answer continues to be, not to try to guess the often binary outcome of political manoeuvrings but to continue to hold and monitor a diverse and differently correlated series of assets in the portfolios. This, based on economic fundamentals, still offers the best way to construct a measured approach to investing.

As ever, if you have any queries about what we have written, or your portfolios, please speak with your adviser.

Bath Office: 01225 437 600