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Chartered Financial Planners

Keeping you informed matters

Economic review

October 2019

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Outlook

There is quite visibly a marked economic slowdown underway. Most leading indicators point to weakness in spending and investment. However, despite the cacophony of noise surrounding Brexit and trade wars, UK and global stock markets have been flat over the period.

When we look at the world economy, it seems there are five or six dominant themes that will shape the outlook for markets in the near-term.

There is quite visibly a marked economic slowdown underway. Most leading indicators point to weakness in spending and investment. Recent Purchasing Manager Surveys (PMIs) have been consistently gloomy.

This is not surprising. Donald Trump has taken an axe to well established trade rules and is disrupting global supply chains. One of the worrying trends that has developed in recent years is the belief that highly complex issues are reducible to simple sloganeering. This is true of Brexit and it is true of US-China trade relations.

Perhaps more importantly, the world economy is so inter-linked that conflicts that could once have been regarded as "bi-lateral" now have multi-lateral effects. A dispute between the US and China, in reducing world trade, affects those economies dependent upon exports. It is no surprise that in a trade constrained world, Germany, heavily reliant on its export machine, is flirting with recession.

World trade growth in 2019 is half the level of 2017 with European and Japanese export volumes to China falling by close to 20%.

Lower trade growth translates into lower GDP growth creating a very challenging environment for company managements. The benign period of economic growth is probably behind us and in the current environment we will find out just how good company boardrooms really are at improving returns.

Donald Trump's weaponisation of trade has global implications, but nearer home, the Brexit saga appears to be reaching some kind of resolution with far-reaching domestic implications.

At the same time that the UK is dealing with the potential shock of a "no-deal" Brexit, mainland Europe is dealing with a sharp slowdown in the Northern states forcing Mario Draghi, President of the ECB, to restart unconventional monetary policy. But, damagingly, he has done this in the face of significant and growing opposition from the German establishment.

Putting the rhetoric of Brexit aside, this is the real fault-line running through Europe. In our view, whilst North and South continue to be unable to agree on sustainable, reflationary economic policy, risks to the future of the Euro itself cannot be discounted. This is a potential risk that investors cannot ignore.

The UK seems to have reached the end-game in the first phase of the Brexit negotiations although as Boris Johnson's hero Churchill would have put it, it may simply be the "end of the beginning."

Whatever happens it is likely that the UK economy will see a significant boost to public spending post Brexit.

Sajid Javid, the Chancellor of the Exchequer, has announced more than £50bn of spending pledges including new roads, rail and "superbus" lanes funded by a combination of Philip Hammond's war chest and new borrowing. Labour, for its part, is planning for an increase of public investment of £250bn over ten years funded partly by borrowing but also higher taxation on corporations and "the wealthy."

Nonetheless, in the short-run Sterling will be the barometer of confidence in the economy. The harder the Brexit, the lower the pound. There are very clear and obvious risks to the outlook but if our prognosis is in the right direction; investors should be wary as inflation and interest rates should rise if government spending increases materially.

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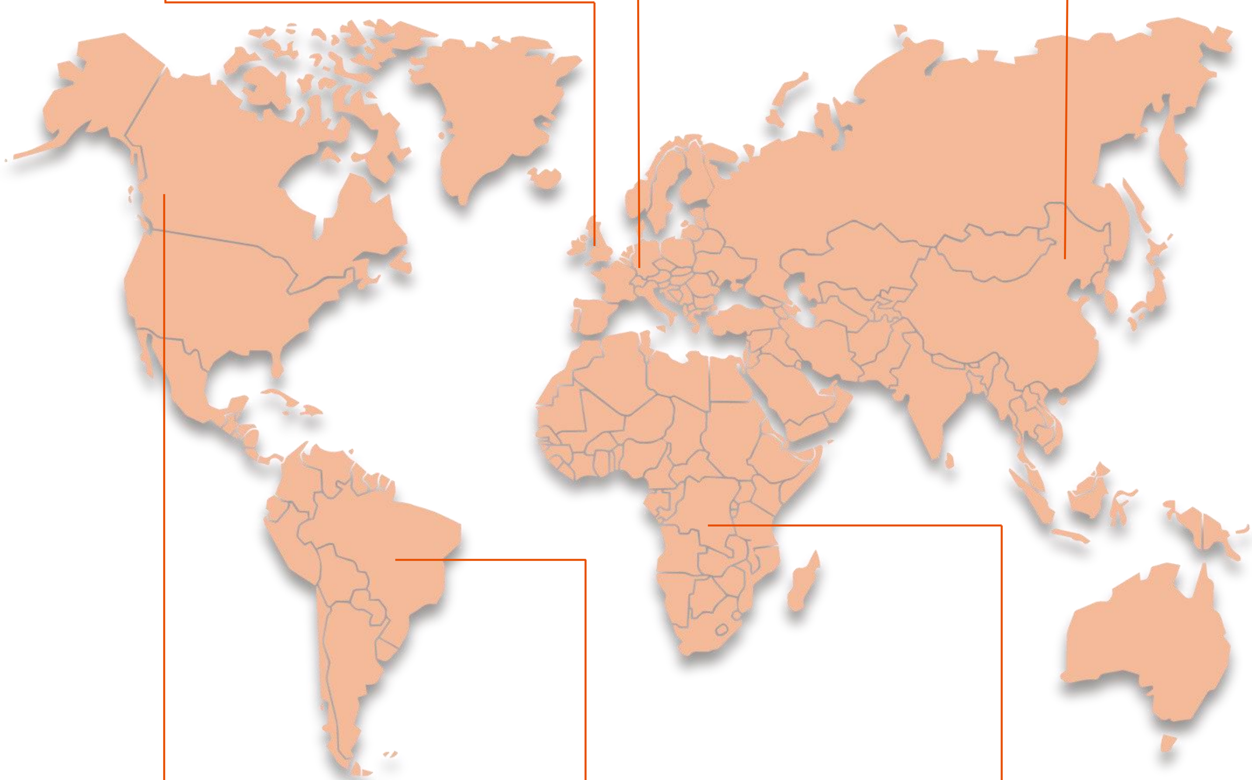
Key facts about the world

United Kingdom
- Brexit continues to vex the political landscape
- Economic growth has faltered in 2019
- An early general election is probable

Europe
- Italy continues to test the boundaries of the Euro
- Germany has suffered from the tariff war
- Economic growth remains chronically low

Asia
- Hong Kong protests continue to put pressure on China
- India has cut interest rates to stimulate growth
- Trade tariffs have led to increased regional trade



North America
- President Trump faces impeachment charges
- US economic growth has softened this year
- The central bank's independence is being tested by the President

South America
- Argentina is engulfed in a political crisis: its equity market has fallen 30%
- Brazil continues to benefit from political stability with solid growth

Africa
- South Africa has avoided a recession with economic growth rebounding
- Japanese companies are increasingly investing in the region following China

Q3 Performance Review

Equity markets were volatile

- Government and corporate bonds rose strongly
- Japanese Yen and the Pound rose against most major currencies
- Our UK equity exposure performed well, providing positive returns
- Financial equities provided strong returns
- Asian markets were a key laggard due to economic growth concerns

Global equity markets were volatile in the third quarter with concerns over weakening global growth leading to markets falling before rising again in September. Performance was mixed, but Japanese and our UK equity exposure provided the best returns. Unlike previous quarters, there was a clear market theme driving returns and falling government bond yields were an indicator of investor nervousness around the ongoing trade wars and political tensions which have materially risen globally.

Our fixed interest exposure mitigated volatility during the period, with the L&G Index Linked Gilt holding returning 7.5%. The next best performer in this period was again the M&G Corporate Bond fund which rose by 3.7%. These holdings have now returned 16.6% and 10.8% year to date respectively.

The best performing overseas equity fund during the quarter was the Man GLG Japan Core Alpha fund, with its bias towards companies trading cheap relative to the market and a strengthening Japanese Yen helping returns. Our position in the Jupiter Financial Opportunities fund performed better than most overseas holdings, returning 2.4% for the quarter and this holding is now up over 25% year to date.

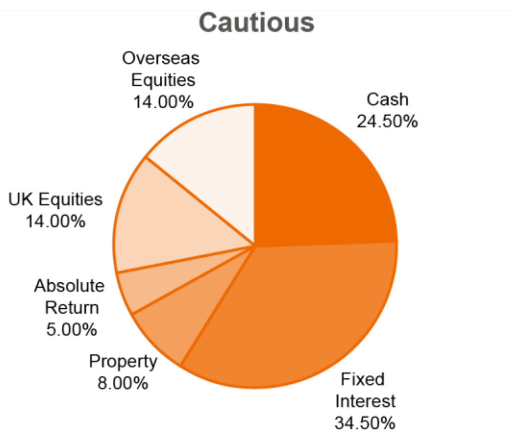
In the UK we saw a change in the previous pricing pattern of UK domestically focused companies performing poorly (due to Brexit) and overseas earners doing well. This led to positive returns from all UK equity holdings in our strategies, with JO Hambro UK Equity Income and Finsbury Growth & Income significantly outperforming the broader UK equity market. BMO Commercial Property Trust again provided positive returns following a period when UK commercial property prices fell and this illustrates its diversification benefits to our strategies.

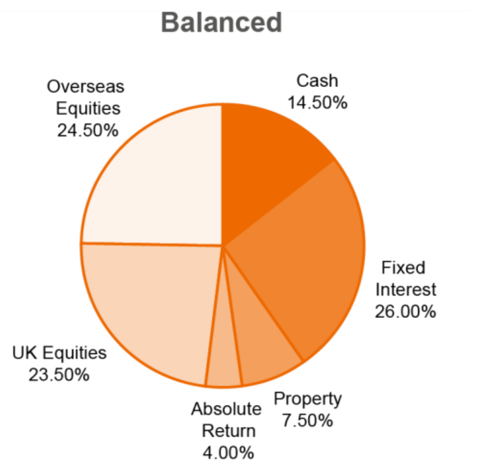
The key laggard was the Merian Global Equity Absolute Return fund which fell 4.6%. This was driven by the volatile equity trading environment.

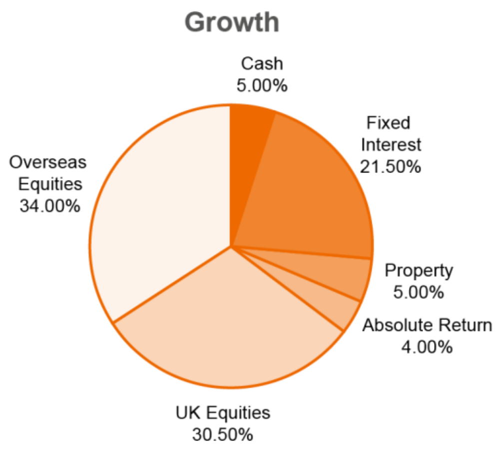
SECTOR	3 months	1 year to 30/09/19	1 year to 30/09/18	1 year to 30/09/17	1 year to 30/09/16	1 year to 30/09/15	5 years (annualised)
IA UK Index Linked Gilts	7.98	19.12	1.30	-6.83	28.59	10.04	9.73
IA Japan	6.23	-1.09	12.60	13.30	33.37	4.00	11.85
IA North America	3.41	7.29	19.65	14.52	30.99	3.06	14.69
IA £ Corporate Bond	3.06	9.01	0.13	0.79	12.97	3.36	5.14
IA £ High Yield	1.24	4.50	1.09	7.70	9.81	-1.10	4.32
IA UK Equity Income	1.09	-0.14	3.47	10.84	11.54	4.11	5.87
IA UK All Companies	1.03	0.02	5.64	13.67	12.00	2.09	6.55
IA Europe Excluding UK	0.53	2.24	1.91	21.95	19.22	3.57	9.43
IA Asia Pacific Ex. Japan	-0.07	5.87	3.67	15.62	37.32	-7.39	10.04
IA Global Emerging Markets	-0.83	6.42	-1.44	17.59	37.53	-13.57	7.95
IA UK Smaller Companies	-1.43	-7.13	10.49	25.21	8.16	11.82	9.22

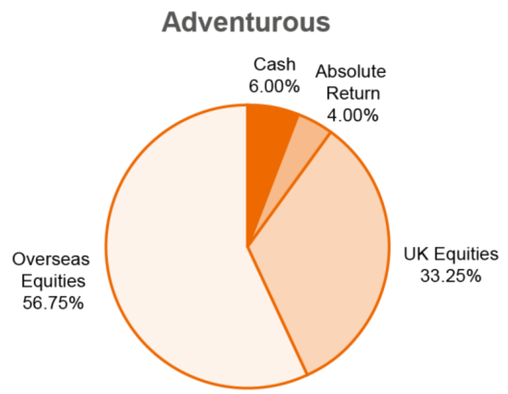
Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

The positioning of our strategies

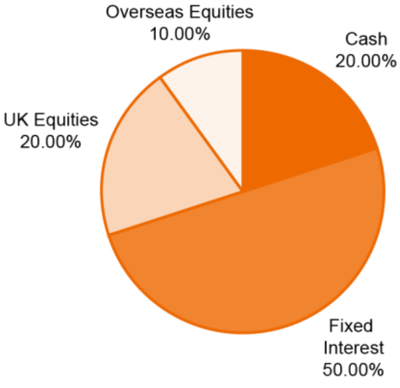




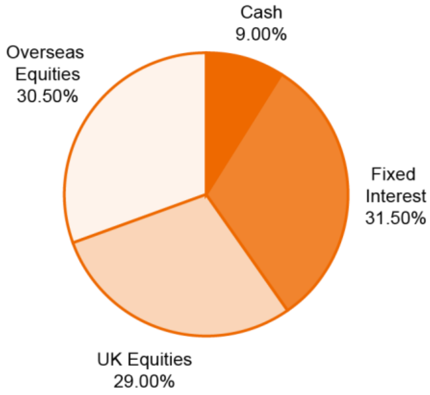




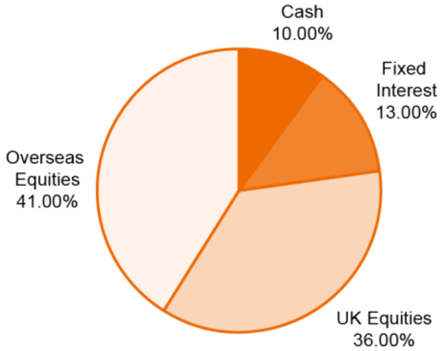
Ethical Conservative



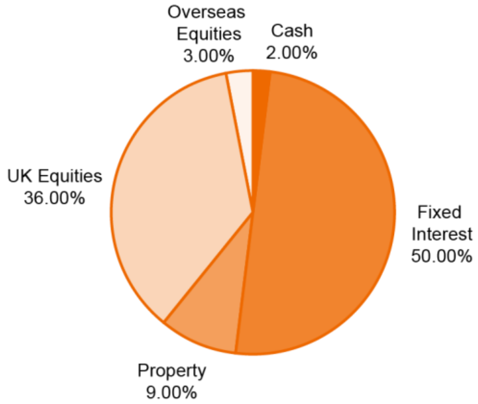
Ethical Balanced



Ethical High Growth



Income Focus Portfolio



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