IMS Capital

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Quarterly Summary
October 2019

It appears that autumn has finally, and rather dramatically for some, arrived. I would be the last person to complain about a long and (generally) hot summer and it was a pleasant surprise to be sat on a beach in the UK at the end of September but despite this, there was an air of inevitability that cooler weather would shortly be on the way despite the stubbornly sunny skies.

It was difficult not to have the same feeling when watching world markets continue to fight off underlying fears over the quarter. Back in June, the US economy surpassed its previous record run of expansion which had started out of the ashes of the global financial crisis in 2009. Many markets around the globe were also in rude health and whilst we understand that bull markets do not die of old age, by definition each month that passes takes us closer to the end of the run. We just don't know when that end will come.

Many pundits are of the opinion that regardless of the challenges facing the global economy, the accommodative approach of central banks, along with low inflation and high employment, would see this run continue. One of the difficulties for central banks, however, is that with interest rates already very low they lack some of the ammunition they would usually have at their disposal to use when conditions became less favourable.

We do know that cash positions are at their highest point since 2008 and whilst this could just be investors waiting to invest on market dips, it could speak to a wider concern that markets are showing signs of weakness which could signal a downturn is on the way. One of the factors impacting on markets this quarter, as has been the case for the last few reviews, is Donald Trump's trade war with China. This attempt to protect America's position as the world's leading economy followed the same pattern over the summer as it did in previous months with the President's frustration about the lack of progress frequently being made obvious.

The trade war has somewhat clouded the water and made other issues less prominent. Usually concerns about political instability in South America, oil supplies in the Middle East or weakening economic growth would dominate but this has often not been the case. Trump's trade tribulations have also distracted from broader issues within the US; the expansion mentioned above may be record breaking in length but it is also one of the weakest on record as well.

Although there are few signs that conditions are worsening, the Federal Reserve was sufficiently concerned that they decided to cut interest rates for only the second time since the global financial crisis at their September meeting. The chances of America falling into a recession in 2020 have been rising and while a resolution with China will calm nerves, it is not a magic solution.

On the same theme, we will soon know whether the German economy has fallen into a recession. Recent data would suggest this is likely to be the case and it is evidence that the US/China trade war is not limited to those two countries. As Europe's largest economy, this would be bad news for the region and the European Central Bank has already begun to take steps to stimulate growth by cutting interest rates and promising a return to quantitative easing.

Looking closer to home, one of the questions we get asked most frequently by clients is why have such large allocations to our domestic market given concerns over Brexit. One key factor is that the main UK index, the FTSE 100, is dominated by companies which make their profits overseas. The degree to which this is the case varies depending on how the numbers are crunched but the figures are usually between 65% and 85%. These companies which earn dollars, euros and renminbi bring those earnings back to the UK and this explains why they do well when sterling falls, as it has done since the referendum in 2016.

It is also the case that there remains a great deal of value in UK PLC. Relative to historical norms, UK stocks are favourably priced and we use fund managers who will seek out pockets of value in order to benefit from pricing adjustments. Of course, we also understand that there is always an element of timing in when this return to fair value will happen and this is why we invest in a broad range of UK funds which each seek to produce returns from different sections of the market and in different conditions. It is this diversification which is key.

As we enter the final quarter of the year and prepare to don jumpers and coats, we are aware that our portfolios may also be heading into a changing climate. We believe that the steps we have taken to diversify holdings stand them in good stead.

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Performance summary

Further offensive actions in the trade war between the US and China, along with persistent worries about the state of the global economy made it difficult for markets to gain traction over the quarter. Currency fluctuations in the UK caused by ongoing Brexit negotiations also hampered the returns on UK equities. Despite these challenges, the portfolios all finished the quarter in positive territory, helped by the weighting to fixed income assets as well as the other holdings we have introduced to boost diversification. The yields on the same fixed income funds have struggled a little over the period as the trend towards negative interest rates continues to bite.

Portfolio	3 month performance	12 month performance	36 month performance	60 month performance	12 month historical yield %
Defensive Income	2.36	5.83	12.78	27.39	2.91
Benchmark	1.83	4.69	9.38	20.94	n/a
High Income	2.21	4.31	17.11	37.66	3.28
Benchmark	1.86	3.97	16.46	32.88	n/a
Cautious	1.74	4.34	17.61	36.24	2.51
Benchmark	1.75	3.90	12.8	26.4	n/a
Balanced	1.78	4.02	21.75	46.26	2.28
Benchmark	1.94	4.02	19.26	37.99	n/a
Growth	1.48	3.85	25.46	54.33	2.06
Benchmark	1.70	3.07	19.85	38.33	n/a
Ethical	2.08	7.17	26.36	48.55	1.71
Benchmark	1.94	4.02	19.26	37.99	n/a

All data are to 30/09/2019. Source: Financial Express Analytics

Portfolio changes

We have received the annual reappraisal of our strategic asset allocation models which form the basis of our long term asset allocations. These strategic allocations are based on historical volatility and return levels and give an indication of the potential performance profile at varying levels of risk. They help guide our thoughts when we review the portfolios each quarter and although we are not required to follow them precisely, they are one of the tools we use as we assess our models

The general theme of the update was a reduction in perceived risk. This included a reduction to Asia Pacific and Emerging Markets equity across the range and increases to cash and gilts. As we have mentioned in previous updates, these are adjustments that we have been implementing over the last 18 months.

In the accumulation portfolios we have reduced our Asia Pacific equity positions, mainly in favour of the UK. Whilst our home market has faced its own challenges, it offers greater value at this stage in the market cycle. We have also directed this holding into smaller and mid cap stocks rather than larger companies. The aim is to hopefully remove some of the currency risk based on the fact that these assets are more likely to generate returns domestically rather than overseas.

In the fixed income portfolios we have reduced the weighting to global inflation linked bonds on the back on concerns about their sensitivity to interest rate changes and our outlook for inflation. We have reallocated into more general global bonds in order to benefit from the greater flexibility they bring.

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