September 2020 Portfolio Review

So as September moves into October, it appears the optimism of summer is well and truly receding, along with many equity market levels. Equity markets have reacted to all the uncertainty by selling off in the latter half of the month. The S&P 500 has fallen 10% from its recent high and the Nasdaq by 12%. In the UK, shares have fallen by 7% since their August high. However, all these falls do follow one of the most impressive six-month rallies in modern history, so a period of retraction was perhaps to be expected.

Grim headlines abound with concerns over the growing virus cases in the UK and Europe. The US election is drawing ever closer, just 34 days away at the time of writing. The world does not need further instability at the moment and the first Presidential debate did nothing to alleviate that potential, especially when coupled with the uncertainty of President Trump suggesting that he would not commit to a peaceful transfer of power should he lose!

In the UK, Rishi Sunak, the Chancellor, acknowledged that he cannot save every job and the official unemployment rate is now climbing. The latest data from the Office of National Statistics (ONS) suggests that around three million workers, approximately 12% of the workforce, are still on furlough or partial furlough as of September.

But every cloud, and there appear to be many, does or should have a silver lining. On UK (un)employment, there are encouraging signs in the latest data on hours worked and rising vacancies. The true picture will only begin to emerge as employers have to make a greater contribution to the costs of the furlough scheme over the next couple of months. But Governments having free fiscal rein is an economic positive and politicians look happy to exercise that freedom. In response to the ending of the furlough scheme, Sunak announced a new work support scheme. The top-up pay scheme was praised for its similarity to those in Europe, particularly the German Kurzarbeitergeld programme.

And while markets remain concerned by the prospect of further lockdown measures, news of vaccine development remains supportive with Oxford/Astra Zeneca re-starting its vaccine trial in the US and Pfizer said it should know if its vaccine works by the end of October. The Chinese Centre for disease Control & Prevention said that it may have a vaccine for use by the general public by November. Compared to March, the health impacts of Coronavirus are significantly less uncertain. Not only have health services been able so far, to treat those most at risk, but also those who are vulnerable are this time likely to be better shielded. In the best case, this means COVID-19 has lost a little of its fearsome public health impact and no longer automatically leads to a much higher excess mortality than usual flu epidemics. At worst, our ability to cope better buys time, which gets us ever closer to an effective vaccine.

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Europe's economic recovery may have stumbled after a spike in coronavirus cases and business sentiment for the services sector has been particularly disappointing. Thankfully, European government support measures are stable. Manufacturing PMIs and other indicators remain positive, such as the Germany IFO Business Climate, which rose from August's 92.6 to September's 93.4 and Germany's economy ministry updated its economic forecasts, reiterating its expectation of a stronger recovery in the third quarter.

Politics aside, US industrial output expanded marginally in July but was weaker than expected due to a slowdown in car production and retail sales grew by less than expected in August. However, the US Federal Reserve (Fed) issued a slightly less downbeat outlook for the American economy which it expects to contract by just 3.7% in 2020. Monetary policy is set to remain extremely accommodative with interest rates held close to zero until inflation moderately exceeds 2% with most Fed members expecting zero policy rates until the end of 2023.

The falls in equity markets do have some "positive" aspects in that sterling itself is also down, thereby cushioning any impact from overseas earnings resulting in a much smaller drop (or in some cases a rise) when translated back to UK investors. And despite the drama in stock markets, bond markets have been calm. Government bond yields have been stable; not falling amid stories of the impending economic slowdown but likewise not rising in disapproval when governments around the world look to issue vast amounts of new debt. This inert response has good and bad implications. Immovable bond yields allow governments to borrow at practically non-existent rates indefinitely, helping them reflate their lagging economies through fiscal action. In just one issuance, the UK's Debt Management Office sold £6.5 billion of 40 year(!) bonds at a yield of just 0.66%. The amount of orders (demand) that investors put in massively overshot supply when they came in at about $50 billion. This is a clear signal from capital markets that, if higher debt levels are what is needed to stave off a classic recession, then higher debt levels it is. Markets are practically giving money away to governments, but governments are somewhat hesitant to take it.

On this point we have previously written that how the support through this period of contraction is paid should not get in the way of the fact that it is very much needed. As Rory MacQueen, principal economist at the UK's highly regarded National Institute for Economic and Social Research (NIESR), points out: "Now is not the time to be talking about scare stories about government debt." And "there is no indication whatsoever that the current approach is causing any problems or any question marks to appear over the sustainability of government debt". Recent bond market moves suggest he is right.

Portfolios – September 2020

Considering the issues arising from the second wave of virus cases and the implied return to lockdown in some form, a flat month for portfolios was a welcome result. Mid-way through September most indices were continuing to recover strongly with returns of between +2% and +4%. As concerns applied pressure, major indices dropped to end the month at between -1% for the FTSE100 (nearer minus 8% in

sterling non-adjusted terms – see earlier) and as the Nasdaq retreated to -1.95% this dragged the S&P 500 lower to -1.19%.

In the UK, smaller companies retrenched as the AIM All share dipped approximately -3.8% and higher yielding funds were impacted as Banks and Oil and Gas fell around -10%. The pressure on traditional dividend paying stocks continued to weigh on the income portfolio.

Global Socially Responsible Investment (SRI) continued to forge a strong path, lifting the ethical portfolio 1% over the month, whilst growth portfolios held steady at between +0.05% for the lowest risk 3/10 portfolio to +0.57% for the highest risk 10/10 portfolio.

The Income portfolio lagged, as mentioned above, finishing the month -1.4% lower and the balanced Income and Growth portfolio dipped by -0.28%. However, the yield remains steady around 4% and we will look at the Income portfolio in a little more depth next month once the October dividend reporting is concluded.

Underlying constituents within the portfolios again delivered reassuring steady returns. Outliers included the Baillie Gifford Japanese Smaller Companies funds which rose just under +16% continuing the surge fuelled by a stable Japanese market. Year to date the fund has returned +25% overcoming a drop of -30% from the start of the year to the March trough.

Larger portfolio holdings include the Vanguard UK Inflation linked gilt index tracker which supported lower risk portfolios with a return of +2.45%.

Midway through the month as commercial property valuers confirmed they could confidently value the majority of portfolios again, steps were taken to lift the suspension on funds with Threadneedle leading. Understandably they have kept fund flows a closely guarded secret, though data midway through October should give a clearer picture on the market's reaction to the reopening of trading. Legal and General also confirmed the lifting of the suspension on their funds with effect from 13th October. We are watching the position closely on the property funds, and whilst generally reassured by the underlying cash balances and portfolio construction of the funds held, we will report shortly on the position moving forwards, to address the restriction imposed when trading is suspended on funds.

All returns rounded and quoted gross of ongoing fees and as always, please contact your adviser at Beckford James with any questions or call 01225 437 600.