Harwood
Wealth Management Group Ltd

Quarterly Update
Q4 2020

IMPORTANT INFORMATION

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INTRODUCTION

Compared to the first and second quarters of this new decade, the third quarter could arguably be considered “boring” from an investment perspective, almost mundane… The incredibly large stimulus packages experienced in Q1 and Q2 have not continued although a few tweaks have been implemented here and there. Understandably unemployment numbers remain very high and the furlough scheme in the UK has been extended albeit with not as generous terms as when the coronavirus pandemic first hit.

In the US – the world’s largest economy – the Federal Reserve Bank committed to not raising the already low interest rates for another three years. This basically tells you the US is not worried if inflation starts to become an issue. With a few choice words the committee that oversees the monetary policy of the US changed their stance on how they will use interest rates to control inflation. Instead of inflation being a target number, it will be measured as an average number. For a long time now, the actual inflation number has been below the target number and therefore the Federal Reserve can, in essence, “borrow” from this number to allow actual inflation to be above the target number until the “average” starts to rise.

Many commentators discussed a “V” shaped recovery, citing the unprecedented size of the stimulus package being enough to stop the global economy tail spinning into depression, and depending on what metrics you are looking at you could argue they were right. This global recession is unlike others and lots of lessons will be learned. A number of stock markets have responded very favourably and some are now at higher levels than the beginning of the year. But, as we all know, stock markets are not the economy and the economy is not the stock market. As previously mentioned, unemployment is much higher than a fully functioning economy would find reasonable. Governments have taken on board trillions in debt and some industries have essentially collapsed (think airlines, hotels, hospitality, cinemas, high street retail and many others). Admittedly there will be and have been winners – ecommerce is thriving for instance, and from a business perspective, where would we all be without Zoom? But, considering Zoom only employs roughly 2,500 people globally and EasyJet have recently announced almost twice that amount being made redundant in the UK alone, the redistribution of jobs and wealth is not going to be equitable.

The S&P 500 (an index of the 500 largest publicly quoted companies in the US) as at the end of August was up – on a year to date basis – 9.70% which is mightily impressive especially considering the economic situation we find ourselves in. 5 stocks (Apple, Microsoft, Alphabet (Google to you and me) Amazon and Facebook) have contributed 9.40% of the 9.70% - which, by the powers of deduction tell you 495 companies have returned the remaining 0.30%. The concentration of returns is a little unsettling. The 5 stocks mentioned account for less than 20% of the total weight in the Index. They've done all the heavy lifting this year – can it be sustained?

There is a US Presidential election in the forthcoming quarter; the UK is less than 100 days from Brexit being a reality and the US / Chinese are no closer to a deal or compromise in their trade negotiations. No vaccine has yet been found for coronavirus; the "R" number threatens further localised lockdowns and with Prime Minister Johnson and President Trump both succumbing to the disease, it's fairly safe to say the next quarter will have some surprises up its sleeve as 2020 continues to throw curveballs at us all.

Sector Analysis

Top Performing 30/06/2020 - 30/09/2020		Top Performing YTD 2019 (30/09/2020)	
Japanese Smaller Companies	9.93%	Tech & Telecom	26.65%
European Smaller Companies	8.86%	China/Greater China	19.91%
China/Greater China	7.62%	UK Index Linked Gilts	11.45%
Tech &Telecom	6.82%	Asia Pacific Including Japan	10.96%
Asia Pacific Including Japan	5.83%	Japanese Smaller Companies	9.79%
Worst Performing **30/06/2020 - 30/09/2020**		**Worst Performing** **YTD (30/09/2020)**	
UK Equity Income	-3.05%	UK Equity Income	-22.61%
UK Index Linked Gilts	-1.56%	UK All Companies	-18.47%
UK All Companies	-1.06%	UK Smaller Companies	-12.65%
UK Gilts	-1.01%	Property Other	-11.63%
UK Direct Property	-0.51%	UK Equity & Bond Income	-7.16%

Data from FE fundinfo 2020, dates as above.

FIXED INCOME

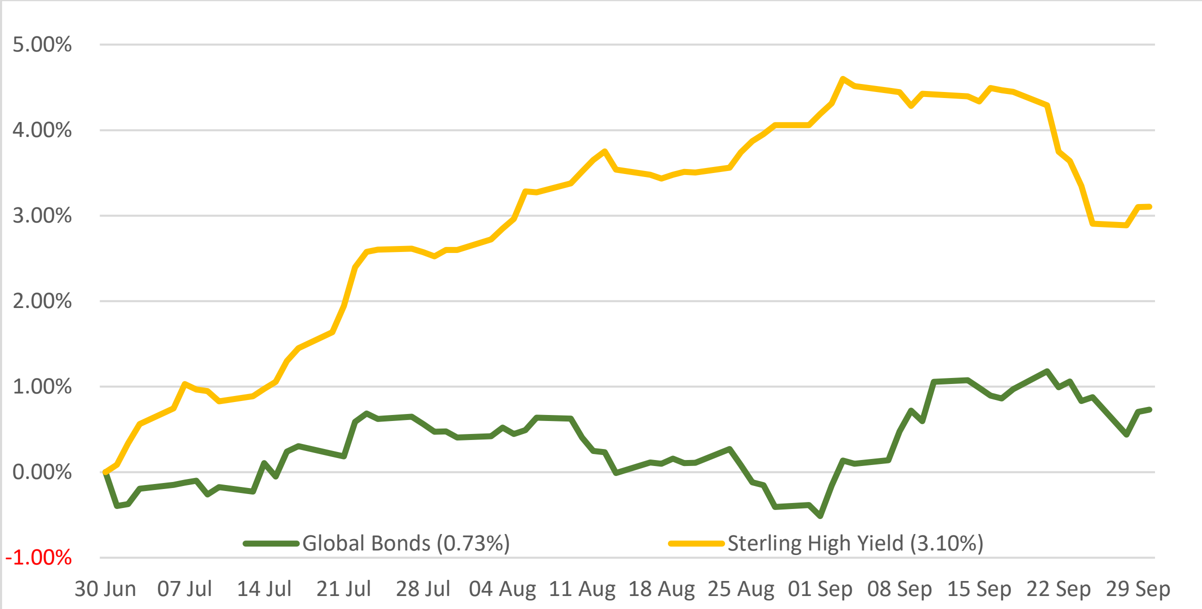
<u>Sterling Bonds</u>

The big question for this sector that is yet to be answered is whether the Bank of England will follow the approach of the European Central Bank and introduce negative interest rates. Rates are already at a record low of 0.1% and have been since the scale of the pandemic emerged in March. The theory behind moving to a negative rate is that it encourages people to spend money because they don't earn anything for keeping their funds in cash, however, there is a great deal of debate about the merits of doing this. Critics point out that negative rates appear to do little to stimulate corporate investment because banks are reticent to pass the cost onto their customers out of fear that they would remove their deposits. The result is that the banks incur higher costs, become less profitable, and are therefore less able to lend funds so support the economy

As well as keeping the interest rate unchanged, the Bank's Monetary Policy Committee also agreed in August to maintain purchases of UK government bonds and non-financial investment grade bonds to maintain liquidity and support the economy. The committee will also be wary of UK government borrowing which is predicted to hit levels last seen during the Second World War by the end of the year, and of the chancellor's comments about the tough decisions that will be need to be made about this in the future.

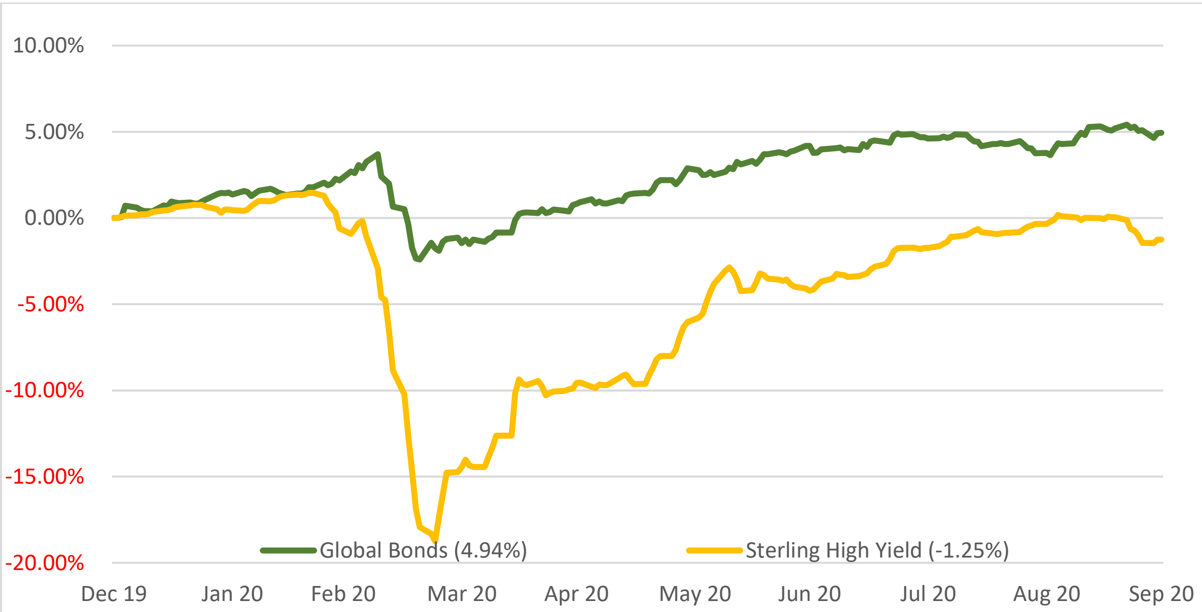
UK fixed income enjoyed a positive quarter despite a rise in bond yields (which move in the opposite direction to prices) with the historically riskier high yield sector producing the best returns. One factor that impacted on the volatility of returns over the period were the fluctuations in sterling which initially rose versus the dollar as a result of a weakening in the US currency, however, as the quarter wore on, increased apprehension about the outcome of the protracted Brexit negotiations were a headwind that saw sterling fall sharply. Along with Coronavirus concerns, the outcome of this process will decide how the sector performs come the end of the year.

Sector comparison: Global Bonds and Sterling High Yield – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Sterling High Yield – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

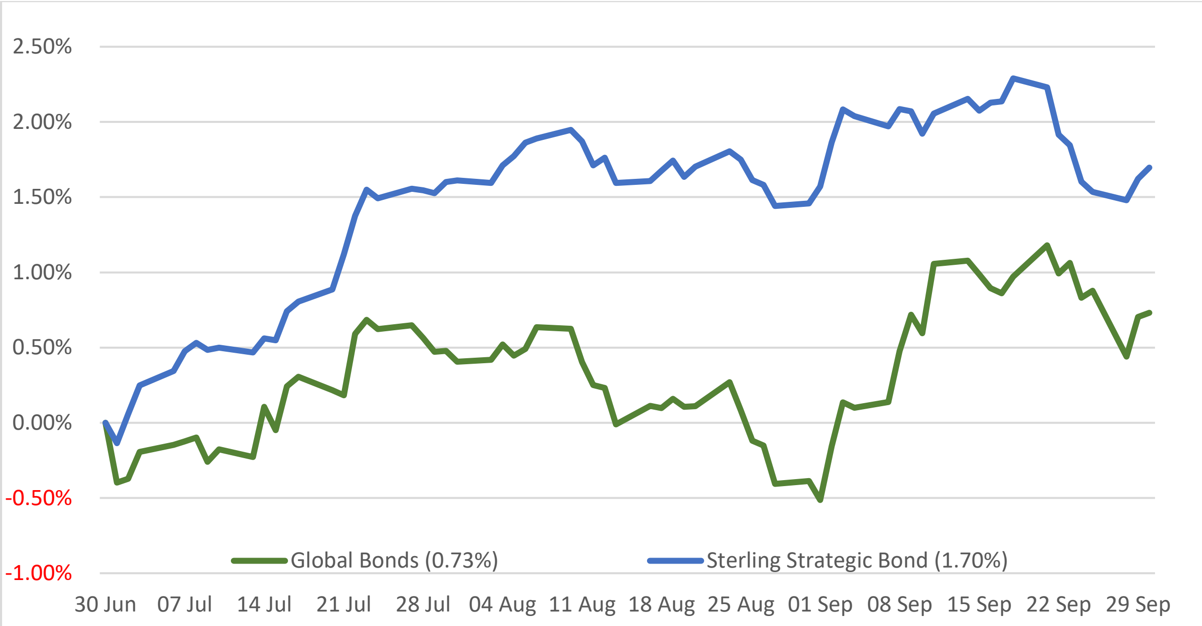
Sector comparison: Global Bonds and Sterling Corporate Bond – 3 month performance

30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Sterling Corporate Bond – YTD performance

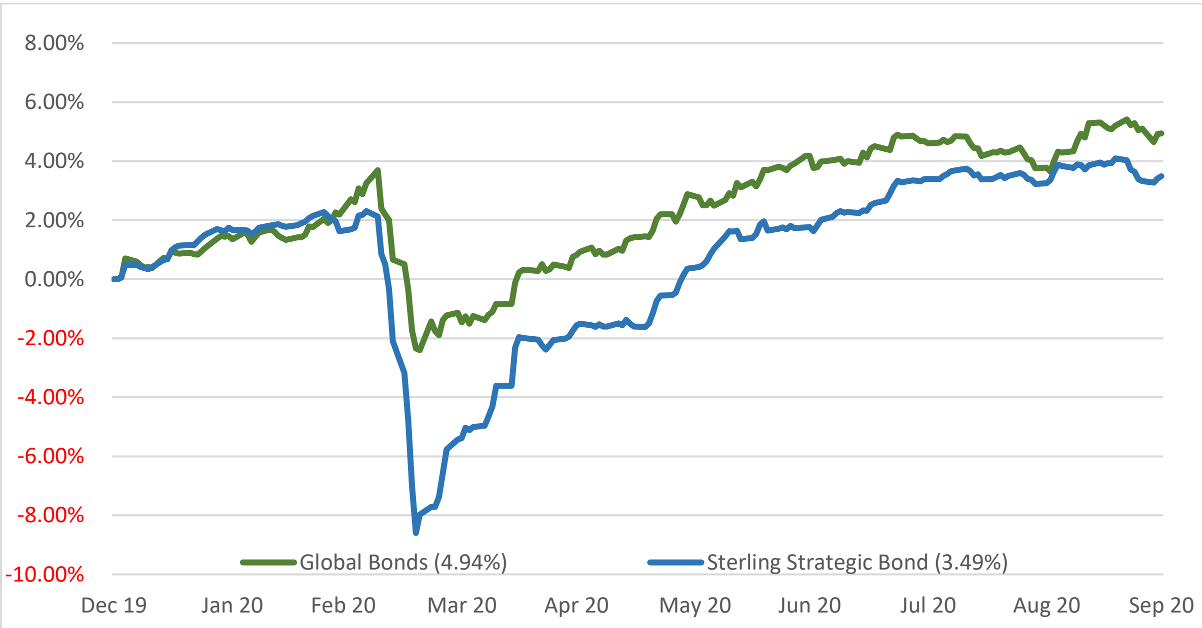
31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Sterling Strategic Bond – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Sterling Strategic Bond – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

Global Bonds

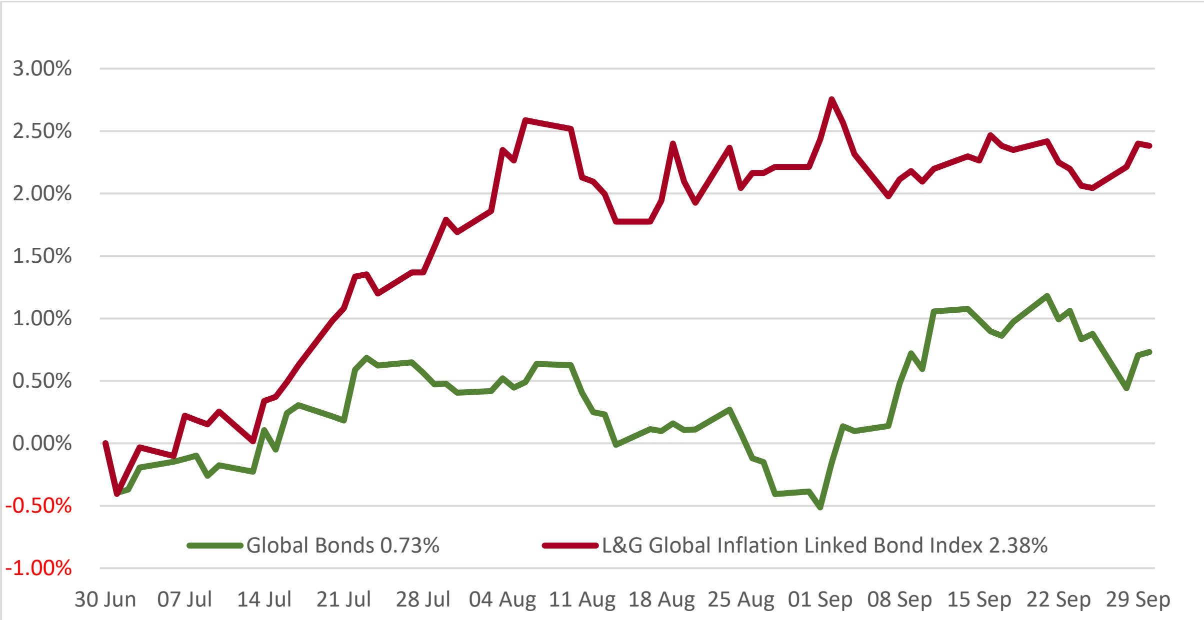
Bond markets continued their recovery in the third quarter, with high yield bonds leading among fixed income sectors. Investment grade and emerging markets bonds also recorded solid returns. Returns from government bonds were relatively flat, and are expected to be limited from here, reflecting the low level of interest rates by the major central banks.

During the quarter, data from Moody's rating agency has shown, unsurprisingly, that defaults have begun to pick up and US high yield defaults are running above the levels we saw in 2016. While defaults are already north of 6%, we recognise that there will be much more to come in the next twelve months with suggestions that defaults might easily rise to 12%. Defaults in the GFC rose to ~15%, a level that could be breached if the economic disruption from the current crisis is protracted.

Sector comparison: Global Bonds and Short Term Money Market – 3 month performance

30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Global Inflation Linked Bond Index Proxy – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global Bonds and Global Inflation Linked Bond Index Proxy – YTD performance

31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

UK Gilts

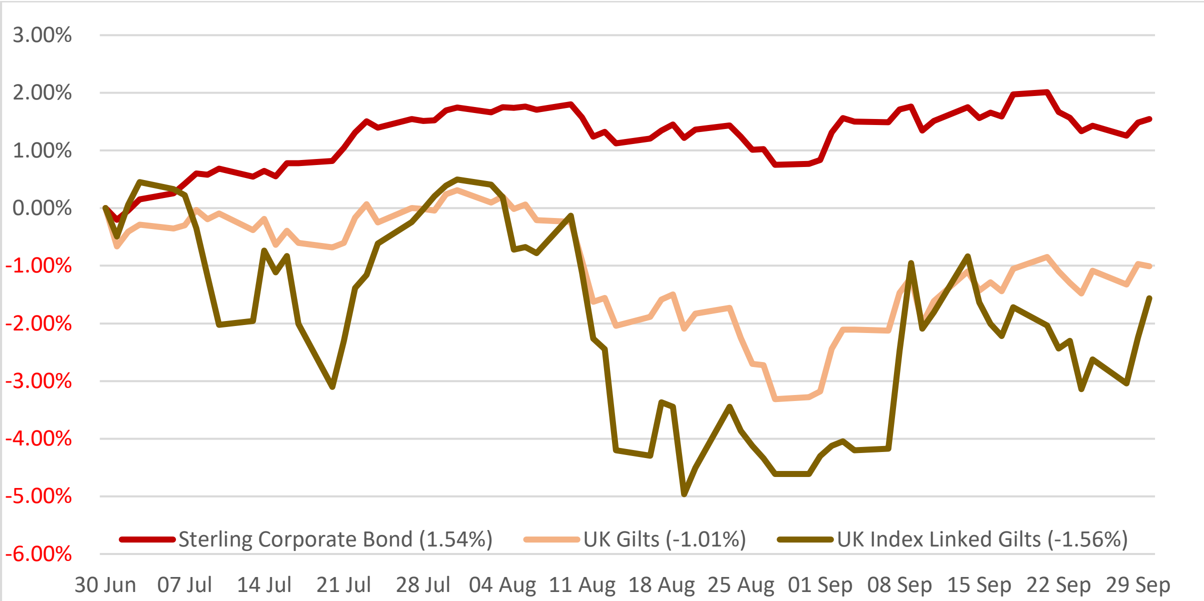
UK Government bond yields were already historically low before the Covid-19 crisis began, driven by long term structural drivers and a lack of inflationary pressure. As the pandemic hit, yields tumbled further still. Central banks slashed interest rates, and openly contemplated negative rates, which caused short dated government bond yields to plummet. Meanwhile a combination of aggressive QE, forward guidance, and investor pessimism over the long-term global outlook caused longer dated sovereign yields to collapse too.

The third quarter provided a mixed picture for bond investors as markets moved on sentiment between risk on and risk off. Concerns about an increase in the pace of Covid-19 infection rates in some were countered by rising hopes of a vaccine following successful early trials. By the end of July, yields (which move inversely to prices) on all UK government bonds maturing in less than 8 years were negative, and on 4 August the UK 10 year government bond yield closed at a record low of just 0.10%.

Assisted by reduced supply, ongoing central bank support and strong investor demand for yield, from this point on investors saw an increase in government bond yields which reflected both a general preference toward riskier assets, as well as rising inflation expectations. However, September saw UK government yields fall again, which could be attributed to a combination of factors such as growing perceived risks around the US Presidential election, fears of a second wave of Covid-19 in Europe, and contagion from a sharp selloff in technology and bank equities,

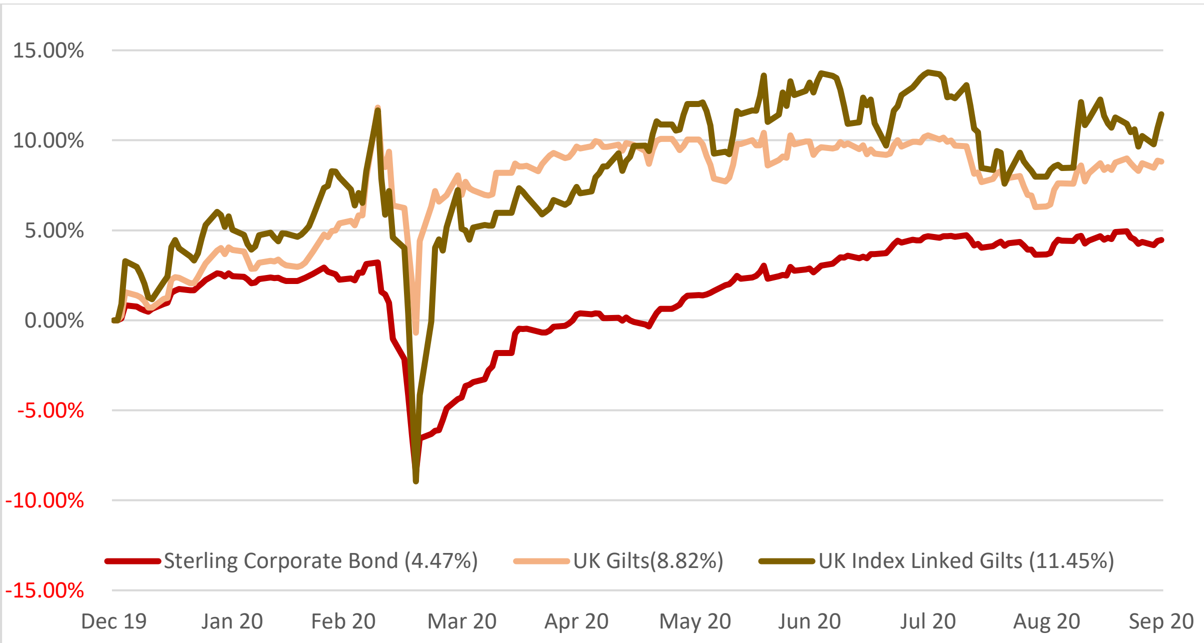
Until we have more certainty on how the long the pandemic will last and its effect on the UK economy, with the outcome of Brexit still on the horizon, and low inflation to remain for the foreseeable future, UK government bond yields will continue to remain low.

Sector comparison: Sterling Corporate Bond, UK Index Linked Gilts and UK Gilts – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Sterling Corporate Bond, UK Index Linked Gilts and UK Gilts – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

DEVELOPED MARKET EQUITIES

UK

The UK economy continues to battle with the fall-out from the Coronavirus-induced close down from the last quarter, although Gross Domestic Product (GDP) rose by 6.60% In July, the third month in a row of growth. In a "normal environment" 6.60% growth in a month would be outstanding and politicians and businessmen (and the stock market) would be celebrating, but considering GDP actually fell in the three months to July by 7.60% there is still a long way to go. Even accounting for such a strong month, economic activity was almost 12% behind the levels witnessed only as recently as February.

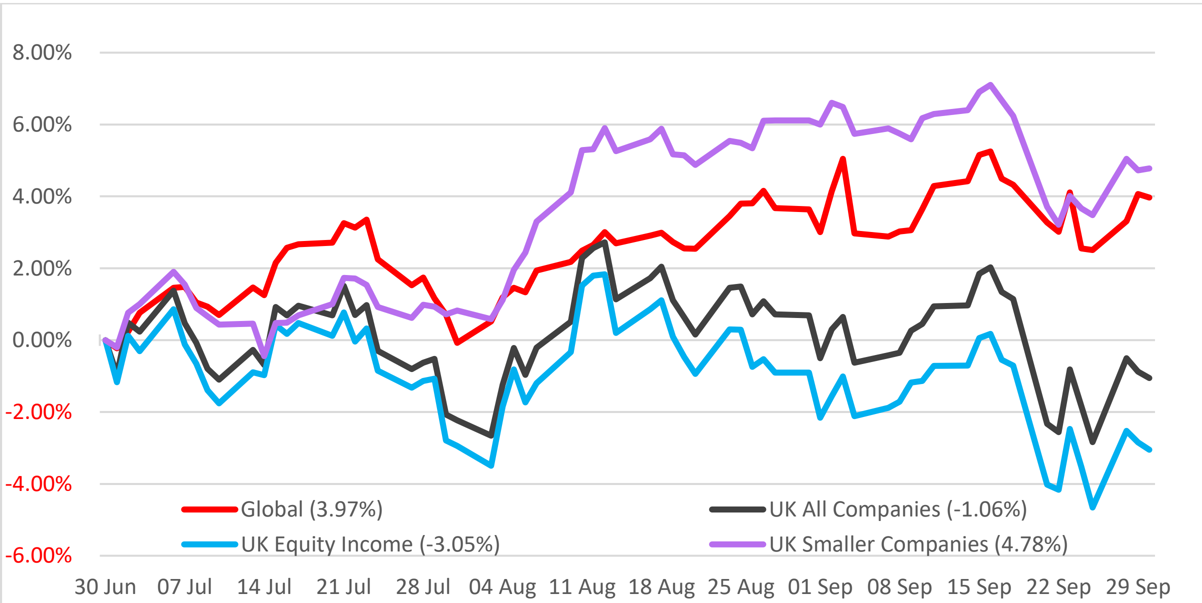
The government introduced a scheme for the month of August called "Eat Out To Help Out" to assist the struggling bar and restaurant industry and to attract customers again by subsidising some of their expenses – which was seen as successful, but in reality barely scratched the surface as not all eateries joined the scheme; there was a limit to the subsidy; it was only valid on Mondays through Wednesdays and due to social distancing there were strict limits as to occupancy levels. A wider array of shops started to open again in the third quarter (although it was requested that face masks are worn) with limited appeal from the public and some leisure facilities were allowed to open their doors again. Even though cinemas and gyms for instance are open again, personally I think it will be a long time before customer numbers are back to pre-pandemic numbers.

Most stayed in the UK for their holiday this summer, and many of those that did go to Spain for instance were hit with self-enforced quarantine as they returned. Fortunately, the weather was quite good at home (for a change) but the images of crowded beaches will remain and it certainly looked like social distancing guidelines were not being fully adhered to, and this was absolutely the case in a number of parts of the country as regional lockdowns were instigated.

The dreaded "R" number – reflecting the ratio of infected individuals looks like it is rising again and the potential of wider curfews are being discussed by the government. Bars have to close early for instance. As we enter the final quarter of the year – as nights draw in and the temperature cools - there still is no cure and no cohesive action plan from the government in tackling this ongoing issue.

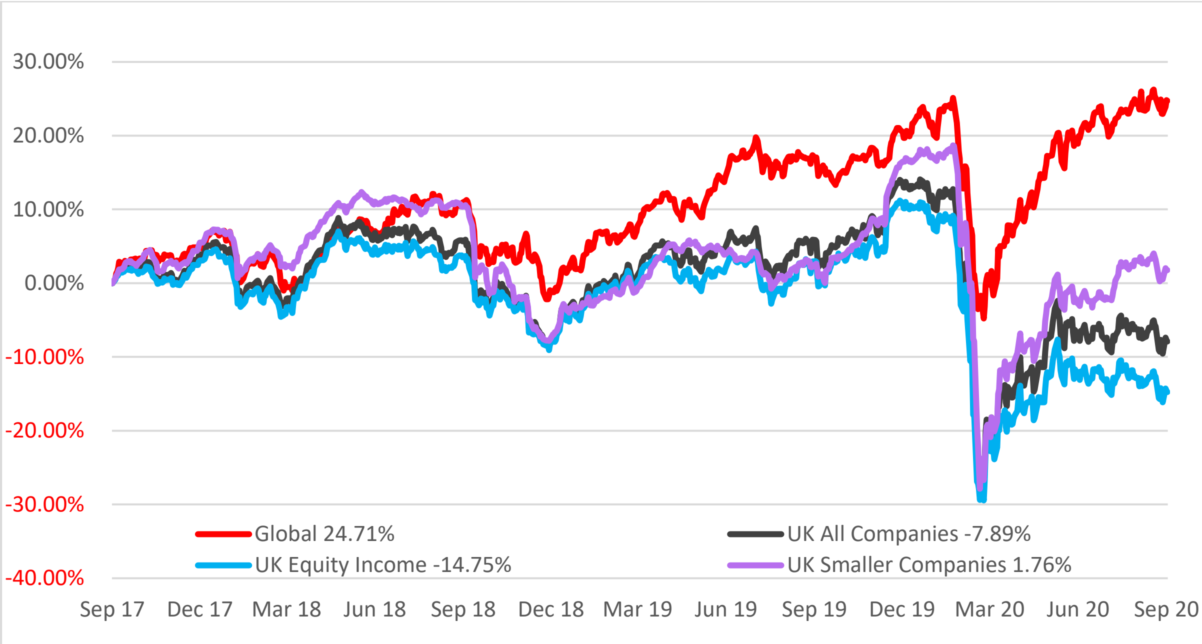
From an investment perspective, the third quarter saw poor returns from the largest companies in the Index. The FTSE 100 has a large bias to financial stocks and energy companies. With interest rates low, the potential for outsized profits is hard to achieve, and with a warm summer and less travel, the demand for oil has fallen too. The UK is known as a country with above average dividend yields, but the listed banks have been asked to suspend their dividends by their regulator to help strengthen their balance sheets (which is turn will be used to help out companies that are suffering due to coronavirus) and with the collapse in demand for (and price of) oil compared to the beginning of the year, both BP and Shell have massively cut their dividends. Companies with a smaller capitalisation, and those with a tech bias have performed slightly better, but the market still has more questions than answers, and one of those – Brexit – hasn't even been discussed this quarter.

Sector comparison: Global, UK Equity Income, UK All Companies and UK Smaller Companies – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global, UK Equity Income, UK All Companies and UK Smaller Companies – 3 year performance



30/09/2017 – 30/09/2020 Data from FE fundinfo 2020

Europe

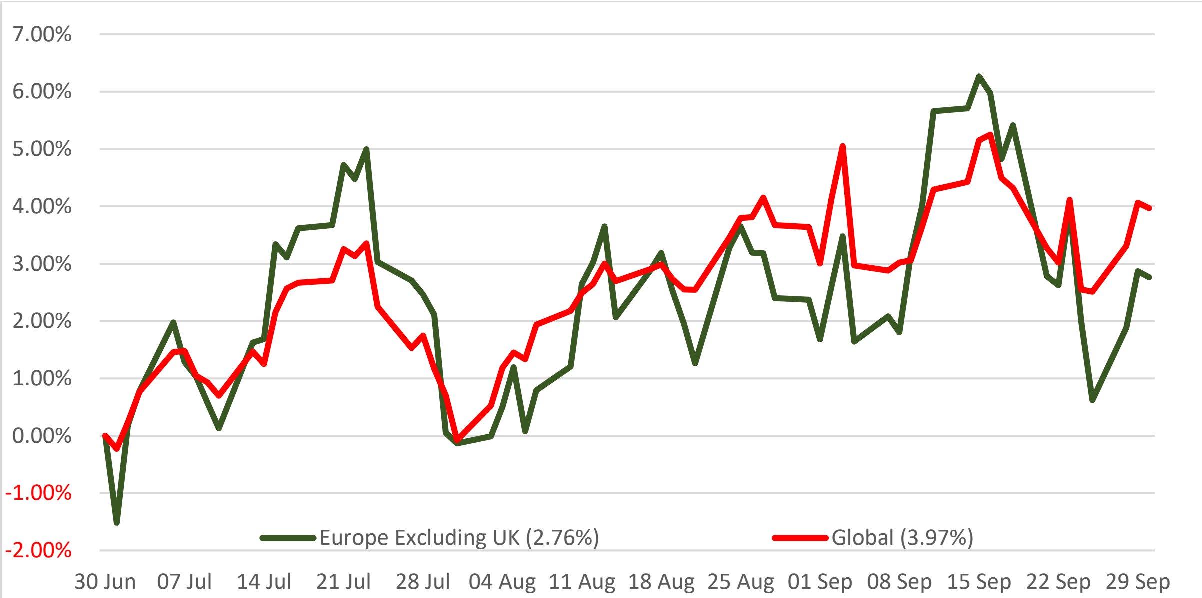
The returns for European equities were much more muted than they had been in the previous quarter as earlier optimism about the recovery from the pandemic suffered as infection rates began to rise once again. European funds fared better over the last three months from a sterling perspective, but on a dollar basis they were in negative territory and well behind global markets.

The challenges facing the region are clear, but they are similar to those in other parts of the world so the reason for the underperformance relative to other indices, specifically those in the US, is worth further mention. Based on MSCI data, America represents over 65% of the global market, up from 37% in 1995. The bulk of this increase is thanks to the growth in technology stocks and these have helped to hide the extent of the damage incurred by the virus, making other countries appear worse in comparison.

In contrast, the EU's reaction to the crisis has been more robust and despite a record-breaking GDP fall of 11.9%, this was a lot better than many other western countries. This reaction included a €750bn package agreed by European leaders with almost €400bn of this to be handed out in the form of grants with the rest to come in the form of loans to the countries and sectors most affected by the pandemic. On top of this, the European Central Bank has stuck by its guns with no change to its negative interest rate, however, they are concerned about the appreciation of the euro versus the dollar because of the impact this has on exports and how it might hold back their economic recovery.

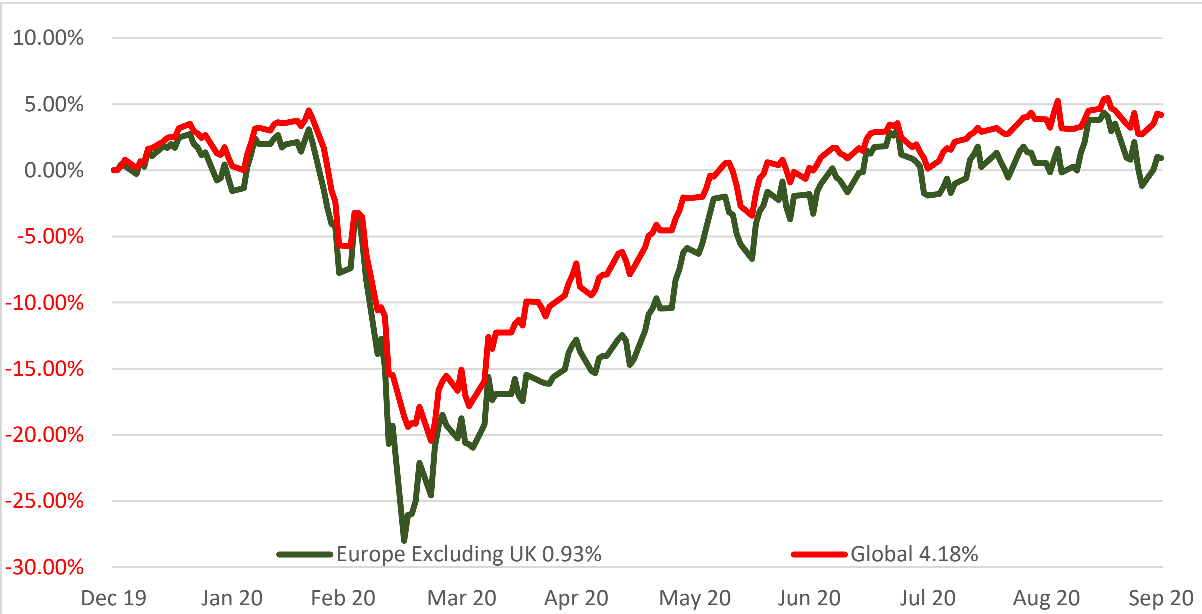
Looking forward, one of the obvious challenges for the region is the culmination of the Brexit withdrawal process. These are rapidly approaching the point of no return and the pressure is on for both sides to reach a resolution which addresses the concerns that have plagued the negotiations up to now.

Sector comparison: Global and Europe Excluding UK – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global and Europe Excluding UK – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

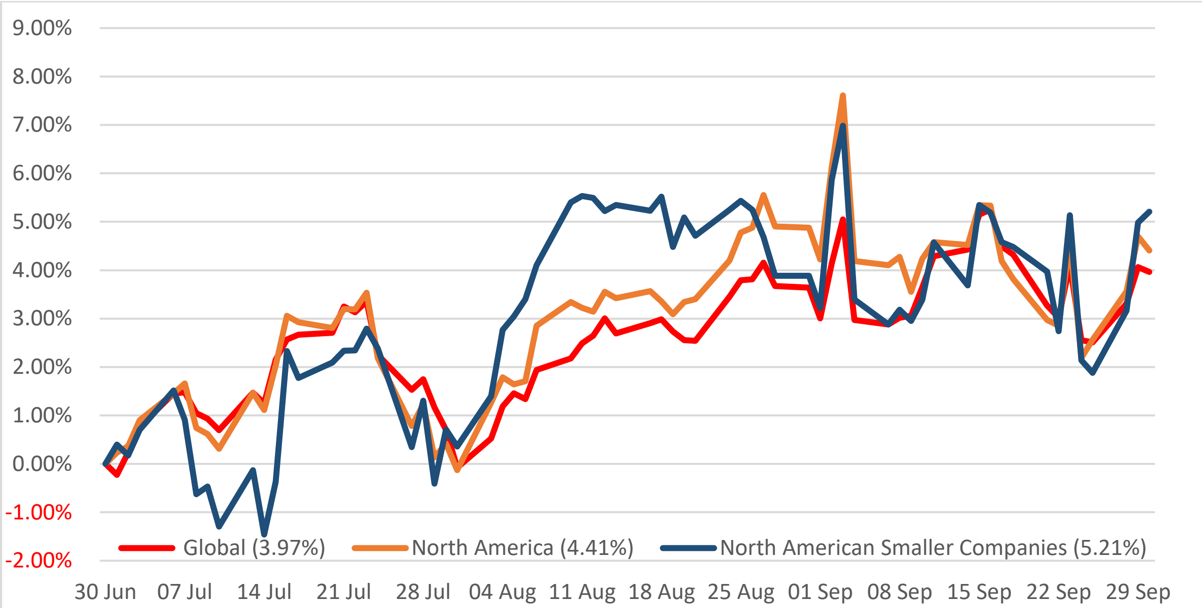
US

The US equity market continued its recovery at the start of the quarter and into August, but performance in the second half of the period was held back by rising concerns about the number of coronavirus cases and the need to agree further stimulus, as slowing retail sales and manufacturing indicate the economic recovery is running out of steam. The forthcoming election and political deadlock in Washington make that particularly challenging, with markets beginning to recognise the difficulties this will pose for the US economy. In the event of a Democrat victory, the risk of a legal challenge could lead to further delays in providing support to the economy.

The vast divergence in the performance of different parts of the US equity market make it increasingly hard to consider as a single entity. In themes that are mirrored globally, but seem particularly acute in the US, the small number of large technology names whose share prices have risen to dominate the market, have a significant bearing on the index return, while vast swathes of the market outside this exclusive club have struggled.

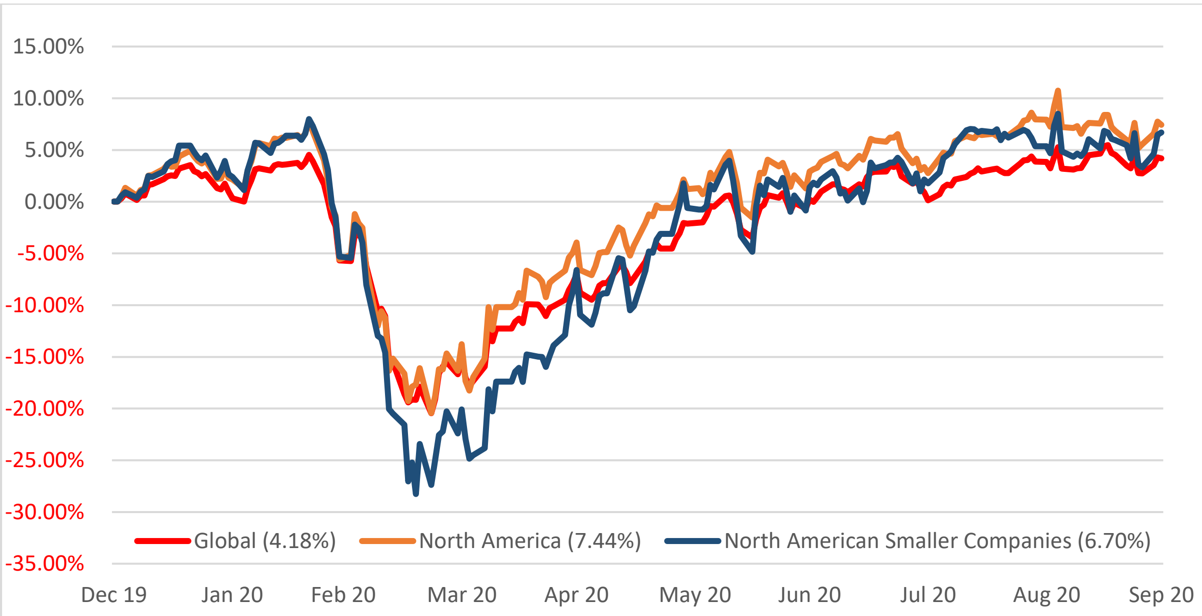
The recovery in US equities since the start of the crisis has favoured the technology companies that have been seen not just as survivors of this crisis, but as outright beneficiaries of the need to transition to online services. Their share prices reflect their highly prized characteristics and many investment managers expect them to be resilient over a difficult winter period. Conversely, the main risk that is now attached to these businesses is that positive news on vaccine development will lead investors to take a more optimistic view about economic growth and we could see some rotation into more economically sensitive businesses that are currently on depressed valuations. This outcome could lead to relative underperformance from the technology giants that have done so well.

Sector comparison: Global, North America, North American Smaller Companies – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global, North America and North American Smaller Companies – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

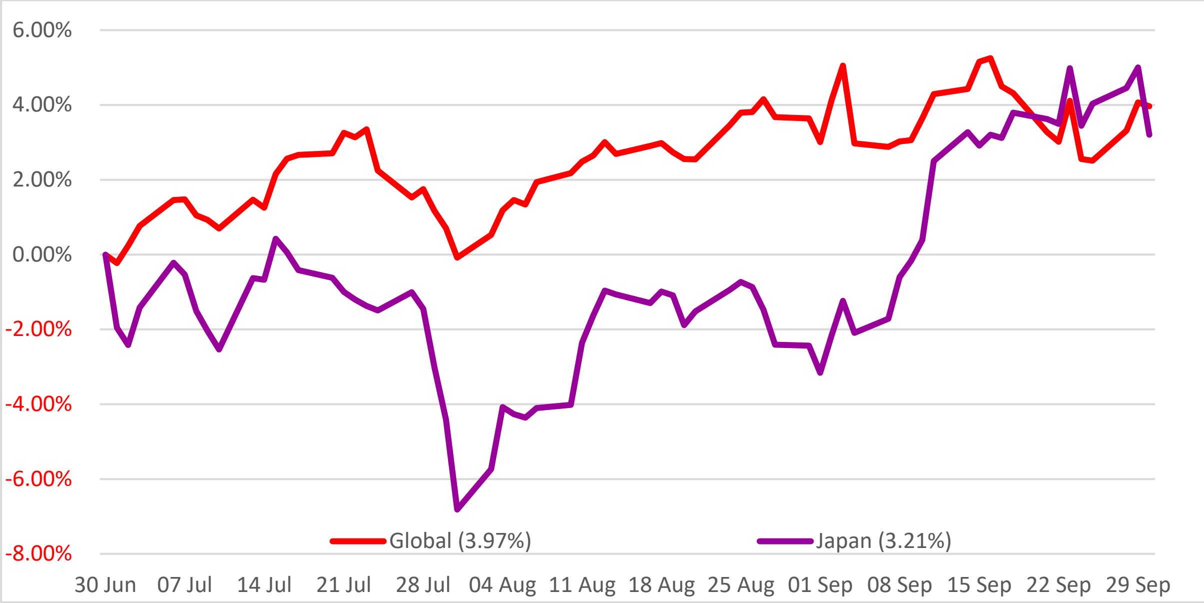
Japan

Japan’s equity market rose over the quarter, helped by optimism surrounding global growth and signs that Japan’s Covid-19 outbreak has peaked. However, the lacklustre second quarter earnings of some domestic companies dampened investor sentiment somewhat while, at the same time, there were some concerns about a notable decline in the second quarter domestic GDP data.

Meanwhile, at its Monetary Policy Meeting, as was widely expected the Bank of Japan decided to maintain the status quo in all its key monetary policies to bolster the economy, including its special corporate program (totalling 110 trillion yen) for supporting the financing of companies.

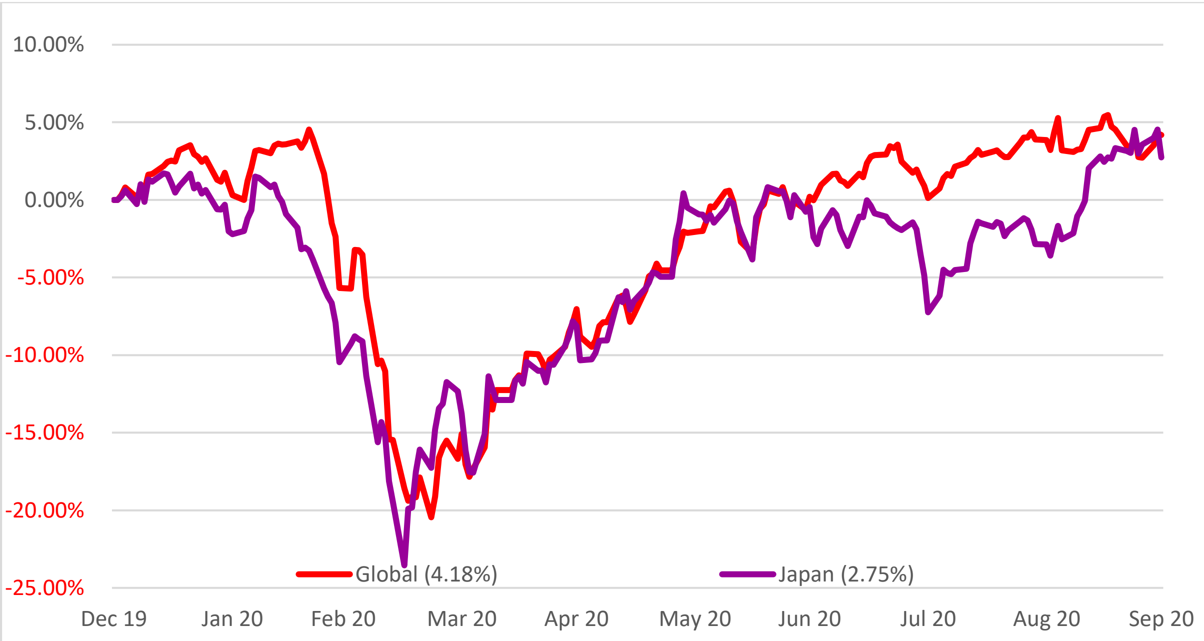
Towards the end of August, Japanese Prime Minister Shinzo Abe announced that he would resign due to a serious illness, drawing to a close a period as one of Japan’s longest serving leaders. Abe brought with him hope of marked changes when he first launched “Abenomics”, aiming to re-anchor inflation at 2%, boost potential growth and reassert Japan’s standing in Asia. This triggered uncertainty about the direction of Japan's economic policies, which have been focused on proactive fiscal measures and monetary easing. However, investor sentiment was helped during the period by expectations that existing economic policies will be maintained by Yoshihide Suga who was expected to win the leadership race within the Liberal Democratic Party. Mr. Suga duly won the election and was formally appointed as Prime Minister in September. In addition, sentiment was also boosted by the prospect of further structural reforms, given Suga’s strong track record in this area, and hopes for economic normalisation. There were also reports that restrictions on large events could be eased, and that the request for bars and restaurants in Tokyo to close early maybe withdrawn.

Sector comparison: Global and Japan – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global and Japan – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

EMERGING MARKETS

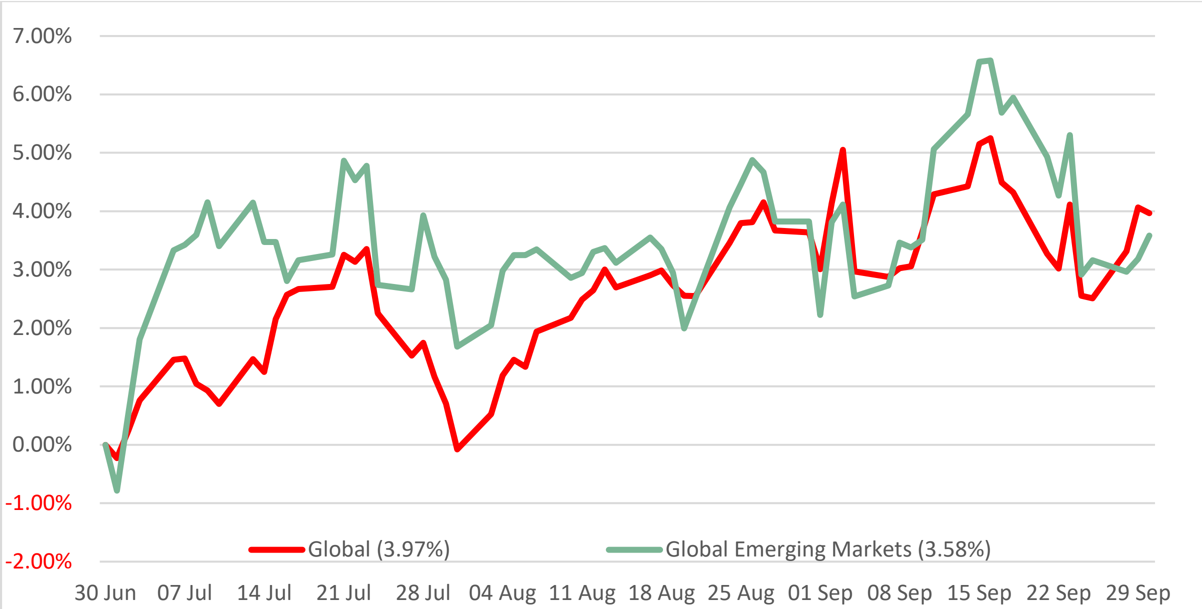
As mentioned in the last quarterly update, Emerging Markets delivered strong returns in the second quarter due to their more proactive stance on controlling the spread of the Coronavirus. With the exception of India and Indonesia, infection rates have been much more muted compared to the West. Track and Trace technology has been in place for many years and the region has greater acceptance of mask wearing and arguably better adherence to the demands of their governments.

Emerging markets were the first into this; they locked-down quicker and harder. They were also the first out of the lock-down and in many countries it is almost business as usual. Company profits have rebounded quicker, economies have recovered faster and it is not surprising that stock markets have responded either.

Although there are many Emerging Markets, and these are scattered all over the world, the largest, and most important – by some way – is China. The majority of countries considered Emerging Markets (from an investment perspective) are in Asia and tend to orbit the fortunes of the largest, but, Latin America, Eastern Europe and Africa can boast their fair share of emerging markets, although African markets are broadly considered “frontier markets”.

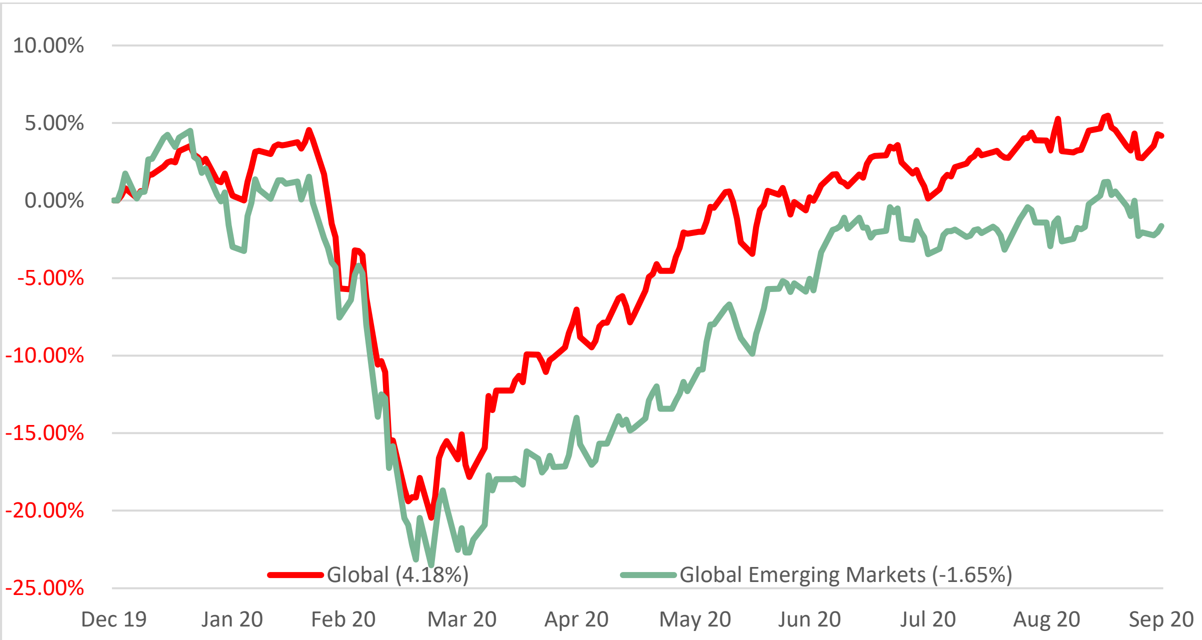
Another tailwind for the strength of the emerging markets has been a falling oil price. Although many emerging markets possess oil reserves (The Middle East, Russia, Venezuela for instance) many more do not and will gain from a fall in the oil price. Year to date, the price of oil has fallen by about 30%, and considering Chinese GDP will benefit by about 0.25% per $10 fall, and India by almost 0.50%, the upside potential is attractive too.

Sector comparison: Global and Global Emerging Markets – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global and Global Emerging Markets – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

ASIA PACIFIC/CHINA

The returns from the Asia Pacific Region have been quite strong in the third quarter, led by China, but the South Korean, Taiwanese and Indian markets are also noteworthy of their returns. Singapore and Hong Kong registered negative returns.

The Asian markets generally take their lead from China, but different markets have different nuances – one of the key drivers in Australia for instance are commodity prices and South Korea is reliant upon semi-conductors and high tech. If you seek a high dividend income, then Australia is the place to look again – not just because the economy is more mature than most others in the region, but an advantageous tax system ensures it.

Over 60% of Asian exports are traded with other countries in Asia, suggesting the region is becoming increasingly interdependent upon each other and less reliant on demand from the West and this is only likely to accelerate as the region, as a whole, has handled the Coronavirus crisis very well.

The Coronavirus isn't the first infectious disease the region has had to navigate. It has learned from the panic of previous outbreaks and has been able to act swiftly this time around. SARS affected the region in 2003 and although there were fatalities, the spread was much better contained – partly due to the fact there was less global trade and travel. Since then, improvements in technology, Track and Trace, mobile telephony, no stigma associated to wearing a face mask and so on really helped the region this time around. Because of this, the region was able to lock down quickly, isolate issues and get back to work much more quickly than other regions of the world. The West could learn a great deal from the lessons learned in the East.

China and the US continue to be locked in strong words and debate surrounding intellectual capital and it seems that this will be one of President Trump's key messages to voters in the upcoming election in November. Recent action relating to the ownership of Tik Tok and the threat to remove WeChat (owned by one of China's largest businesses – Tencent) from the app stores of Android and Apple is probably more to the detriment of the US than China, but the rhetoric and column inches looks like strong affirmative action is being made.

Chinese exports to the US are less than 1% of its Gross Domestic Product. Most of China's international trade is with the Asia Pacific Region, not the US.

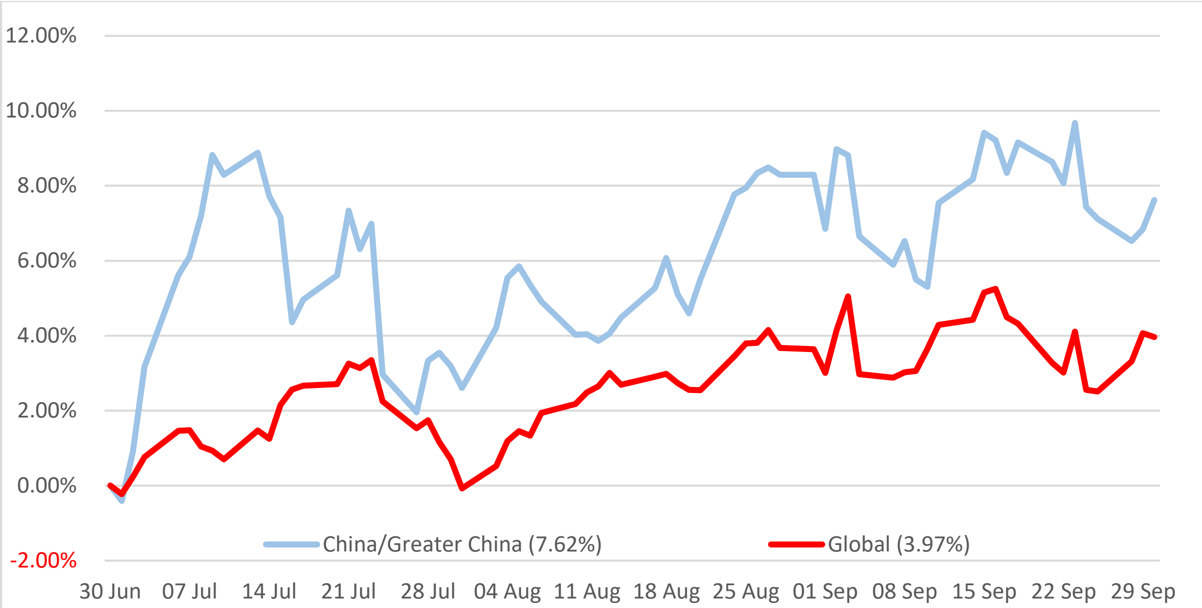
The spread of Covid-19 has been very well contained in the region since the initial pandemic, and new registered daily cases seem to be less than 20, and this has been the case for several months. Track and Trace seems to be working well and the Chinese economy seems to be returning to some degree of normality. Death rates in total are less than 5,000. Notwithstanding the fact that across the world countries are counting their infection and death numbers differently, in a country with a population of over 1 billion, this is an impressive number, especially considering the virus emanated here.

Unlike the West, China has the potential to cut interest rates to boost productivity and stimulate economic growth. Rates have not moved since May which is a sign the economy is doing well – especially when you consider the Bank of England has "had internal conversations" about operating with negative interest rates.

The main Chinese stock markets have witnessed strong returns in the third quarter of the year, registering returns in/around double digits. The economy has bounced back strongly, oil prices have retreated, the weaker US Dollar has been a benefit and the "new economy" stocks have continued to power ahead.

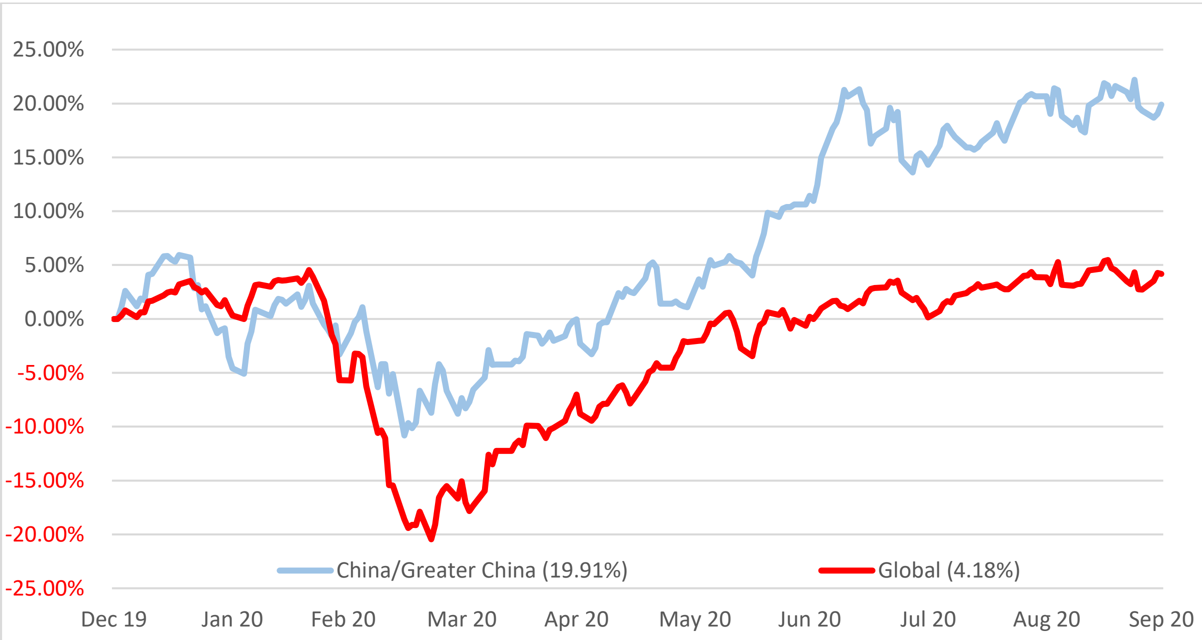
To highlight the confidence in the country at the moment, Ant Group (formerly Ant Financial) – a market leader in the fintech space is reportedly looking for an IPO – making its shares available to the public for the first time. This innovative company (which was only founded in 2014) has 700m monthly average users and boasts the largest money market fund in the world. It also owns Alipay – the largest online and mobile payments platform in the world. When its shares list, the company is likely to have a market capitalisation of between $150bn and $200bn.

Sector comparison: Global and China/Greater China – 3 month performance



30/06/2020 – 30/09/2020 Data from FE fundinfo 2020

Sector comparison: Global and China/Greater China – YTD performance



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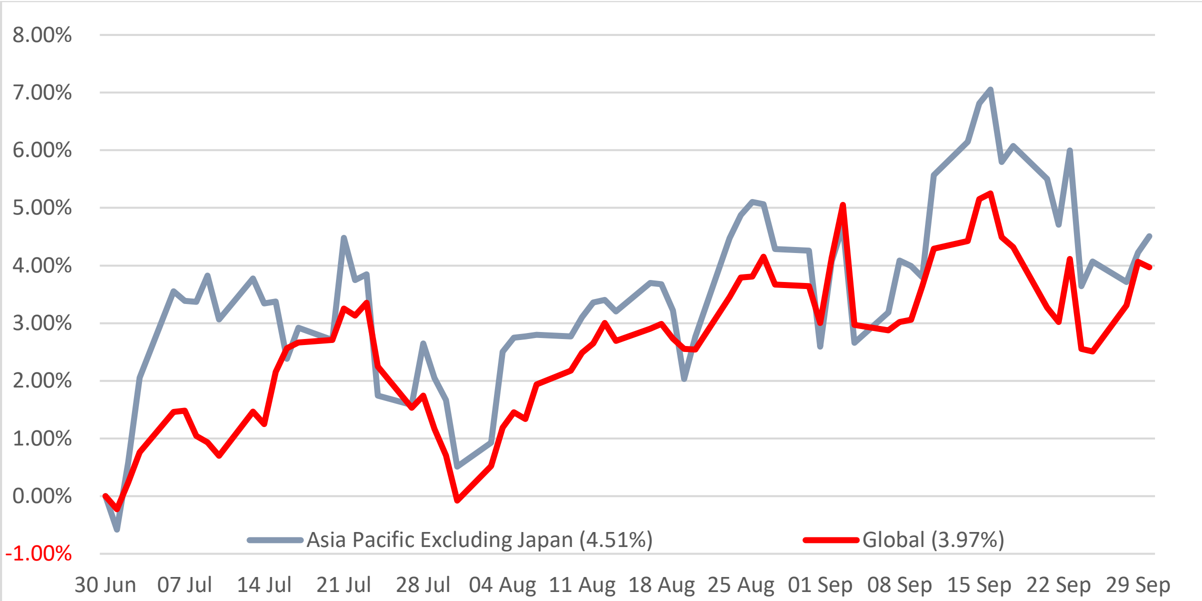
Sector comparison: Global and Asia Pacific Excluding Japan – 3 month performance



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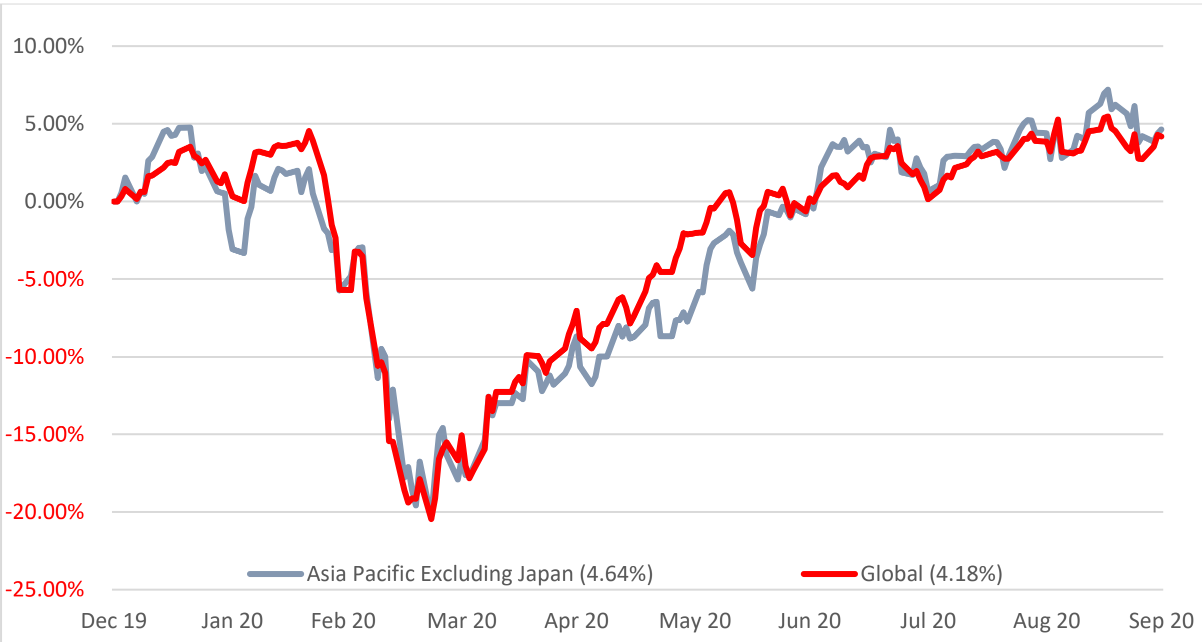
Sector comparison: Global and Asia Pacific Excluding Japan – YTD performance



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COMMODITIES

Demand continues to disappoint in oil markets, with prices slipping under $40 per barrel at the end of the quarter. Temporary supply cuts agreed by Opec had helped to bring the oil market into balance and stabilise prices in the $40-$45 range, but as Coronavirus cases have seen a recent increase in many countries, demand for oil has continued to be weak. Oil supply had been due to begin slowly increasing, but Opec may now need to reconsider its plans to support an oil price that fell below $20 in the depths of the Coronavirus shock.

Demand for oil is running at 5-8 million barrels per day below pre-Covid levels, reflecting the severity of the economic contraction, the impact of lockdowns on demand for fuel, compounded by a surfeit of plane fuel which has been repurposed for haulage vehicles.

In precious metals, the strong demand for gold continued pushing the gold price over the $2000 per ounce threshold in August, as concerns about the cost of the economic response to the Coronavirus crisis fuelled flows into gold ETFs. Later in the quarter as the US dollar strengthened, gold prices fell back, as precious metal prices tend to move in the opposite direction to the dollar.

ALTERNATIVE STRATEGIES

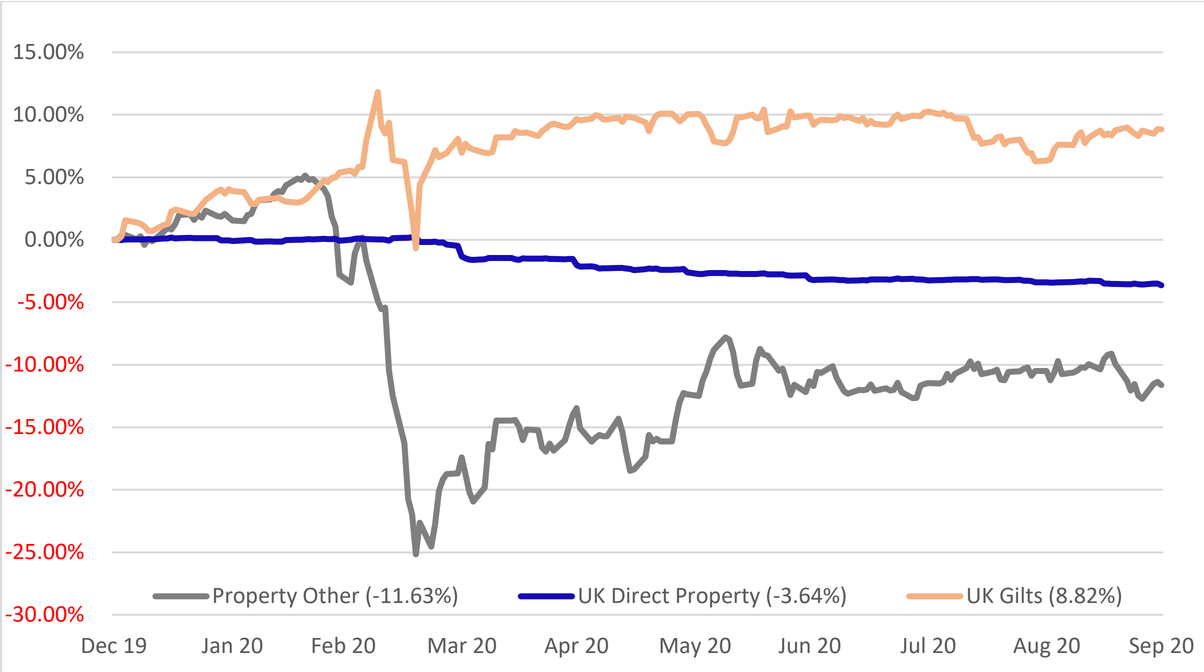
UK Direct Property

The last three months has seen activity in the property markets starting to pick up again from the extremely low levels seen during Q2. With children returning to schools in August and September, employers being more assertive about staff returning to the office and the opening of the retail and leisure sectors it is likely to drive growth again. Transaction volumes remain extremely limited. The industrial sector is the most active but whilst uncertainty surrounds occupational demand for office, retail and leisure we can expect transactional volumes to be well below historic trends. We also expect to see this trend continue as the economy emerges from lockdown although there are near term risks as the furlough scheme ends and the infection rate rises as well as Brexit.

The property market has been incredibly volatile since the disruption caused by the global outbreak of Coronavirus. It became almost impossible to value properties and transaction data almost dried up, so a rule known as 'Material Uncertainty' was instigated which caused most property funds to suspend an investor's ability to either invest or disinvest respectively.

Despite the lack of market activity, September was an interesting month from a news flow perspective as valuers have agreed to lift the Material Uncertainty Clauses from valuations issued after 9 September 2020. This will allow funds to re-open and to start trading again, although due to the uncertain outlook it will be some time before the market fully opens again as most managers are likely to increase their liquidity positions before reopening.

Sector comparison: Property Other, UK Gilts and UK Direct Property – YTD performance



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Cash / Money Markets

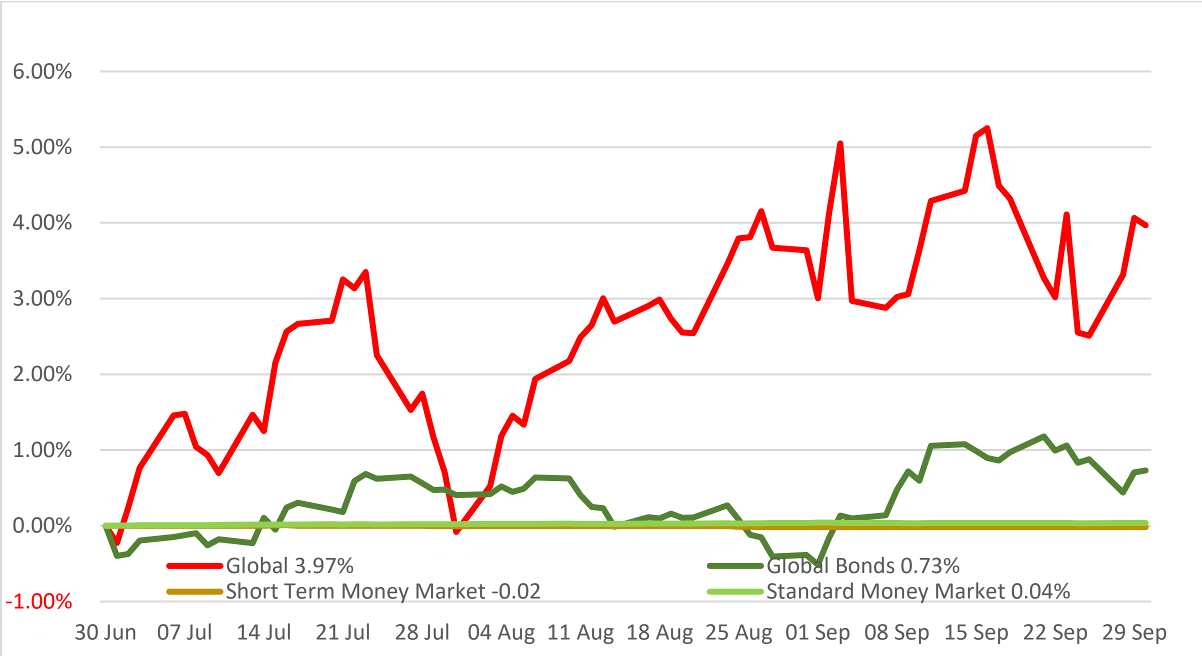
The cash markets are somewhat constrained at the moment. The Central Banks of the World (e.g. the Bank of England (BoE), the Federal Reserve (Fed), Bank of Japan (BoJ), European Central Bank (ECB)) generally use interest rates to help control the pace of economic activity. If economies are growing, interest rates generally also rise to stem demand. The global shutdown of economies in Q1 and Q2 of this year, accompanied by cuts in interest rates basically mean there are no opportunities left.

The ECB has been operating with negative interest rates for quite some time. In essence, if you place money on deposit, and withdraw it twelve months later for instance you are guaranteed to have less money. The BoE have been discussing the use of negative interest rates and in September the Fed intimated that interest rates will not rise in the US until the end of 2023.

Central Banks use interest rate policy also to stave off inflation. The effects of Coronavirus have seen inflation collapse too, so there are very little tools available for Central Banks to stimulate growth. The baton has in essence been passed to governments to stimulate their respective economies by using fiscal policies (by providing tax breaks for instance – as witnessed in the UK with the stamp duty changes which should create demand for individuals to move house).

Low interest rates should spur spending as there is no benefit for having cash on deposit. Spending should spur growth, growth should infer inflation and inflation should suggest rising interest rates. Unfortunately supply, demand, confidence and sentiment are not “normal” at the moment. Interest rates being close to zero in the UK and US and negative in Europe and Japan suggest we are probably some way from “normal.”

Sector comparison: Global, Short Term Money Market, Global Bonds and Standard Money Market – 3 month performance



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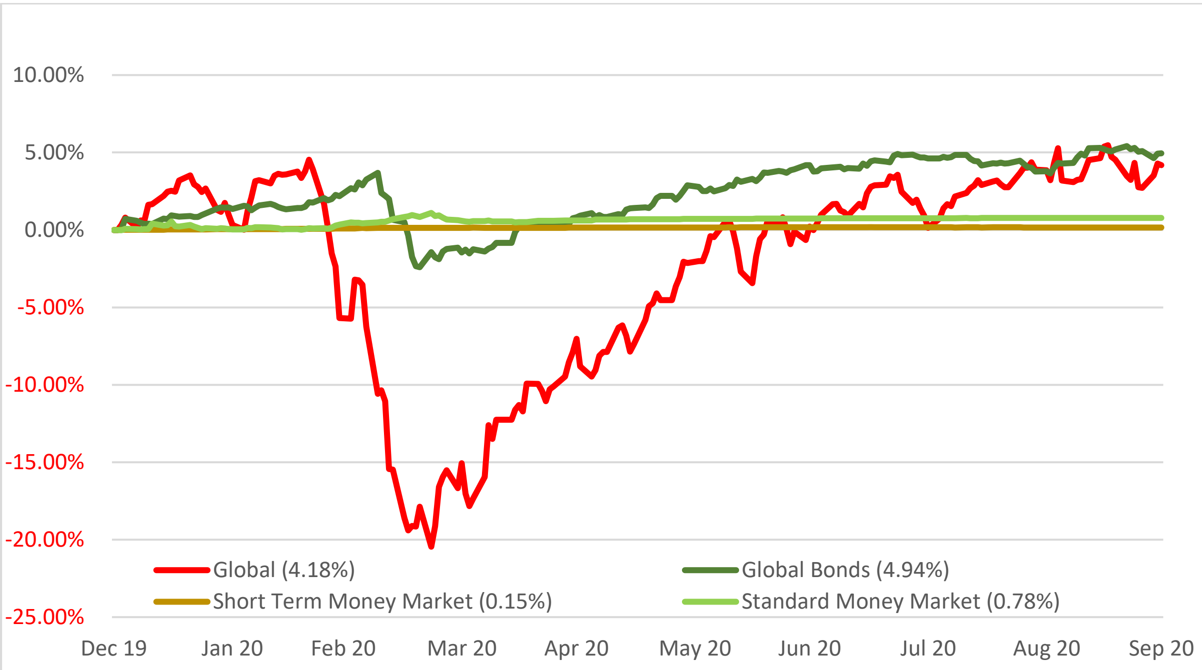
Sector comparison: Global, Short Term Money Market, Global Bonds and Standard Money Market – YTD performance



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Infrastructure

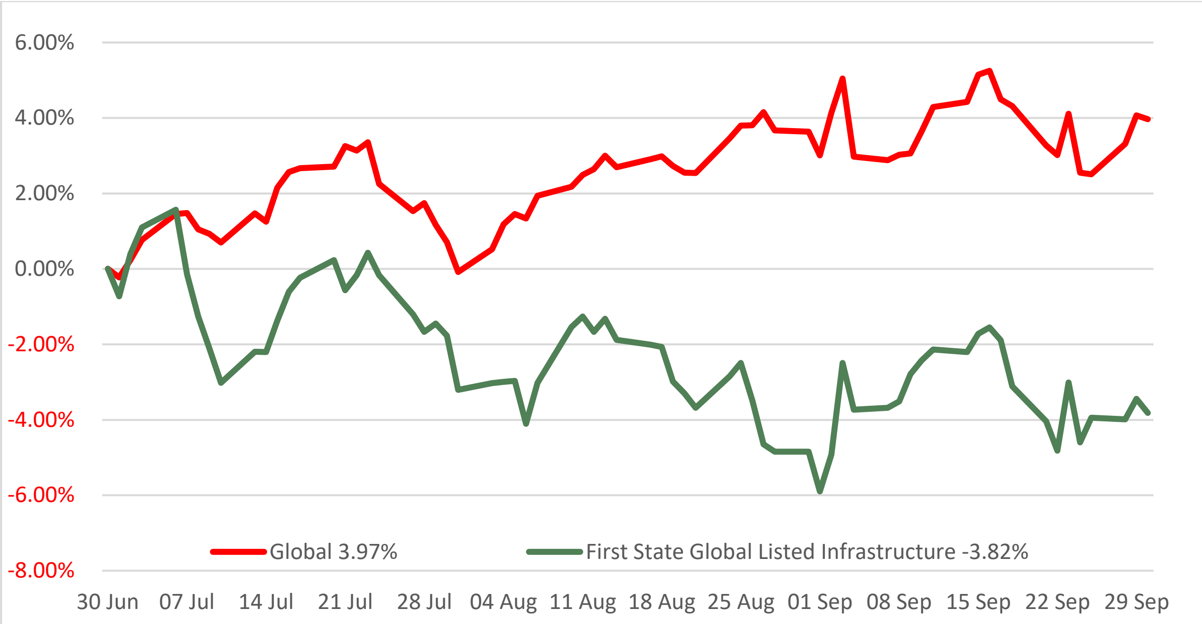
Infrastructure equities were left behind over the quarter, underperforming the wider global equity markets, which itself has been driven upwards by a small number of increasingly dominant US technology stocks.

Investment in this sector is typically made either directly or indirectly into a broad range of global companies involved in the ownership and operation of infrastructure assets, including, for example, electricity, water, gas, telecommunications, airports, roads, railways, seaports and social infrastructure assets. The pandemic and subsequent lockdowns look to have accelerated existing trends such as remote working, videoconferencing, online shopping and social networking, all of which require reliable, robust high speed fixed and mobile data networks. If electric vehicle penetration is to rise this would require a largescale build-out of EV charging infrastructure across urban areas in developed markets, and this in turn would require significant investments in existing electricity transmission and distribution grids, owned by the regulated utilities. Regulated utilities continue to have a strong income profile while continued growth in renewable generation is seen as a major positive, enhancing the valuation of existing assets and providing wide-ranging growth opportunities.

On the other side of the infrastructure story the use of airports and railways have fallen dramatically this year, although we are starting to see them pick up again from the extremely low levels seen during Q2 as travel restrictions have begun to be lifted and some commuters have returned to work.

With lower-for-longer bond yields and with many traditional sources of income challenged by recent equity market conditions and by the impact of the pandemic, listed infrastructure continues to play a part in providing investors with stable, sustainable and growing income over the next years and decades.

Sector comparison: Infrastructure Index Proxy and Global – 3 month performance



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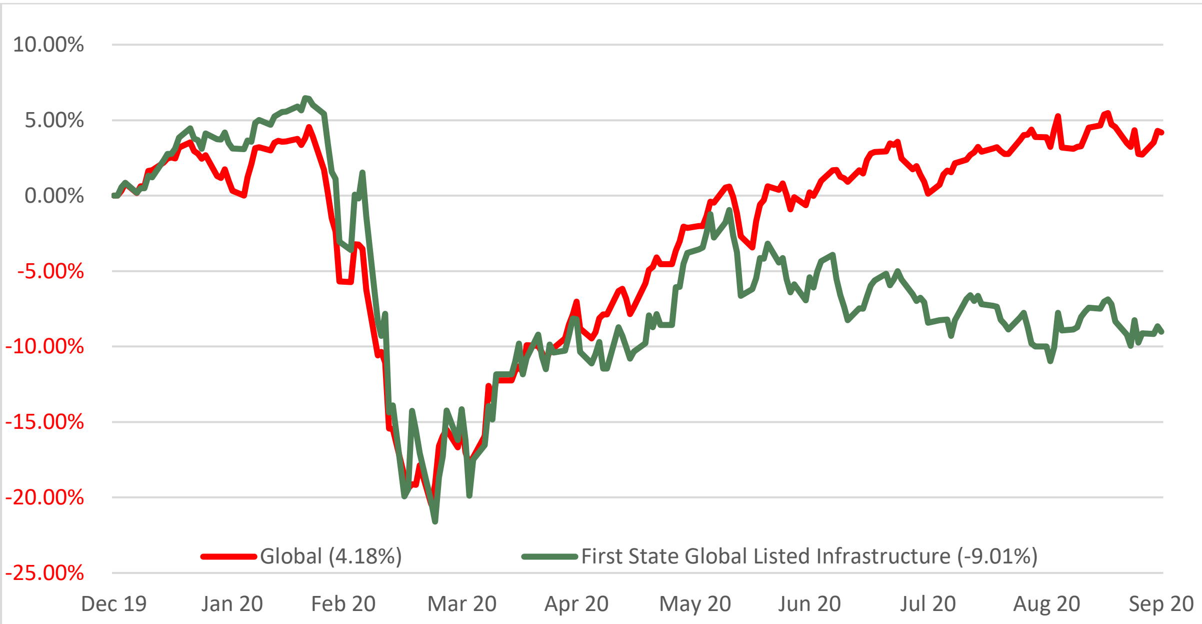
Sector comparison: Infrastructure Index Proxy and Global – YTD performance

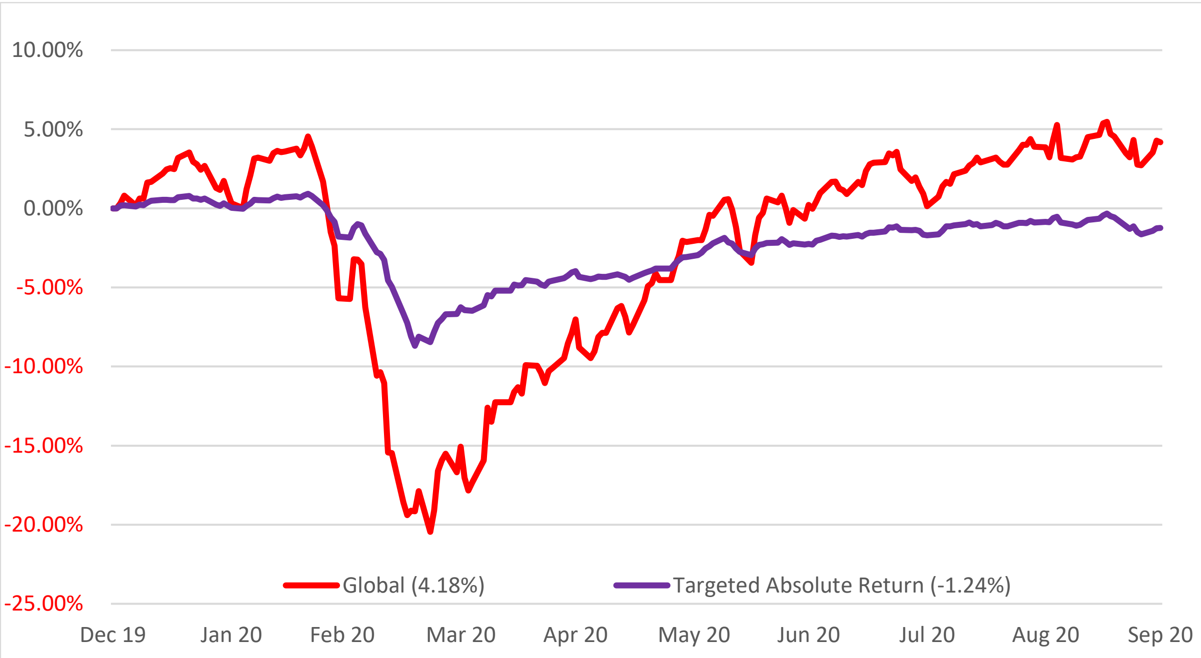


31/12/2019 – 30/09/2020 Data from FE fundinfo 2020

Targeted Total Return

The sector is inherently difficult to analyse given the diverse nature of its constituents, ranging from largely equity based approaches to those employing a wide array of derivative strategies which are designed to leverage the price of assets without necessarily investing in them directly. Returns over the quarter were broadly flat but there was a large disparity between the top and bottom of the index, helped by the fluctuations in global currencies. The volatility of the sector remains much lower than global equities which is important because these funds are often used to increase diversification and reduce the overall risk of our portfolios.

Sector comparison: Global and Targeted Absolute Return – YTD performance



31/12/2019 – 30/09/2020 Data from FE fundinfo 2020