IMS Capital

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Quarterly Summary
February 2021

Markets, on the whole, are said to be forward looking. In essence this means that they are more interested in what they think will happen in the future than what happened over the previous month or quarter, or indeed what is happening on any given day. This was amply demonstrated over the period since the last review with investors firmly focused on a future where the virus is under control and the political landscape is more accommodating. Whilst the former might still be some way off in the US, the Democratic party followed up on their election win with success in both contested Georgia senate seats which is a big boost for the party. It gives them greater freedom to implement their strategy without running into Republican blockages at every stage.

The election of a new president is always closely followed around the world due to the importance of the US economy and the scrutiny was even more intense this time around. Investors will be hoping that the election of Joe Biden will see a return to a more decorous and predictable sort of politics. With the dramatic scenes from early January hopefully behind him, attention turned to Biden's initial acts as president. His first 100 days in office will be closely watched as this period is often the one that helps to set the tone for the full 4-year term.

The reaction to the eventual smooth transition of power saw all of the main markets in the US rise back over all-time high levels, led at least in part by the view that the Democratic party would seek to push through its plans for enormous levels of additional stimulus. The new president has warned that the pandemic will get worse before it gets better and his American Rescue Plan (aka Bidenomics) seeks to put a $1.9tn package in place to help workers and will be followed up by further borrowing to jump start their economy. Janet Yellen, Biden's pick for Treasury secretary, has called for Congress to "act big", but their plans are likely to face a tough ride even with their technical majority.

The latest stimulus package is likely to see between $600 and $2,000 given to each individual in the country and support like this has also been beneficial for corporate America. Despite the loss of some big names, the overall rate for bankruptcy filings in the US fell close to 500,000 last year. This compares to a recent annual average of 800,000, whilst the rate following the Global Financial Crisis was several times higher than that level. The question now is how many of the businesses that have survived will remain viable once the support they have received thus far starts to be removed.

The ebullience was not limited to America and towards the end of the period European equities enjoyed their best week since November while the MSCI World price index passed its record high point. Indices in China have also now moved past their previous peaks from 2008 as the country and wider region benefit from a rapid recovery from the pandemic.

Closer to home, the last-minute agreement between the UK and the EU is in place and all that's left is the trivial matter of years of ongoing negotiations to iron out the "small print". As we've discussed in these updates previously, markets do not like uncertainty and despite the gaps left by the Brexit deal, it removed any lingering concerns about a no deal outcome. This provides a good base for recovery, helped by improving news on the vaccine front. Our main indices have rallied of late but they remain good value having lagged behind markets in the US and elsewhere where high growth stocks staged a remarkable recovery from their low points in the Spring of 2020.

One area that remains depressed is that of dividends. One piece of research suggests that pay-outs from UK firms are unlikely to return to pre-Covid levels before 2025, adding to the woes of natural income seeking investors who have already endured a long period of very low interest rates. Over 2020, dividends fell by almost a half with two thirds of firms reducing or cancelling their payments. Firms will be hoping that as the vaccine programme ramps up and restrictions start to ease, the pent-up demand from consumers will help power their resurgence.

One other theme over the period was the ongoing march of ethical or sustainable investing. Of the funds we use in our Ethical portfolio, the average rise in assets was 15% with a record $347bn of investment going into ethically focused equity funds globally last year. Although we have an Ethical model, we are not prevented from holding the assets we use in that within our other portfolios. Where funds are suitable they can be included, however, we have to remain mindful of the fact that where funds might have performed well, this could simply be a result of their inability to invest in certain areas of the market. Should conditions change, these funds have less flexibility to change course.

This awareness of changing conditions will be important as we look ahead. 2021 is a very different prospect to 2020, even with the stuttered start, and with Brexit and Trump in the rear-view mirror there are fewer "known unknowns" than at this point last year. It is therefore more critical than ever to ensure that we understand the funds that we use to ensure that they have potential and not just past performance.

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Performance summary

The final quarter of 2020 saw a continuation of the rally that started in the early summer. Despite a rise in infection rates and a new lockdown in the UK, markets were focused on the positives in the form of a resolution to the Brexit process and the election of Joe Biden in the US. Returns came from the traditional risk assets with Emerging Markets and Asia Pacific equities leading the way. Recovery assets such as those in the UK also enjoyed a good period as investors started to look for areas that had been unloved, but returns remained low in fixed income assets like bonds and gilts. The final month in the unusually elongated period since the last review saw a degree of pullback but that was not enough to prevent the portfolios registering very strong numbers.

Natural incomes remain low and with central banks appearing set on ultra-low interest rates for at least the next few years, bond yields are unlikely to improve for some time. Rising inflation might help this but in light of the change of approach by the US Federal Reserve, this traditional relationship between yields and inflation might not be as strong as it has been in the past.

Portfolio	3 month performance	12 month performance	36 month performance	60 month performance	12 month historical yield %
Defensive Income	4.23	2.46	9.54	27.73	2.52
Benchmark	4.45	2.66	8.73	23.81	n/a
High Income	8.49	3.80	10.61	41.2	2.95
Benchmark	8.67	4.11	11.25	38.74	n/a
Cautious	5.97	2.56	11.25	36.74	1.95
Benchmark	7.35	2.63	8.67	30.76	n/a
Balanced	8.19	5.18	14.18	50.35	1.78
Benchmark	10.00	5.58	13.85	47.15	n/a
Growth	9.75	8.11	17.25	64.06	1.59
Benchmark	9.72	6.90	14.20	50.21	n/a
Ethical	8.22	10.6	27.23	63.66	1.20
Benchmark	10.00	5.58	13.85	47.15	n/a

All data are to 31/01/2021. Source: Financial Express Analytics

Portfolio changes

At an asset allocation level we have only made minor changes to the sector weightings, as is our preferred approach. We are confident that the portfolios remain well diversified but we have adjusted the allocations to reflect our view that inflation is likely to have more of an impact over 2021. As a result, we have increased our position in Inflation Linked Bonds and, from a total returns perspective, added a little to Emerging Market Debt. This should also be to the benefit of the Income portfolios with the higher yields on offer in this sector.

We have also selectively reduced our allocation to Gilts where possible with due consideration to total risk. The sector has struggled as a result of low (and often negative) yields and while we are cognisant of the security it offers, we also have to be mindful of the risk to values being eroded as a result of inflation. Although we are not currently favouring the sector, we have made a change at the fund level to introduce a new Strategic Bond fund which has a greater ability to hold Gilts which means the manager can increase the weighting at their discretion. We have also introduced a new fund in the Global sector which we already own in the Ethical portfolio. We believe that the additional sustainability screens used by the fund will help to provide a diversification boost and complement the funds already in use. 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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