INTERNATIONAL FUND SOLUTIONS

STRATEGY UPDATE

October 2019

AMONGST THE POLITICAL HEADLINES...

In amongst the market and political headlines – trade wars, interest rate cuts, UK constitutional crisis, US impeachment proceedings and a young girl's impassioned speech to the United Nations – two significant things happened within global equity markets during the last month of the quarter that largely went unremarked: large cap growth equities lost leadership and passively invested assets in US equities outweighed actively invested assets for the first time.

These two factors influence our portfolios, and markets, in different ways but they are inextricably linked.

Firstly passives, or Exchange Traded Funds (ETFs) and index tracker funds. In the middle of September inflows into passive US equity products resulted in the total assets reaching USD 4.271 trillion, outweighing the total of USD 4.246 trillion invested by traditional stock picking 'active' managers. For the first time ever, this means that in the US stock picking managers are no longer the guiding force of the market whilst there are more investor funds now content to simply follow the US market than looking to outperform by way of finding the best companies through active management. We have written before about the influence of passives on the market, and it has long been our thesis that although in isolation passives have no real impact on markets, when investors sell actively managed funds to invest into passives they are effectively selling cheap companies and buying more expensive ones which widens the disparity of investment styles across the market. It should be remembered that passives are price insensitive investors, they simply buy the market in the correct proportion regardless of valuation, and then track the market, up or down.

What the longer-term impact is of having the majority of assets dedicated to replicating a market, rather than seeking to outperform it, remains to be seen, but the fact that passive holdings in some companies are now significantly higher than their average daily traded volume (the amount normally traded in that company in a day) does raise concerns about what could happen should ETFs see a period of sustained outflows.

With the continued inflows into passives it was all the more remarkable to see the large-cap growth stocks lose some of the leadership that they have been enjoying over the last few years. As a multi-manager we blend market caps and investment styles based on relative valuations, with the result that we generally sit as core (neither value nor growth biased) across most of our regional equity exposures. This balanced positioning has hurt our relative performance over the last year, as large cap growth stocks have continued their run of outperformance. However, during September the leadership has been much more mixed, with days where large cap growth fell while other styles and market capitalisations rose. It is certainly too early to call a full-blown style rotation, but the relative outperformance of our equity exposures within multi-asset portfolios during the last month of the quarter shows that a style rotation is not needed, merely a broadening out of market leadership.

During the quarter we spent some time with our fixed income managers and received updates on their positioning and thoughts about the remainder of the year. Broadly the message was consistent, with all being positioned for ongoing volatility with relatively short duration and seeking mispriced opportunities in the cross over credit (investment grade / high yield) space. Seeing a consensus emerge may be comfortable, but we are careful to ensure that we do not unwittingly become over exposed to a limited number of performance drivers. For now, we remain comfortable with our exposures, but it is something we will continue to monitor.

After a difficult August, our multi-asset portfolios bounced back in September, as our maximum overweight equity positioning was maintained, and sit in line with benchmark for both the quarter and year-to-date.

At this month's tactical asset allocation meeting we maintained the maximum overweight equity positioning that we have held since the start of February. With our model showing positive buy signals across the regions, the split across domestic, developed ex-domestic and emerging markets was retained.

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TACTICAL ASSET ALLOCATION UPDATE

Asset Allocation Committee Commentary: **US Dollar - Leading Indicators**

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

Maximum Overweight Equity

Categories	Equity			Fixed Income
	Domestic	Developed ex US	Emerging	
Monetary and rates	▲	▲	▲	▲
Economic	▲	▼	▶	▼
Trends	▲	▲	▶	▲
Total	▲	▲	▲	▲

Asset Allocation Committee Commentary: **Sterling - Leading Indicators**

- The exposure to global equities has been maintained at Maximum Overweight
- Developed ex UK equity is still providing the strongest overall indicators
- Domestic UK equity and Emerging Market equity leading indicators remain positive

Maximum Overweight Equity

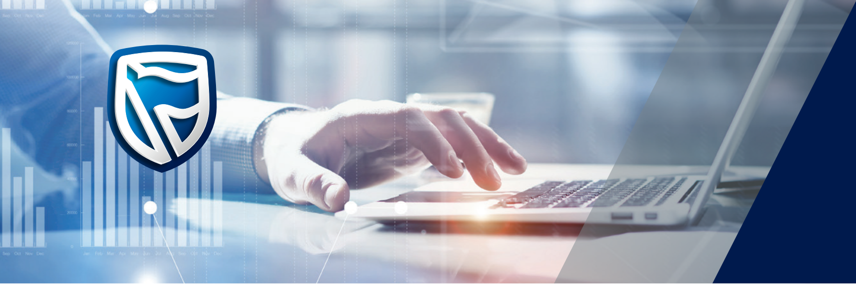
Categories	Equity			Fixed Income
	Domestic	Developed ex UK	Emerging	
Monetary and rates	▲	▲	▲	▶
Economic	▼	▲	▶	▼
Trends	▶	▲	▶	▲
Total	▲	▲	▲	▲

Asset Allocation Committee Commentary: **Euro - Leading Indicators**

- The exposure to global equities has been maintained at Maximum Overweight
- Domestic European equity is now providing the strongest overall indicators
- Developed ex European and Emerging Market equity leading indicators remain positive

Maximum Overweight Equity

Categories	Equity			Fixed Income
	Domestic	Developed ex Europe	Emerging	
Monetary and rates	▲	▲	▲	▲
Economic	▲	▼	▶	▼
Trends	▲	▲	▶	▲
Total	▲	▲	▲	▲



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