IMS Capital

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Quarterly Summary
October 2020

We ended our previous review with a hopeful note that as we entered the second half of the year we might be able to enjoy an increase in freedoms, along with a greater understanding of the economic scale of the Coronavirus pandemic. Well, on those fronts we can probably say that our hopes were not dashed, however it would be difficult to claim that the outlook is quite as positive as it was three months ago.

During August many of us were able to partake in the "eat out to help out" (EOTHO) scheme which was launched by the chancellor alongside a 15% cut in VAT to support struggling pubs and restaurants during their traditionally quieter periods, allowing them to protect the jobs of their workers. Treasury figures suggest that some 100 million meals were claimed under the scheme, but it was not without its critics. Among the reservations were that it encouraged unhealthy eating when dietary health was known to be a factor in a person's susceptibility to the virus. Additionally, despite costing around £500m, the discount was understood to have disproportionately benefited those people who were already least affected by the economic impacts of the virus.

This takes us neatly onto the second point: what do we now know about the damage wrought by the virus so far? Possibly the most obvious impact has been to our GDP, the main measure of the country's economic strength. The first estimate of the UK's GDP between April and June was -20.4% which unsurprisingly is the largest fall since comparable records began in 1955, It was also one of the worst drops within the top 20 economies in the world. Indications are that the support provided by EOTHO, combined with the furlough scheme, which saw the salaries of millions of workers paid for by the government, have helped to return the country to growth in July, but at a substantial cost.

The latest figures for UK government borrowing showed that an additional £35.9bn of debt was taken on in August according to the Office for National Statistics. This is the third record monthly borrowing figure in a row and with £173.7bn borrowed for the year so far, this is more than we borrowed in the whole of 2008 at the height of the global financial crisis. The government's own budget forecasters, the Office for Budget Responsibility (OBR), have predicted that at current rates, the level of borrowing this year could equal almost 19% of GDP by the end of the year, a figure last seen during WWII. The Treasury has committed to spending in the region of £200bn to deal with the economic cost of the pandemic, but Rishi Sunak's reluctance to extend the full furlough scheme past October indicates how nervous he is about runaway borrowing.

Shortly before the end of the quarter, Sunak did announce a new job support scheme, but he was clear that the assistance would only save "viable" jobs and that the number of people out of work would inevitably rise. The clear message was that we should focus on growth now by borrowing what we need, and deal with the consequences later. The challenge for the chancellor and his colleagues is that, as restrictions start to be reimposed, they will rapidly be approaching a point where their generosity is tested.

If markets are worried about what impact Coronavirus might continue to have, they are also paying a great deal of attention to the US election at the start of November. The battle between Donald Trump and his Democratic challenger, Joe Biden, is already one of the most hostile in recent memory (as illustrated by the first debate between the pair) and there are fears that with an estimated one million people having chosen their candidate by post already, the initial tally based on in-person voting might not represent the final outcome. There could be a tense period of uncertainty before we find out who gets to take the helm of the world's largest economy, possibly involving the Supreme Court, which is itself currently a source of considerable discord.

The one thing about which we know we will have a resolution by the end of the year is the outcome of the UK's negotiations with the EU. Although the transition period does not officially end until 31 December, most parties agree that if we reach the end of October without an agreement it is unlikely that there will be time to resolve matters. It is difficult to find a consensus view about what the eventual result will be; the Irish Taoiseach believes that "no deal" is inevitable, while others expect that a deal of some sort will be scrapped together. Whatever the outcome, the UK is heading into uncharted waters at a time of considerable national and international unease, with huge amounts of debt, and unemployment that could peak at 13% according to the latest estimate from the OBR.

Above all else, markets loathe uncertainty and with Brexit, the US election, and Coronavirus, they face that in spades. But as they showed this year, they can rally quickly when the conditions turn. We cannot predict what will happen and nor should we try to; pinning our hopes on a particular outcome leaves us exposed if we make the wrong call. As ever, our responsibility as investors is to look past these concerns and build well diversified portfolios that focus on our long-term aims.

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Performance summary

Markets continued to perform well over the quarter, but with a fairly high degree of volatility throughout the period. Concerns about the rise in Coronavirus infections were responsible for a large part of the fluctuations with the ongoing Brexit negotiations, and their corresponding effect on sterling, also contributing. Given the relatively defensive positioning of the portfolios it was good to see the majority of them perform positively over the quarter. There was some underperformance relative to benchmarks on the 3-month view, but most of the portfolios remain positive on a relative basis over 12 months.

With regards to income, the yield on the portfolios has continued to fall as a result of companies which have cut or cancelled their dividends. Speaking with our fund managers it appears that this trend is beginning to turn with firms beginning to pay "catch up" dividends where they took a safety first approach earlier in the year. However, with central banks appearing set on ultra-low interest rates for at least the next few years, bond yields are likely to remain low for some time.

Portfolio	3 month performance	12 month performance	36 month performance	60 month performance	12 month historical yield %
Defensive Income	-0.07	-0.22	7.63	24.65	2.82
Benchmark	0.91	0.02	6.05	20.08	n/a
High Income	0.17	-1.66	6.10	34.86	3.35
Benchmark	1.60	-1.04	6.89	30.31	n/a
Cautious	0.57	-0.61	9.41	33.20	2.26
Benchmark	1.21	-1.80	4.63	23.75	n/a
Balanced	1.77	0.25	10.78	44.27	2.04
Benchmark	1.99	-0.28	9.17	37.16	n/a
Growth	2.75	1.33	12.73	55.81	1.72
Benchmark	2.53	0.80	9.82	39.89	n/a
Ethical	3.49	8.44	23.92	55.37	1.32
Benchmark	1.99	-0.28	9.17	37.16	n/a

All data are to 30/09/2020. Source: Financial Express Analytics

Portfolio changes

When assessing the portfolios at this review we continued our previous theme of caution, not wanting to make any instinctive changes based on what continues to be a very unusual period. We have talked before about our efforts to increase diversification within the portfolios and this has served us well and we have again focused on ensuring that the managers we work with are driven by a passion for their style of investing, even where that approach may not currently be in favour.

There is one main change this quarter which is that we are removing our allocation to the property sector entirely. This is a change which we have been considering for a great deal of time as the sector is a staple within investment portfolios. We have held it since IMS launched over 10 years ago. The Threadneedle fund which we use was suspended along with all other traditional property funds in March and it became the first retail fund to reopen late in the quarter. However, we are not selling our holding specifically because of this latest suspension as we knew that this was something that could happen. Instead, we are concerned about the impact of the regulator's consultation into the sector. As a firm we are contributing to this consultation, but it is possible that significant changes will be imposed which will impact on our ability to invest in the sector in the future.

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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