IMS Capital

Quarterly Review

Q3 2021

Market Commentary

There are broadly agreed definitions about what constitutes a bull and a bear market, but generally speaking where share prices fall for a sustained period of time and investors are of the view that these conditions won't change any time soon, the outlook is said to be bearish. With many major markets back above all-time highs and M&A activity in the first six months of the year hitting record levels we are clearly in bull territory.

As a portfolio manager (and an investor in IMS) I'm glad to see markets rising, especially after how things looked at the start of last year, but as I've touched on previously, all this ebullience does give me pause for thought.

To be clear, there is a lot to be positive about. In most developed markets restrictions are being lifted and consumers are returning to shops and restaurants to spend a lot of the savings which they were able to build up during the long months of lockdown. This is feeding through to company profits and earnings for US companies in the second quarter of the year have beaten forecasts by almost 20% (much higher than the long-term average which sits around 4%).

Although Q2 is expected to see the peak for corporate earnings, estimates for the rest of the year are still rising as forecasters grow more confident that we are past the worst of the pandemic. Profits are also up, despite rising costs for raw materials, as most companies have been able to pass on increases directly to their consumers. Additionally, the pandemic has rewritten the rules when it comes to corporate expenditure - companies have been able to save money by cutting their property costs, reducing spending on marketing and events, and not flying their executives around the world.

The recovery has been unusual because the market crash that preceded it was also unusual. Few sectors were left untouched as the virus spread and in the months that followed most of them have bounced back. Share prices have risen strongly almost across the board which is when people can start to get nervous. This was put into perspective towards the end of the quarter when a resurgence in fears about rising infection rates saw markets fall by up to 2.5%. Such are the current levels of enthusiasm that it took only a matter of days for the drop to be reversed, but it serves as a reminder about not being over-confident.

Countries like Australia and Japan are increasing restrictions in order to contain infection rates and in the US concerns are building about the Delta variant. Having believed that they had conquered the virus thanks to an effective vaccination drive, authorities are once again trying to convince people to wear masks with experts saying that the new variant is as contagious as chickenpox and could potentially lead to worse symptoms. As above, there are plenty of reasons to be cheerful, but like the proverbial bear, we're not out of the woods just yet.

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Performance Update

In our previous update, we noted that many developed markets had passed through record highs as the rebound from the pandemic saw economies surge upwards. This theme continued in our second quarter, with US indices again leading the charge. There were some periods of increased volatility where concerns about inflation and central bank action gave investors pause for thought, but robust corporate performance was enough for those worries to be largely ignored. Consequently, every portfolio saw strong performance over the period.

Gilts also had a good period after the 10-year government bond yield fell to its lowest level since the middle of February. This fall, the largest since the start of 2020, caused prices to rise thanks to the inverse relationship shared by the two factors. This was especially the case for index-linked gilts, those that are tied to inflation. Of course, falling yields are less positive for those investors who take a natural income and with the rate falling across the fixed income spectrum, payments were lower over the period.

Returns from emerging market equities were one area that disappointed over the last three months as rising Covid infection rates and lower rates of vaccination lowered expectations of economic growth. China faired especially badly as a result of the government's attempts to curtail the influence of private companies.

Portfolio	**3 month performance**	**12 month performance**	**36 month performance**	**60 month performance**	**12 month historical yield %**
IMS Defensive Income	1.81%	6.68%	11.90%	22.09%	2.35%
Benchmark	*1.56%*	*6.88%*	*11.13%*	*18.40%*	*n/a*
IMS High Income	1.65%	14.25%	15.52%	32.95%	2.77%
Benchmark	*1.95%*	*15.50%*	*16.88%*	*33.68%*	*n/a*
IMS Cautious	2.47%	11.56%	14.55%	31.27%	1.75%
Benchmark	*1.97%*	*12.80%*	*13.67%*	*26.46%*	*n/a*
IMS Balanced	2.66%	17.09%	19.45%	42.86%	1.53%
Benchmark	*1.94%*	*18.25%*	*20.14%*	*41.25%*	*n/a*
IMS Growth	2.51%	20.15%	22.70%	51.87%	1.35%
Benchmark	*1.96%*	*19.49%*	*21.34%*	*44.73%*	*n/a*
IMS Ethical	4.03%	19.02%	34.88%	62.53%	1.05%
Benchmark	*1.94%*	*18.25%*	*20.14%*	*41.25%*	*n/a*

All data are to 30/07/2021. Source: Financial Express Analytics

Portfolio Change Summary

In line with our usual approach, we have made minimal changes to our asset allocations this quarter. The only adjustment occurred in IMS Growth and involved a small increase to the Emerging Market Equities weighting. The portfolio has no maximum level for equities and has a relatively low holding in comparison to the strategic asset allocation. Although this has not held it back over recent months, we decided that an increase could be beneficial. In order to make this change we have decreased the allocation to UK Fixed Income as this helps to reduce the potential inflation and interest rate risk within the portfolio.

When assessing how to implement this change we considered using the existing fund, Fidelity Emerging Markets, however, we felt that the current weighting was already sufficient. In order to increase the diversification within the sector we elected to introduce a new position in Jupiter India. Despite suffering particularly acutely from the pandemic, India has continued to enjoy strong returns which speaks to the huge potential that exists within the country. As long term investors, a small allocation in the portfolio which has the most adventurous approach is appropriate. The other change in the Accumulation models was to adjust the weighting in M&G Global Bond which was flagged during our fund review process.

Within the income portfolios we have made a change in response to the news that Aviva are to close their Multi-Strategy Target Income fund. The fund has a number of objectives, one of which is to generate a good income and on this front it has been a success. Unfortunately, following a change of approach within Aviva Investors they have decided that the fund is too small to achieve the other objectives and they have no choice but to shut it. Alongside the income element, we held the fund as a diversifier thanks to its absolute return approach and as such we replaced it with Aviva's other Multi-Strategy fund: Target Return. In order to ensure that yields are maintained we have also brought in a low cost US Equity fund which has a specific income focus.

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