Award Winning Wealth Managers

Whitechurch Securities Ltd
WEALTH MANAGERS

Whitechurch Asset Views

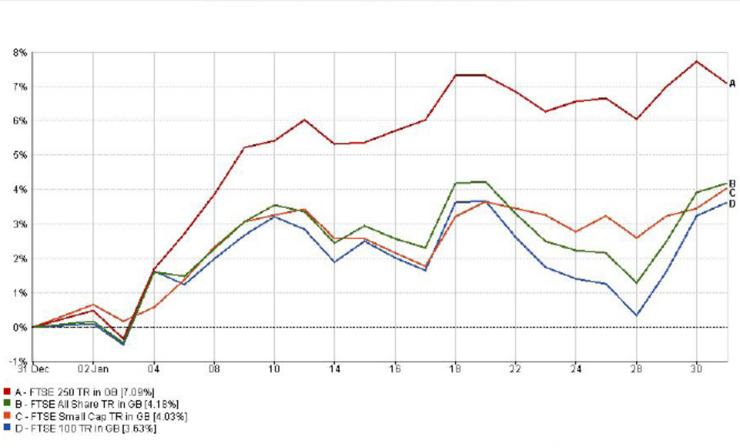
Strategic Overview - February 2019

Welcome to the Whitechurch monthly investment review. This round up covers the key factors that have influenced investment markets, over the past month, and a summary of the Whitechurch Investment Team's current views and broad strategies being employed.

Two significant shifts have helped risk assets over the course of January. First, the US Fed's move to a more dovish stance regarding its rate guidance has helped to ease the market's fears about rates getting too tight at a time when the pace of global growth looks to be slowing. Second, the rhetoric from the US administration towards China also softened somewhat. The trade tensions have hurt China and Europe and now look to be biting in the US. Any deal would be a welcome relief for markets, but the US and China are still some way from striking a deal, so risks still remain.

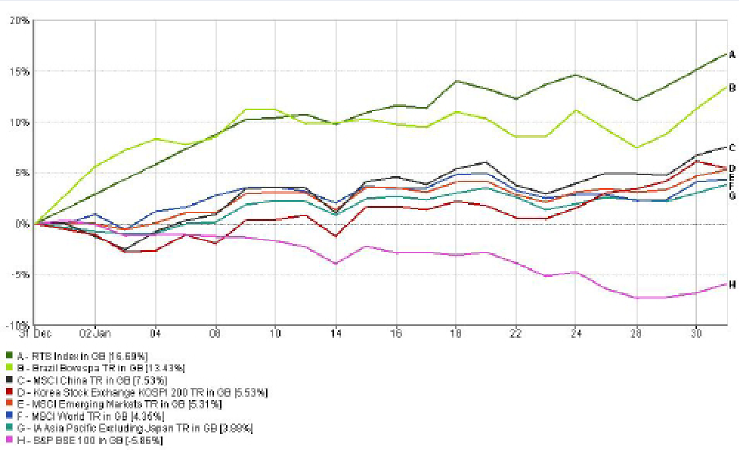
UK Equities

A diminishing view of a no deal Brexit helped support UK domestic stocks with the FTSE 250 being the best performing index.



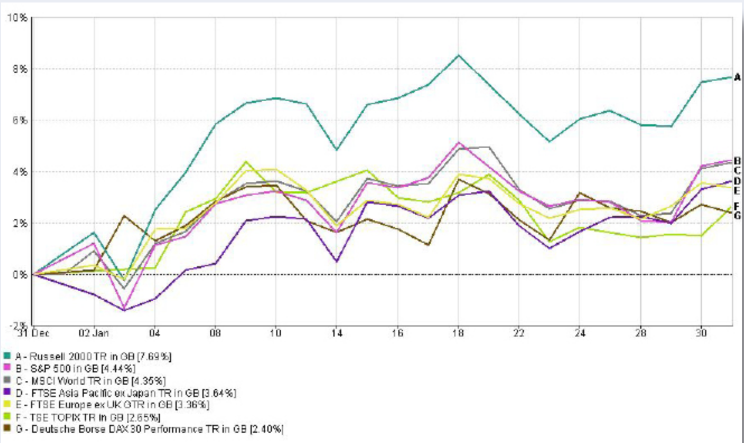
Emerging Market Equities

Russian Equities lead the charge for Emerging Market Indices, supported by rising oil prices and the lifting of sanctions on Rusal, one of the largest oil compaines in Russia.



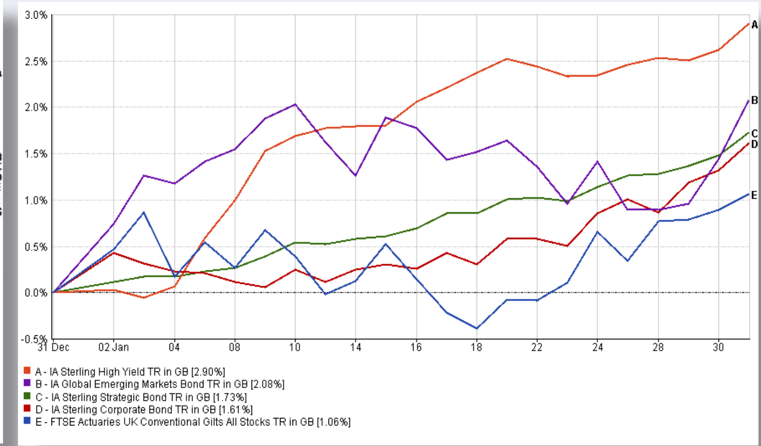
Developed Market Equities

In a complete reversal from December, US small caps (Russell 2000) were the best performer in the developed market space.



Fixed Interest

With strength in Equities, Fixed interest achieved modest performance in comparison, with Sterling High Yield and Emerging Market bonds being the best performers in January.



Source of graphs: Date from FE 2019 - 31/12/2018 to 31/01/2019

On the following pages we provide a detailed review of how stockmarkets and other asset classes have been performing, and touch on the markets and touch on how we are positioning our portfolios.

UK Equities

The UK economy expanded at its slowest annual rate in six years in 2018, after a sharp contraction in December. Growth in 2018 was 1.4%, down from 1.8% in 2017 and the slowest rate since 2012, according to the Office for National Statistics. Falls in factory output and car production were the main reasons for the slowdown.

The UK Manufacturing PMI fell to 52.8 in January as figures showed the sector was stockpiling raw materials at a record pace due to Brexit concerns. The PMI stock of purchases index rose to 56.3 in January up from 48 in the same month last year and the highest level since records began in 1992. Concerns of a hard Brexit are leading companies to stockpile goods that would usually be shipped through Eurozone territories.

Despite the negative data releases and Brexit uncertainty, there were healthy increases across all UK indices during January. Parliament voted against Theresa May's deal by a significant margin and negotiations are still ongoing. Despite this, an increasing view that a majority of MPs want to avoid a no deal scenario, provided a boost to UK equities, leading the main indices higher.

The domestically focused FTSE250 was the stand out performer, increasing 7.09%, with the FTSE All Share gaining 4.18%. The more globally diverse FTSE100 rose by 3.63% over the month. The FTSE100 lagged due to a significant strengthening of sterling in January on the diminishing view of a no deal Brexit. The movement in the FTSE250 perhaps illustrates that as we move closer to understanding the likely outcome of Brexit, the undervaluation in UK domestic stocks is likely to decrease, providing some long overdue recovery to our UK equity positioning.

The best performing sectors in the UK were Food and Drug retailers gaining 16.07% following solid numbers from Tesco, Morrisons and Sainsburys. General Retailers continued to plough forward aided by strong figures from JD Sports. The worst performing sectors in January were mobile telecommunications and healthcare. Vodafone released a weak set of results that unsettled the sector. Healthcare was affected by weakness in Astrazeneca that was pulled down by a strengthening sterling.

As we move closer to the leave date (29th March), there will likely be bouts of volatility that will positively and negatively affect different areas of the UK equity space. Our positioning in the UK will remain consistent until we see firm guidance. A combination of global overseas earners and UK domestic businesses will remain in place to help manage some of the anticipated currency volatility in the near term.

US Equities

US Equities enjoyed some recovery following a torrid final quarter in 2018. There were uplifts across all the main indexes. The S&P 500 returned 4.44% for sterling investors as buyers picked up stocks during the Q4 earnings season. With around 40% of companies having reported their fourth-quarter earnings (at the time of writing), earnings-per-share growth is 15% year on year so far.

The best performing index was the small cap focused Russell 2000, a reversal from last month, where US small caps were hit the hardest in December's rout. The index returned 7.69% for sterling investors.

Signs are however, starting to show the impact of trade tensions with China on the US economy. The December ISM manufacturing survey fell significantly to 54.1—the largest monthly decline since 2008. A fall in the new orders was the main component for the poor reading. However, equity markets have been buoyed by the truce between the US and China, which is set to be active until at least 1 March.

The US government entered the year partially closed. A funding battle over border security led to the 35-day government shutdown, which was the longest in history. The January jobs report may be affected by the government shutdown, but the December jobs report (released in January) was quite strong. 312,000 non-farm jobs were added to the US economy and wage growth inched up to 3.3% year on year.

While the next few jobs reports will continue to be watched by the Federal Reserve for signs of higher wage growth, the US central bank has signalled that it is in less of a rush to tighten this year. The lower oil price, despite recent gains, meant that the latest headline inflation reading for December fell to 1.9% year on year. This means there will be less pressure on the Fed to raise rates in order to control inflation.

The Whitechurch investment team took advantage of the December declines to address our underweight position in the US by adding L&G US Index to our US equity basket. We have already seen an uplift of 5.4% over the course of January and anticipate seeing the benefit of this increased weighting as we move through Q1 2019.

European Equities

Europe has also been caught in the crossfire of the trade war and has been hurt by the fall in demand from China. The manufacturing new export orders component of the Purchasing Managers' Index (PMI), for the eurozone, remained below 50. In France, the flash composite PMI fell further to 47.9, despite a slowing in the momentum of the "Yellow Vest" protests that have caused significant violence and disruption to the country.

Elsewhere in Europe, the Italian government's budget proposals were approved by the government and the Italian president. While the two main features of these proposals—the citizens' income and pension reform—are unlikely to be beneficial to fiscal sustainability in the longer term, the near-term risks appear to have eased.

Despite the minor improvement in some of the political uncertainties, concerns over the persistence of slowing growth in the eurozone were still prevalent. The European Central Bank (ECB) made reference to the unexpected nature of the persistence of the factors that have contributed to the slowdown in growth. The ECB also said the risks surrounding the euro area growth outlook have moved to the downside.

One positive for Europe was that the unemployment rate for November fell to 7.9%. The lower oil price and the continued improvement in the labour market should help to support the Eurozone but risks need to be monitored closely.

The Whitechurch position in Europe was reduced in December to take advantage of declines in US equities, which was pleasing, given the underperformance of European equities in January.

Japanese Equities

Alongside other developed markets, Japanese equities enjoyed a positive performance in January, albeit to a lesser extent when compared to other developed markets. The TSE TOPIX returned 2.43% for sterling investors leaving Japan at the bottom of the leader board for performance.

The Bank of Japan left its key short-term interest rate unchanged at -0.1 percent, at its January meeting and kept the target for the 10-year government bond yield at around zero percent. At the same time, the central bank lowered its inflation forecast for 2019 to average 1.1%, from an earlier projection of 1.6%, mainly due to a decline in crude oil prices and worries over the global economic outlook.

After a volatile second half of 2018, with economic growth significantly disrupted by a series of natural disasters in the third quarter, the auto industry was relieved to see the market start 2019 on a positive note. Volume was driven higher last month by a 9.3% rise in truck sales. Passenger car sales struggled to make progress however, with a rise of just 0.8% to 342,477 units.

Our position in Japanese equities was slightly reduced in December and re deployed across the US and China but our view is that some exposure to the stability of Japan should be maintained as global risks are still increasing.

Asia Pacific & Emerging Market Equities

In China, real GDP for the fourth quarter was announced at 6.4% year on year - dipping below the 6.5% mark for the first time. In the face of rising uncertainty emanating from the domestic slowdown, as well as the trade tensions with the US, the Chinese authorities announced a stimulus package to inject into the economy.

The People's Bank of China (POBC) said it would cut its Reserve Requirement Ratio by 100 basis points throughout January, injecting roughly RMB 800 billion into the Chinese economy – equivalent to roughly 0.8% of Chinese nominal GDP. Further easing from the PBOC is expected throughout 2019 to help support the domestic economy.

Despite the recent slowdown in GDP growth, both retail sales and industrial production beat expectations in the recent data releases. There was also further proof that infrastructure spending was continuing to pick up, which should also help provide some targeted stimulus to the economy. The MSCI EM index rose by 7.2% over the month.

Our positioning into Fidelity Special Situations in December gave additional exposure to the recovery in Chinese Indexes. Given the 30% decline in 2018, despite risks, Chinese equities still look attractive on valuations alone. The increasing government stimulus should be supportive to further upside.

Russian Indexes continued to set record highs throughout January and the RTS was the best performing index globally in January, returning 16.9% for UK investors. The oil price recovery was the main contributor for upside. The lifting of US sanctions against the Rusal oil company also improved sentiment in the region, attracting buying activity.

Brazil continued its solid performance following the election of Bolsonaro. February's congressional elections are likely to see the pro-reform speaker of the lower House re-elected. This should facilitate progress in structural reforms, especially in the social security system. Such an outcome would be market friendly and trigger inflows into Brazilian assets, supporting the BRL and setting the stage for its outperformance vs emerging market peer currencies.

Brazil is going through some historic shifts since voters elected Jair Bolsonaro to lead Latin America's biggest country for the next four years. After choosing to turn the page on years of recession and corruption scandals, hopes have been revived for structural reforms to address chronic issues of mounting deficits and a loss-making pension system.

India was the only GEM that didn't participate in the global rally during January with the BSE100 losing 5.80%. Indian equities bucked the trend in Q4 2018 and managed to climb when all other emerging indexes were falling significantly. That combined with India having the most expensive valuation in the GEM sector, investors seem to be redeploying money into other areas to capture value. There is also building concern regarding Modi's re-election in May, with favour building for other parties. This could act as a barrier to performance until elections have concluded.

We increased exposure to Emerging Markets in December for those strategies that had the risk tolerance. Our preference was for China following the 30% drop in 2018.

Fixed Interest

Safe haven bonds rallied with equity markets over the month as the US Federal Reserve put rate hikes on hold and the global economic outlook softened over the month. Whilst US and UK bonds were relatively unchanged over the month, European bond yields fell as risk off sentiment / deflationary pressures mount in Europe (Italy, global trade/ German recession risks).

In the US, the Fed decided to put rate hikes on hold as the global economy outlook and the government shutdown clouds the inflationary outlook for the US. The decision to put rates on hold caused some modest weakness in the dollar.

Risk aversion remains high in the UK. The 10Y Government bond yield fell to 1.17%. For context, the record low was 0.5% post referendum in 2016. Interestingly the two year is priced at 0.72% - lower than Bank of England base rate, suggesting the BoE's next move is more likely to be a rate cut.

10-year Italian government bond yields ended the month 37 basis points lower than the January high. Initial estimates of Italian GDP for the fourth quarter of 2018 showed a contraction of 0.2% over the previous quarter which put Italy into a technical recession. The fall in Italian government bond yields means that their price goes up, allowing Italian bonds to have given a positive return of 1.2% over the month. As a sign of the stabilising European periphery, Spanish bonds ended the month returning 1.5%.

A weakened dollar saw our favoured position Vanguard US Government Bond fall back 2.8% over the month (the other side of this trade – UK £ equity exposure performed well). Falling government bond yields globally saw exposure that is hedge back to £ perform well. Gilts up 1.3% over the month. Linkers up 1.2%.

Commercial Property

Commercial Property has formed a core source of income within our cautious and balanced portfolios for a decade. However, the yield available to investors within commercial property has narrowed compared to the yields we can achieve from fixed income. In addition to this, the outlook for capital growth has become more uncertain as the deterioration in the value of retail assets has accelerated through 2018. It is becoming less clear whether the strong performance of regional offices, industrial and logistics properties can continue to counterbalance the weakness in retail.

To this end we are becoming less positive on the asset class and are reducing our weighting towards property in favour of fixed income allocations.

Alternatives

Alternatives Investments continued to disappoint in January. We look for alternative assets to provide a portfolio with greater diversification than simply holding traditional asset classes, whilst generating attractive risk adjusted returns. January was not a great month for performance in alternatives with the IA Absolute Return Sector only increasing by 1%. This is a continuation of a pattern we have seen for some time.

We reduced exposure to underperforming alternative funds in January, starting with SVS Church House. The proceeds of which were reinvested into defensive fixed income, offering an attractive yield at a much-reduced cost (a saving of 0.56%).

Commodities

Gold continued to perform in January as investors positioned themselves in safe haven assets. The less aggressive stance from the US Federal Reserve boosted prices through the month, taking gold to an intramonth high of $1320 per ounce. Other commodities also benefited in January as dollar weakness buoyed most industrial metals. Despite risk surrounding global growth, a continuation of the dollar's slide combined with potential infrastructure stimulus in China could be supportive to further increases in commodity prices.

Oil prices enjoyed some much-needed recovery in January. Again, dollar weakness helped prices push above $50 following a torrid 4th quarter in 2018. West Texas Intermediate increased from around $44 a barrel to end the month at $54. Brent Crude also pushed higher from $54.80 to $63. Even after January's rise, oil is still some way off its October high of $87 (brent crude).

We do not have direct exposure to commodities within our portfolios due to the lack of income. Mining and energy shares will however feature within UK and overseas equity exposure and gold within absolute return mandates.

Cash

Our view of cash remains unchanged, cash deposits continue to offer a negative real return for savers and this is likely to remain the case for a prolonged period of time, therefore holding cash is unattractive for long-term investors. Whilst in 2018, investors were fearful of the prospect for rising interest rates, this has proved to be short-lived. Weakness in global economic growth and inflation data in Q4 2018 has led central banks to hold off on raising interest rates, which could prove supportive for investor confidence and asset prices through 2019.

Whitechurch Investment Team, February 2019

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