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Keeping you informed matters

Annual Investment Review

January 2020

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Outlook

2019 turned out to be a good year for global stock markets. Markets generally ignored the risks of a deteriorating economic backdrop in 2019 but the outlook for 2020 is still one of falling growth and elevated trade and political tensions.

2019 turned out to be a good year for global stock markets. Led by the US, most markets achieved double-digit returns with Europe, slightly surprisingly, outperforming Asia and the Far East. Within Europe, the core, Germany and France, largely outperformed the periphery.

Somewhat more surprisingly, achieving double-digit returns, the UK was one of the world's better markets as political fears surrounding Brexit and the General Election dissipated and international investors returned in the final quarter. One of the key questions for 2020 is whether the definitive election result will provide a springboard for a resumption of financial flows into the UK.

It is worth noting that the UK has moved from a deeply politically unstable environment, where the threat of uncompensated wholesale nationalisation hung like a Damoclean sword over the market, to one of the most stable political entities in the world. The size of Boris Johnson's majority and the Fixed Term Parliament Act effectively removes political risk from the UK for the foreseeable future.

Markets generally ignored the risks of a deteriorating economic backdrop in 2019 but the outlook for 2020 is still one of falling growth and elevated trade and political tensions.

The trade war being waged by Donald Trump against China, but also with almost any country with a trade surplus with the US, has succeeded in slowing trade sharply. The volume of global trade has, in fact, reduced by two-thirds from 3.7% in 2018 to just 1.2% in 2019.

This has weighed on global growth and the recent Economic Outlook published by the Organisation for Economic Co-operation and Development (OECD) puts real GDP growth about 12% below the 2012-2019 average of 3.3% to just 2.9% in 2020.

On a more granular basis, expectations for the US, Europe and Japan are all downgraded by 0.5%. The strong recent expansion in India is forecast to slow sharply and the recent downward trend in Chinese growth is expected to continue. Not so long ago, China was averaging annual growth rates of over 10%; today that has fallen to between 5% and 6%.

Overall, the picture is one of moderating but not recessionary conditions in the year ahead. What then could give reason for optimism?

To get a sense of where the UK might go now, it is worth looking at how the economy has been performing before and since the historic referendum of June 2016. The fact is that there is plenty of room for improvement: spending and investment have largely been put on hold for the last three years.

Growth in private capital investment in the UK has been weak for many years largely due to the aftermath of various financial crises including the "tech wreck" in 2000. Private investment growth peaked in 2007 failing to recover to that level until 2015. Public investment peaked in 2010 but has never recovered to that level since, due to the years of austerity under David Cameron and latterly Theresa May.

A modest recovery in private investment up to 2016 came to a halt following the referendum in June 2016. As a result business investment is running at some £8bn per quarter below where it would otherwise be. That suggests in a softish Brexit, a strong investment recovery might take hold in a period of investment catch-up.

The problem is that the amended Brexit Bill contains a sunset clause. If no agreement is reached in 2020, the UK will fall out of the EU on a no-deal basis. It is likely that a recovery in UK growth will be front-loaded and investors will continue to have to monitor the ongoing negotiations. The external value of the Pound will act as a real-time barometer.

It is also true that for most people the recent election settles the question; we are out, and the details can be left to the politicians. Brexit fatigue is palpable.

Should Europe and the UK fail to reach agreement on a future trade relationship, the OECD estimates the cost to the UK at 2-2.5% of GDP in the first two years after exit. In cash terms that is around £60 billion which is equivalent to 40% or so of the current NHS budget. It's a big and significant number.

By contrast the cost to the European economy would be about 0.5% of GDP. Interestingly this is a similar number in cash terms as the residual EU economy excluding the UK is about five times the size of the UK.

However, those costs are distributed around Europe very unequally with those geographically closest to the UK bearing the highest costs. Ireland would be particularly hard hit but so too would Belgium, Netherlands and Denmark.

Importantly however, these countries are already putting in place a coordinated fiscal response to a negative Brexit shock to their economies. Moreover, for the first time the German structural budget deficit rule which prevents counter-cyclical deficit spending is being seriously debated and vigorously questioned. As the sun sets on Angela Merkel's tenure, Germany itself is looking at a change not only of political direction but of economic direction too.

European growth is weak without the threat of a no-deal Brexit but the underlying mood music seems to be moving on from sole reliance on monetary policy to support growth, to a more active use of fiscal policy. That is a reason for some, albeit modest, optimism.

The US adopted a more active use of public funds much earlier than the UK or Europe to support the economy. Moreover, the US banking authorities took a much more aggressive position with respect to writing down the value of impaired bank balance sheets. They dealt with bad debts more efficiently and quickly.

As a result of this, the bad news is that public support for the economy is now largely in the past. Donald Trump has already pushed through his $1trillion tax cut and US public finances are now widely regarded as on an unsustainable path.

At the same time, Trump has worsened the outlook by launching his trade war. This is self-defeating on many fronts: a trade war will amongst other issues: raise production costs, lower demand, raise domestic inflation, lower efficiencies brought about via trade and reduce policy flexibility.

Since US net debt to GDP is over 90%, the US is one of the few major economies that will be tightening fiscal policy heading into 2020.

It is noticeable that the American economy is already slowing: business investment has ebbed as tariffs and weaker demand from US trading partners has hit; a further £300bn of tariffs are due to be imposed shortly; payroll growth has slowed and wage inflation is beginning to push higher.

A key metric to monitor will be the outlook for Blue-collar (un)employment. This socio-economic group is a key component of Trump's base and is central to his re-election. Paradoxically, many of Trump's economic policies hurt the economic interests of this group.

A further paradox associated with Trumpian foreign and economic policy is that it has forced China to withdraw from global supply chains and focus on domestic economic development. In other words, Trump has accelerated China's emergence as a genuine geo-political competitor to the US in violation of the old Chinese proverb, "Keep your friends close but your enemies closer."

China has reduced interest rates, cut reserve requirements at the key commercial banks and has made available central government funds for investment. As a result, at a time when key US metrics are turning down, key Chinese metrics in manufacturing are turning up. Thus into 2020, China will remain an important contributor to net global demand.

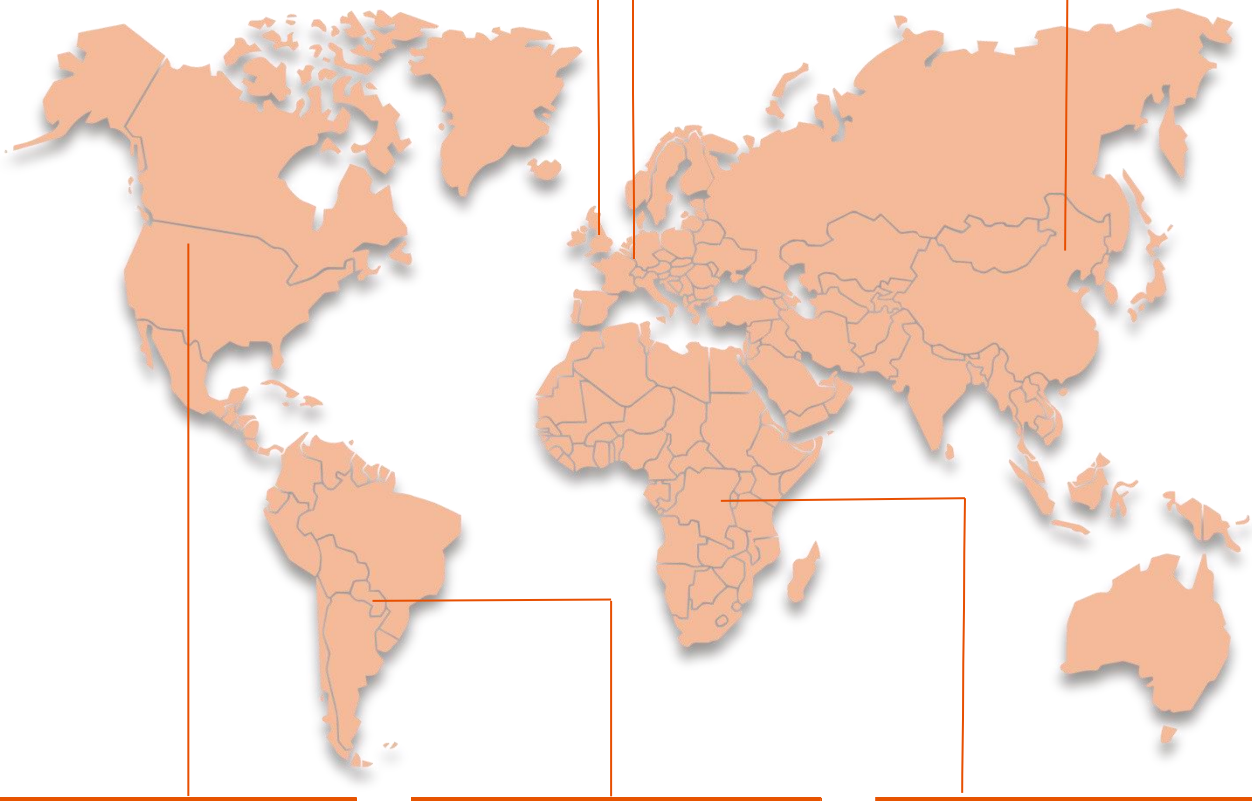
2019 was a good year for risk assets but we have to acknowledge that asset prices have been supported for many years by ultra-easy monetary policy right across the developed world. It is therefore too early to call the end of this long, albeit weak, global economic expansion.

Key facts about the world

United Kingdom
- A general election was won convincingly by the Conservative party
- The UK will now be leaving the EU early in 2020
- Interest rates in the UK are likely to fall

Europe
- European economic growth is expected to be 1% for 2020
- Christine Lagarde has become the first female President of the ECB
- German economic activity has fallen sharply

Asia
- The trade war between China and the US has affected growth
- Japan undertook another quantitative easing programme to boost growth
- Australian wildfires will materially affect economic growth in the region



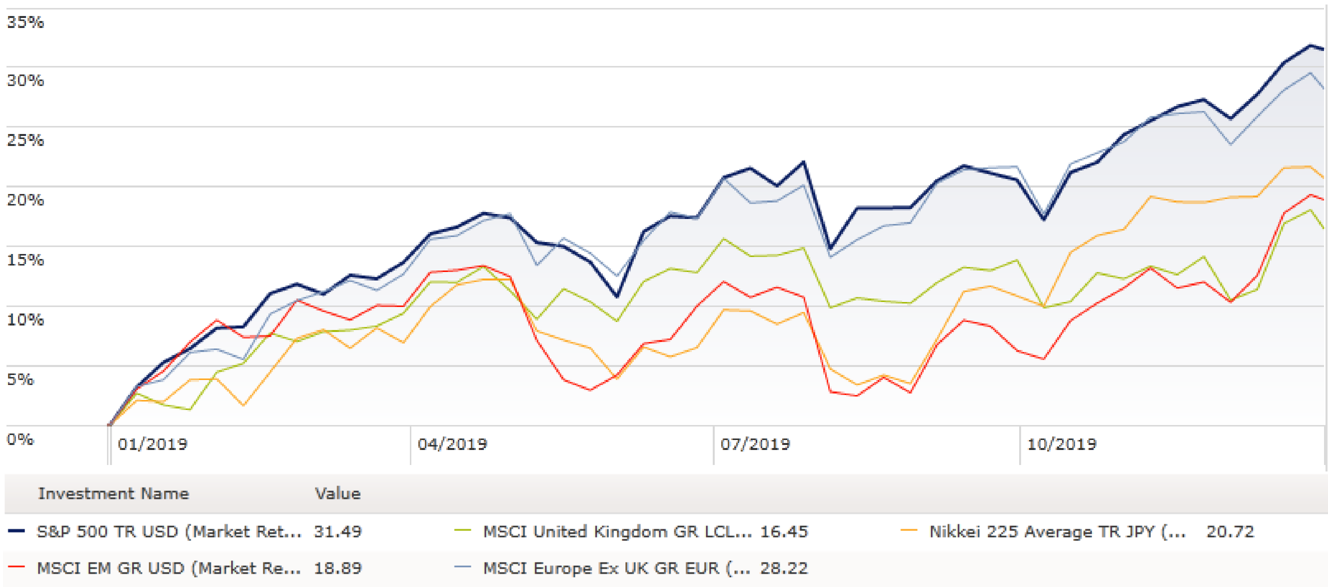
North America
- The US presidential election is scheduled for Autumn 2020
- Economic tariffs continue to hinder sentiment
- Interest rates were reduced to offset economic weakness

South America
- Latin American GDP grew 0.7% and will recover moderately in 2020
- The region is heavily reliant on the oil price
- The updated trade deal between Mexico and the US is a positive development

Africa
- South Africa grew at less than 1% in 2019
- China continues to be the largest investor in the region
- Middle East tensions remain a key drag on returns from the Continent

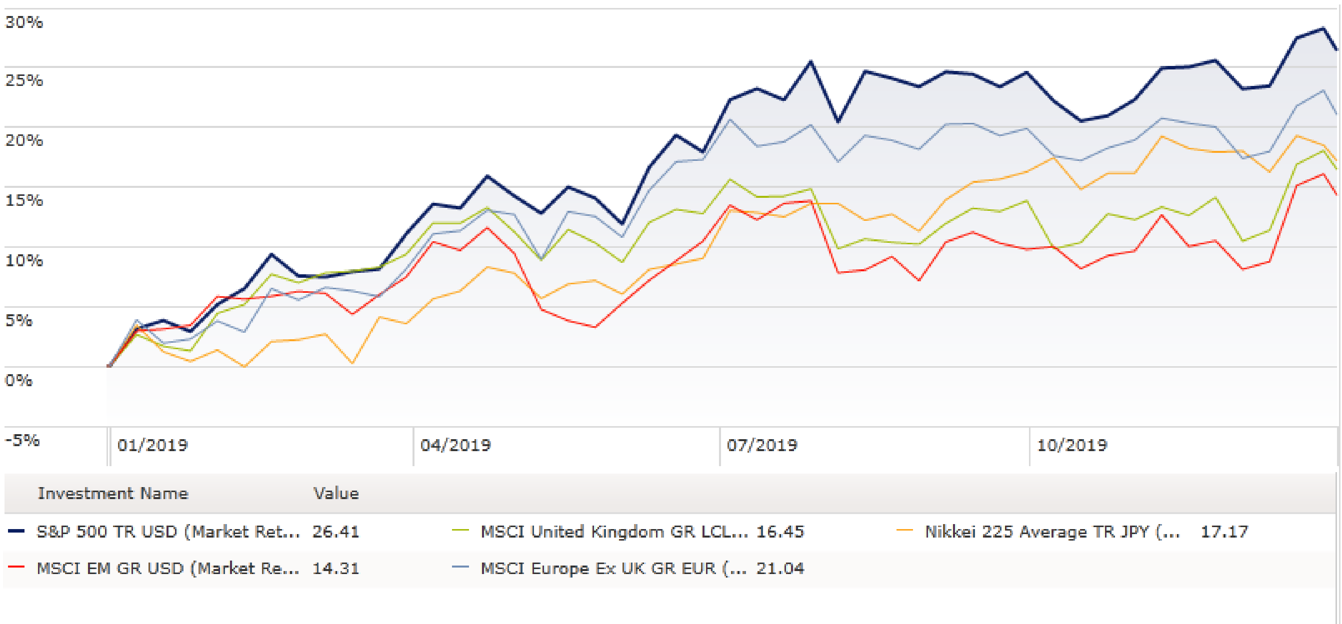
2019 in charts

Major market movements in local currency (1 year)



Source: Morningstar, bid-bid basis, net income

Major market movements for sterling investors (1 year)



Source: Morningstar, bid-bid basis, net income

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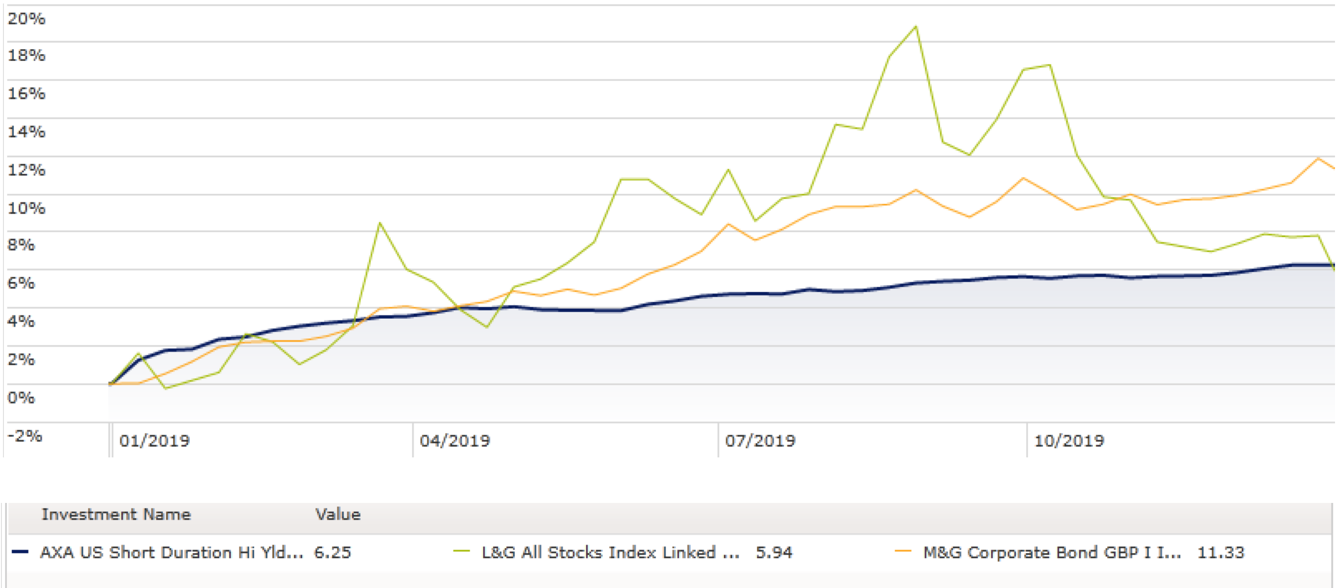
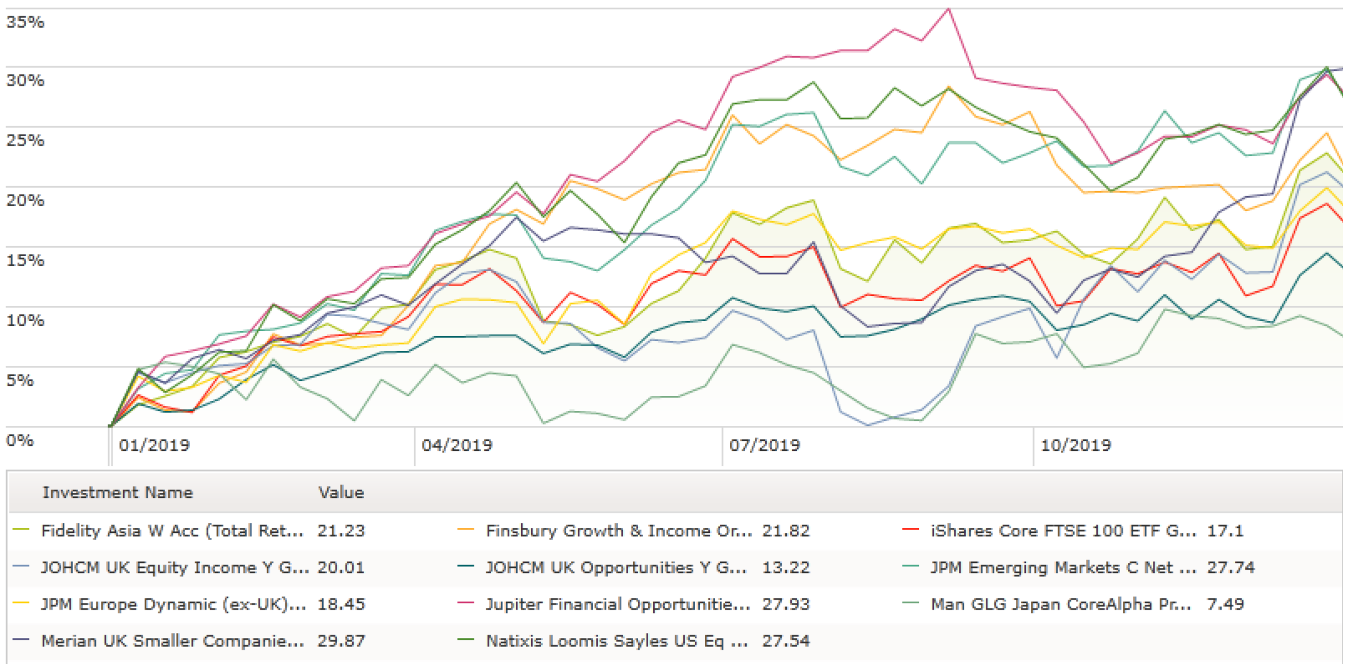
2019 in charts

Model Growth Returns Fixed Interest (1 year)



Source: Morningstar, bid-bid basis, net income

Model Growth Returns Equity (1 year)



Source: Morningstar, bid-bid basis, net income

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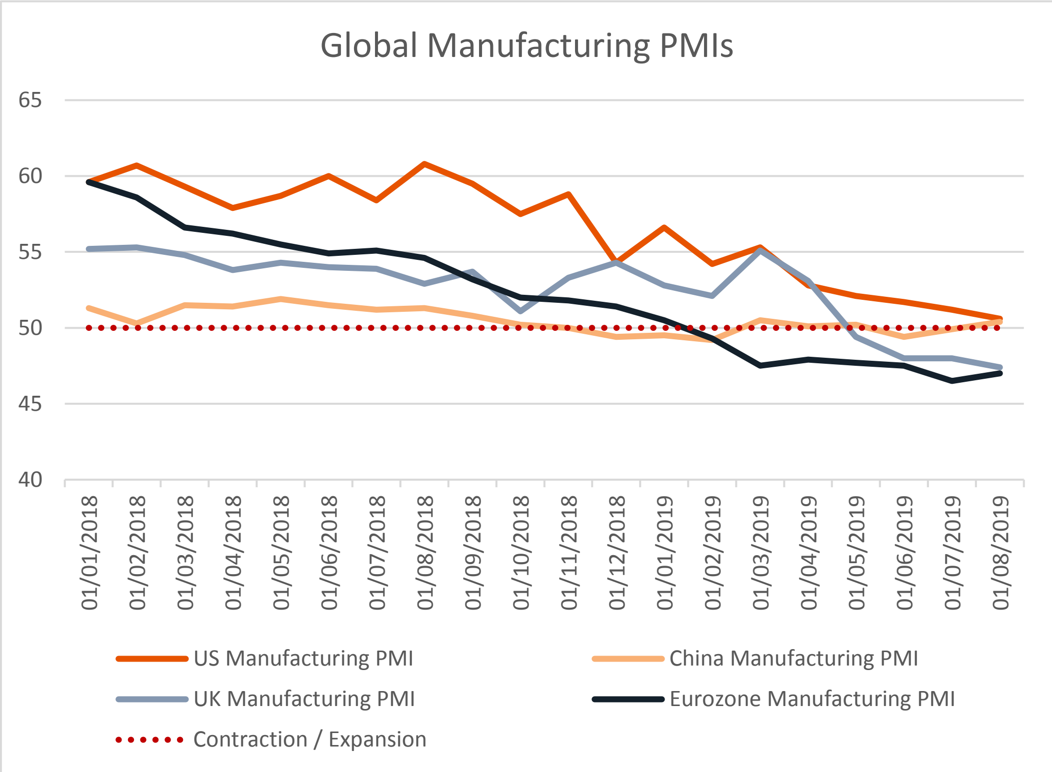
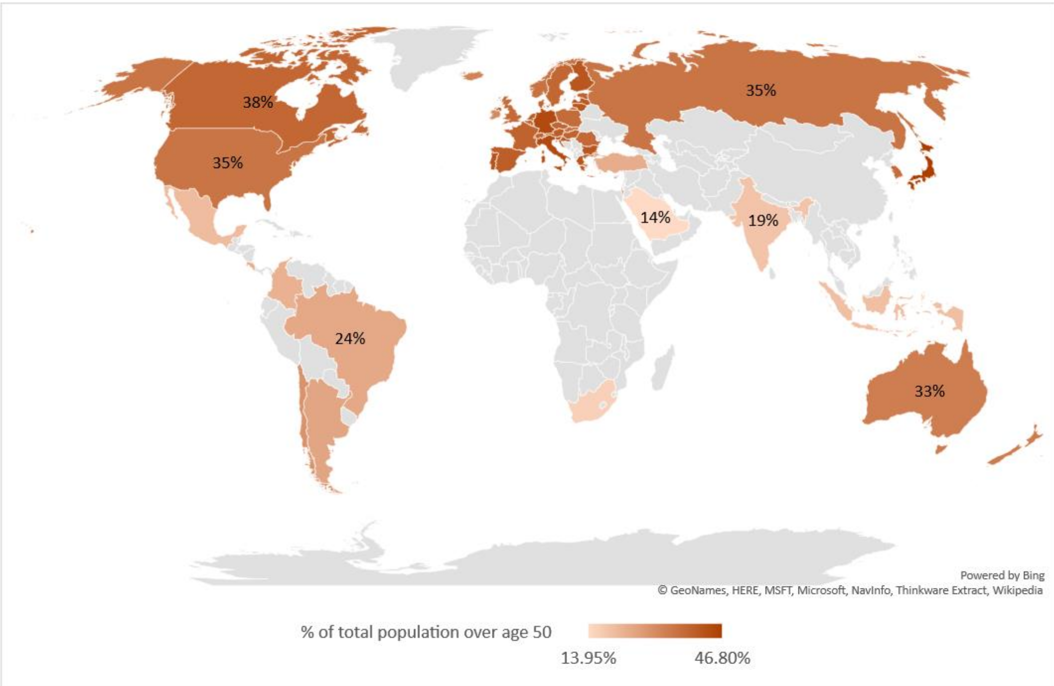
2019 in charts

Synchronised Global Growth Slowdown



Source: World Bank

Aging Populations In Europe & North America Lower Inflation Expectations



2019 performance review

A positive year for all strategies

- Equities rose strongly following the falls experienced in 2018
- US, European and Emerging Market equity exposure helped returns
- UK equity exposure benefitted from the Conservative election win
- The Pound was strong against most major currencies
- Fixed Interest exposure benefitted from falling bond yields

A strong year for most equity markets

All strategies provided positive returns during the year, driven by equity markets in the US, Europe and the Emerging Markets. Each of these regions provided returns of over 20% during 2019.

One holding that had previously lagged, JO Hambro UK Equity Income, actually performed very strongly as the undervaluation in UK equities was acknowledged by investors and equity prices rose following the UK election result. The fund was up 20% during the year but still provides a dividend yield of 5.8% which provides significant further upside in our view with cash rates remaining near zero.

We added the Jupiter Financial Opportunities fund to strategies to take advantage of the changes in the monetary environment and to get exposure to very cheap companies that had been tarnished by the 2008 crisis. This fund rose 27.9% during the year as US banks and Fintech companies performed better than the broader equity market. As in 2018, our exposure to the Loomis Sayles US Equity Leaders proved a positive, generating returns of marginally less than the Jupiter fund (27.5%).

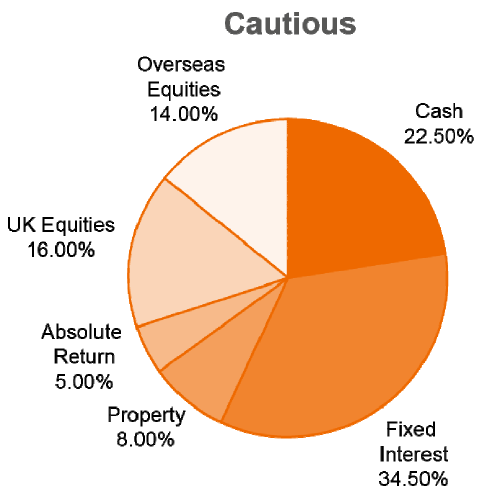
The JPM Emerging Markets fund also rose just over 27%. Its exposure to Emerging Asia boosted returns with companies such as Alibaba, a technology stock and its largest holding, performing extremely well. This also helped the Fidelity Asia fund return 21.2% during the year.

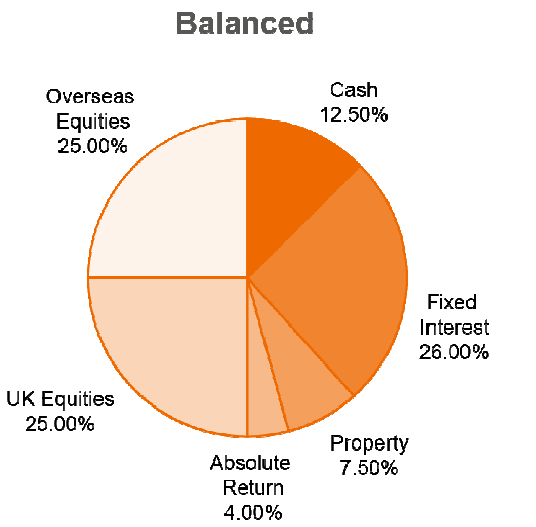
Our fixed interest exposure is included in strategies to provide diversification primarily, however as bond yields fell globally, this provided very positive returns with the corporate bond exposure rising over 10%. This is a reminder that returns can be generated from this asset class even though interest rates have been low for over a decade.

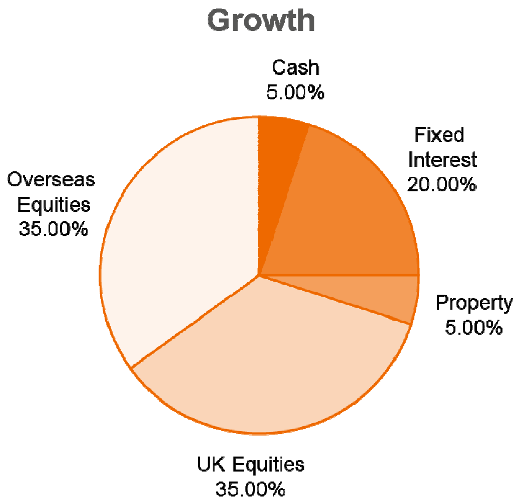
SECTOR	3 months	1 year to 31/12/19	1 year to 31/12/18	1 year to 31/12/17	1 year to 31/12/16	1 year to 31/12/15	5 years (annualised)
UK Smaller Companies	13.73	25.43	-11.79	27.13	8.52	14.92	11.90
UK Equity Income	7.18	20.12	-10.53	11.50	9.05	6.62	6.86
UK All Companies	7.07	22.37	-11.15	14.05	11.04	5.01	7.65
Global Emerging Markets	3.37	15.71	-11.53	24.52	31.62	-9.23	8.78
Europe Excluding UK	2.54	20.38	-12.16	17.45	17.06	9.38	9.72
Asia Pacific Excluding Japan	2.12	15.84	-9.81	25.29	26.00	-2.80	9.90
North America	1.23	24.56	-1.15	10.48	30.09	4.53	13.09
Japan	1.16	17.08	-11.32	17.79	23.55	16.21	11.92
£ Corporate Bond	-0.06	9.52	-2.20	5.24	9.69	0.22	4.38
UK Index Linked Gilts	-9.39	5.86	-0.46	2.21	25.13	-1.34	5.86

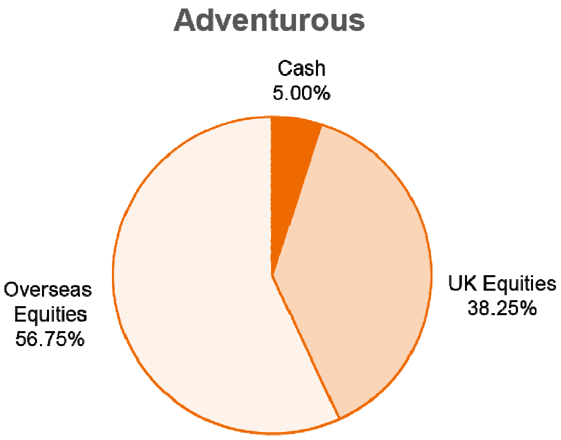
Source: Morningstar, bid-bid pricing, net income

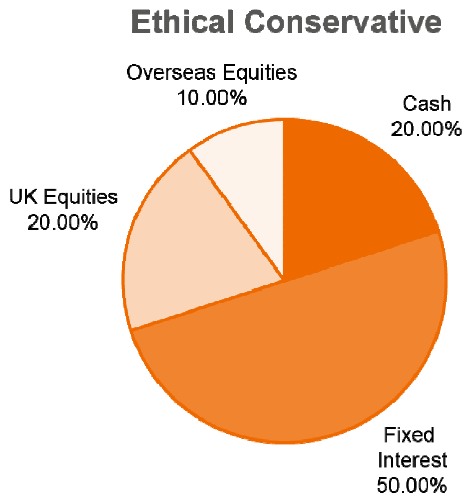
The positioning of our core strategies

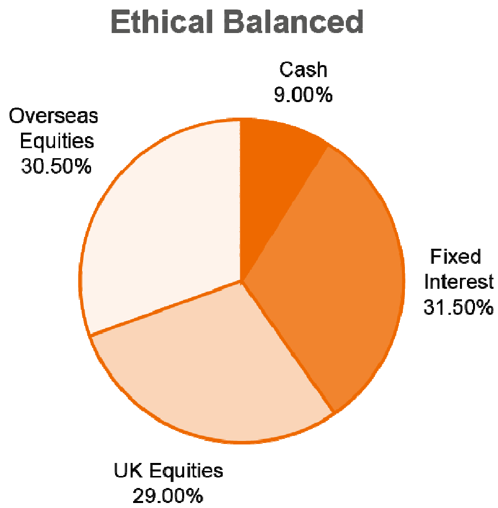


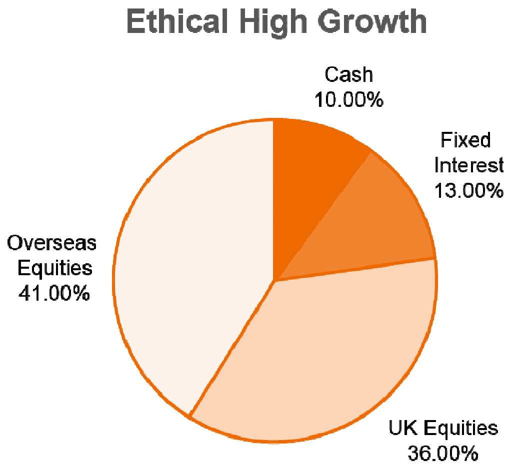


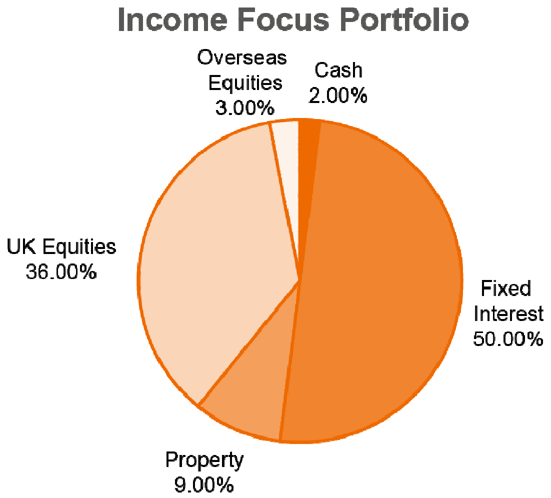





Ethical Conservative
Overseas Equities
10.00%
Cash
20.00%
UK Equities
20.00%
Fixed
Interest
50.00%


Ethical Balanced
Cash
9.00%
Overseas
Equities
30.50%
Fixed
Interest
31.50%
UK Equities
29.00%


Ethical High Growth
Cash
10.00%
Fixed
Interest
13.00%
Overseas
Equities
41.00%
UK Equities
36.00%


Income Focus Portfolio
Overseas
Equities
3.00%
Cash
2.00%
UK Equities
36.00%
Fixed
Interest
50.00%
Property
9.00%

Disclaimer

Opinions constitute our judgment as of this date and are subject to change without warning. The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance is not a reliable indicator of future results and forecasts are not a reliable indicator of future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down. The information in this document is not intended as an offer or solicitation to buy or sell securities or any other investment, nor does it constitute a personal recommendation.

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