IMS Capital
Quarterly Summary
January 2020

Two familiar themes were prevalent over the quarter once again with the U.S./China trade war and UK politics dominating headlines. The first of these themes was connected to a series of factors which contributed to a bout of volatility early in the quarter.

The initial cause for concern was a report which showed that U.S. manufacturing levels fell to their lowest level in over a decade and it is hard not to make a connection to Donald Trump's antagonistic relationship with China. Employment data coming out of America were also weak, reversing an earlier trend. This added to existing fears that the world's largest economy was showing signs of weakness. The impact was exacerbated with Eurozone manufacturing data showing that in September the sector contracted at its quickest rate in almost seven years.

The U.S. Federal Reserve (Fed) were quick to respond to this weakness and they made their third 0.25% cut to interest rates of the year at their October meeting. The Chairman of the Fed, Jerome Powell, has said that he feels that rates are now in a "good place" and that further rates cuts would only come as a result of a material reassessment of their outlook. With other major central banks also appearing intent on maintaining interest rates, this will mean that the period of ultra-low bond yields is likely to continue for some time yet.

As the quarter was coming to a close there was positive news on the subject of trade tensions with the announcement of an agreement between the two sides. This limited trade pact means that the U.S. will not impose the next tranche of penalties and in exchange the Chinese will purchase large amounts of American agricultural goods.

President Trump is seeking re-election in 2020 and whilst the view that China isn't playing fair is a largely bipartisan issue in America, news of this deal did not come as a surprise as his administration will be keen not to let the dispute have a demonstrable effect on their economy. Historically, presidents seeking a second term have not had much success when the economy has been weakening. American markets reacted positively, heading to fresh highs, but with nothing formalised and the targets for exports so high, it would be wise not to rush to judgement about what this deal means for this vital relationship.

Earlier in the quarter the World Trade Organisation ruled that the EU had engaged in unfair trade practices in their dealings with the U.S. which means that the Trump Administration is now able to impose tariffs on a wide range of European goods. The U.S. had been eagerly awaiting the result of this case and this gives them an opportunity to redirect their focus away from China. They have already imposed new taxes on imports of industrial metals from Brazil and Argentina in a move which was unpopular with American manufacturing firms who rely on foreign imports.

Elsewhere, data showed that in the third quarter of 2019, Chinese gross domestic product (GDP) was just 6%. This is the slowest rate for 30 years and demonstrates the challenges facing the country as they battle with America over global trade. It is important to remember, however, that the days of double-digit GDP growth rates are incompatible with an economy which has restructured itself massively as the country's economic power has grown. Whilst the 6% level represents a psychological barrier for investors, it was always going to be the case that a far larger economy growing at a slower rate would be the end result of the transformation they have embarked upon.

The oil price has been on the rise, helped by the sector's big story of the quarter: the Initial Public Offering (IPO) of Saudi Aramco at the start of December. The world's largest oil company set the record for the largest ever IPO when it raised a record $25.6bn but it fell $300bn short of the $2tn total company value Crown Prince bin Salman had sought. The end to the 4-year long saga happened at the same time as OPEC were discussing further cuts to production levels in order to increase the oil price. The original cut began at the start of 2019 and involved an agreement to reduce production by 1.2 million barrels per day.

With Boris Johnson's Conservative party winning a majority it seems that the UK's exit from the EU is all but certain. The initial reaction to the election win was positive with markets rising by over £33bn and sterling leaping more than 2% as investors interpreted the win as a sign that 3 years of indecision were coming to an end. Not long after this, however, it became clear that although one layer of uncertainty had been removed, many questions remained. The biggest of these is the form that Brexit will now take and with parliament voting to ensure there can be no extension at the end of 2020, investors will be watching with interest to try to understand how a complicated and untested process will be concluded in just 11 months.

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Performance summary

In a volatile quarter it was good to see all portfolios bar Defensive Income finish in positive territory over the quarter. Markets were well down in the early part of the quarter on fears that the trade war between the United States and China would escalate. These concerns eased over the period and the record run in markets continued. With American equities heading towards new record highs we continue to be surprised by the ability of markets to press ahead while concerns persist. The yields on the income portfolios managed to increase slightly over the quarter despite persistently low interest rates.

Portfolio	3 month performance	12 month performance	36 month performance	60 month performance	12 month historical yield %
Defensive Income	-0.05	8.91	12.3	24.74	2.97
Benchmark	0.74	8.29	9.63	18.85	n/a
High Income	1.42	13.62	15.44	36.88	3.39
Benchmark	2.21	13.97	16.59	32.56	n/a
Cautious	0.63	12.02	16.24	33.49	2.48
Benchmark	2.08	11.49	13.29	25.82	n/a
Balanced	1.21	14.72	20.48	44.34	2.27
Benchmark	3.22	15.45	19.1	37.8	n/a
Growth	1.65	16.36	24.6	53.02	2.11
Benchmark	3.18	14.65	19.23	38.11	n/a
Ethical	3.27	20.46	29.02	48.44	1.70
Benchmark	3.22	15.45	19.1	37.8	n/a

All data are to 31/12/2019. Source: Financial Express Analytics

Portfolio changes

The record market run continued over the last three months, with the odd road bump, and following our efforts to diversify the portfolios and to decrease risk, this has meant that the portfolios have not benefitted fully from the gains seen around the world. Despite this, with only 7 funds highlighted for further attention across all 6 portfolios this quarter we are confident that our processes remain robust and we continue to focus on our diversified stance so as to prevent the portfolios becoming overly reliant on specific areas of the world in anticipation of potential shocks in the months ahead.

The main changes this month are in our Cautious, Balanced and Growth portfolios. The first of these was the removal of the Merion North American Equity fund. This was held in conjunction with a passive fund which tracks the performance of U.S. markets in a cost-effective manner. With markets performing well, funds such as this form the bulk of the top half of the sector and we have benefitted from our strategy of having the majority of our U.S. position invested in this way. The paired fund is held to increase the diversification in the sector but our research indicates that in times of increased volatility, it does not react in the way in which we would expect. As such we have decided to replace it with Artemis US Select which is ranked highly in our research and is also less correlated to the sector.

The other main change is the replacement of our targeted absolute return fund, Jupiter Absolute Return. We introduced a holding in this sector in 2018 in order to provide a degree of protection in turbulent times, however, as with the fund above, we have identified that it is not sufficiently robust. We have decided to bring in Aviva Multi Strategy Target Return which has an improved performance profile across a range of markets and also scores highly for its performance in negative markets.

Full details of the alterations made this quarter are shown on the Fund Change summaries which are available on our website.

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