INTERNATIONAL FUND SOLUTIONS

STRATEGY UPDATE

July 2019

TIME TO PARTY LIKE IT'S 1998?

World markets enjoyed ongoing strong gains during the quarter as a direct result of a swift change in rhetoric from major central banks with regards to the future positioning of monetary policy/interest rates. Importantly for both equity and bond markets the US Federal Reserve has indicated that interest rates have peaked and that the run-off in its balance sheet will be a lot shallower than what was previously expected. Cheap money for longer seems to be the only tonic that investors require to extend the bull market.

At a recent presentation a high profile, and well regarded, technology investment manager opened with "I am trying to decide if today is 1998 again or 1999. In 1998 we made a lot of money for our clients, in 1999 we more than gave those gains back". Although technology has very successfully grown and matured as an industry and now touches everybody's life in a way that was almost certainly being priced into most technology company share prices in 1998, the recent spate of large high profile initial public offerings (IPOs) for companies with considerable market share, but no profits (Uber and Lyft being the most obvious examples) certainly feels more like 1999. Interest rates also show a parallel, with rates at historic lows in the late 90s and at unprecedented lows now, arguably fuelling the misallocation of capital as the risk-free hurdle for investing is projected as remaining low in perpetuity.

It is not only the technology sector that gives some cause for concern as many mainstream and broader equity indices are again looking expensive following the best first half year gains seen in over 10 years. Furthermore, fixed income markets are now so highly priced that globally there are $13 trillion of bonds that are on a negative yield. To put this in some context, lending to the US government for one year will earn you 1.94%, lending to Italy for the same period will cost you -0.02%, Portugal will cost you -0.36%, Switzerland -0.87% and Germany -0.65%. In fact you would need to lend to the German government for over 15 years in order to receive a positive return (before taking inflation into account) and to the Swiss government for over 30 years.

With valuation overhangs sitting alongside heightened political risks, trade war tweets, Middle Eastern tensions and Brexit, it is unsurprising to see that many professional asset allocators are becoming more cautious in their positioning. However, they remain split on the future direction of investor confidence, inflation, corporate profits and global growth. To some extent the increasing level of investor caution is reassuring as market cycles rarely come to a civilised ending, but rather in a blaze of overconfidence and numerous explanations for why this time it is different, something that is lacking so far in this prolonged stock market cycle.

So how are we navigating this somewhat challenging environment for our clients? In the long term we employ core and proven managers that invest with a clear margin of safety, eschewing expensively valued companies in favour of growing and profitable businesses available at historically reasonable valuations. Although we believe that this is a prudent and sensible approach to looking after our client's capital we are cognisant that there are times when investing in companies offering long term relative value will lag the market. The urge to capitulate and bring our positioning closer to the crowd becomes very strong and therefore we continue to revisit our initial investment thesis and ensure that our assumptions remain valid, which very much remains the case today.

In the short term we make active tactical asset allocation decisions, which are implemented using Exchange Traded Funds (ETFs) where we have no style attachment. These positions are simply taken on a view of the probability of a market rising or falling over the course of the next month, based on an objective appraisal of current market conditions. The tactical positioning is not reflective of our longer-term view of any market.

Last month our tactical call was to remain maximum overweight equities, but to remove emerging markets on a one-month view. This worked well for our multi asset client portfolios, with equity markets rising but emerging markets fractionally underperforming developed markets. Year-to-date the tactical calls have added value for clients.

This month's tactical decision is to remain maximum overweight equity, but with a reintroduction of the tactical emerging market equity exposure. As we noted last month the removal of the emerging markets exposure was largely based on poor short term technicals at the time. These technicals now appear to have improved, and with them the chances of a positive return over the next month.

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TACTICAL ASSET ALLOCATION UPDATE

Asset Allocation Committee Commentary: **US Dollar**

- The exposure to global equities has been maintained at Maximum Overweight.
- Domestic US equity is still providing the strongest overall indicators.
- Developed ex US equity leading indicators remain positive.
- Emerging Market equity has turned positive, and an allocation has been reintroduced.

	US Dollar - Leading Indicators			
Categories	Equity			Fixed Income
	Domestic	Developed ex US	Emerging	
Monetary & Rates:	▲	▲	▲	▲
Economic:	▲	▼	▲	▲
Trends:	▲	▲	▶	▲
Total:	▲	▲	▲	▲

Maximum Overweight Equity

Asset Allocation Committee Commentary: **Sterling**

- The exposure to global equities has been maintained at Maximum Overweight.
- Developed ex UK equity is still providing strong overall indicators.
- Domestic UK equity leading indicators remain positive.
- Emerging Market equity has turned positive, now providing the strongest overall indicators, and an allocation has been reintroduced.

	Sterling - Leading Indicators			
Categories	Equity			Fixed Income
	Domestic	Developed ex UK	Emerging	
Monetary & Rates:	▲	▲	▲	▲
Economic:	▼	▲	▲	▼
Trends:	▶	▲	▶	▲
Total:	▲	▲	▲	▲

Maximum Overweight Equity

Asset Allocation Committee Commentary: **Euro**

- The exposure to global equities has been maintained at Maximum Overweight.
- Domestic European & Developed ex European equity indicators remain positive.
- Emerging Market equity has turned positive, now providing the strongest overall indicators, and an allocation has been reintroduced.

	Euro - Leading Indicators			
Categories	Equity			Fixed Income
	Domestic	Developed ex Europe	Emerging	
Monetary & Rates:	▲	▲	▲	▲
Economic:	▶	▲	▲	▲
Trends:	▲	▲	▶	▲
Total:	▲	▲	▲	▲

Maximum Overweight Equity