CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

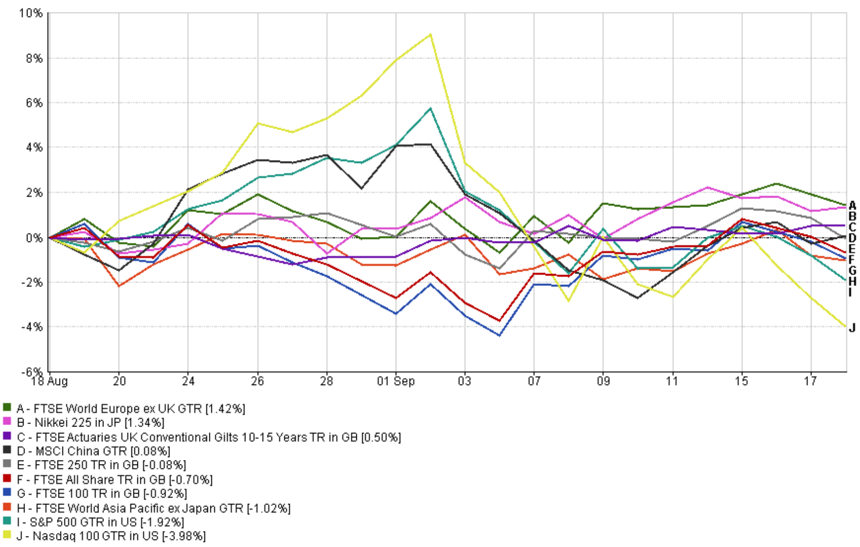
INVESTMENT COMMENTARY

18 SEPTEMBER 2020

OVERVIEW

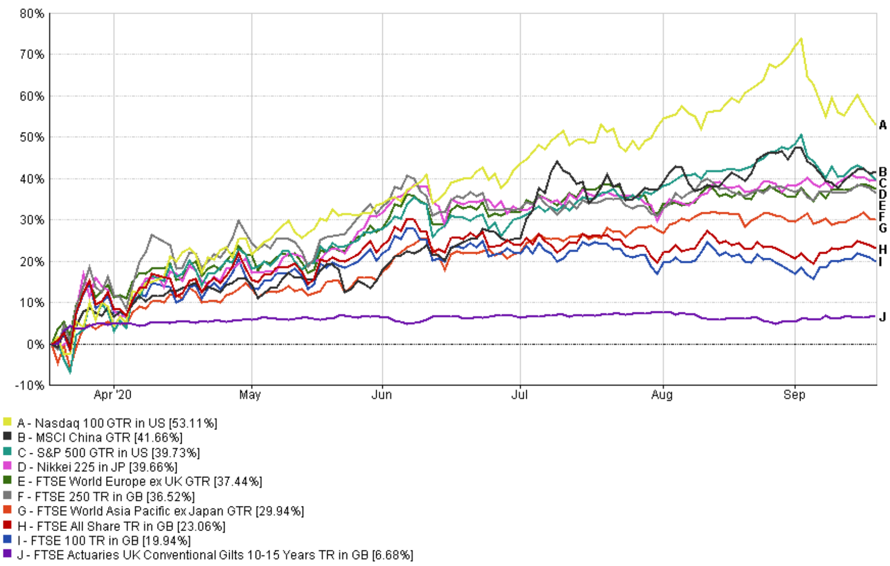
The last six months have seen equity markets rebound from lows in late March 2020 as countries moved out of Covid-19 pandemic lockdowns and economies gradually re-opened. Global economic growth has risen as demand has increased. New virus infection rates remain high in the US, India and South America and are increasing again in parts of Europe. A second wave of the virus is a threat to global economic recovery, but hopefully improvements in medical treatment and changes in behaviour will lead to better outcomes than the first wave, which together with positive news on possible vaccines should be supportive of markets. Investor sentiment could be negatively affected by any escalation in US/China trade tensions, lack of progress on UK/EU trade negotiations or further extensive virus-related economic lockdowns.

ONE MONTH INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES

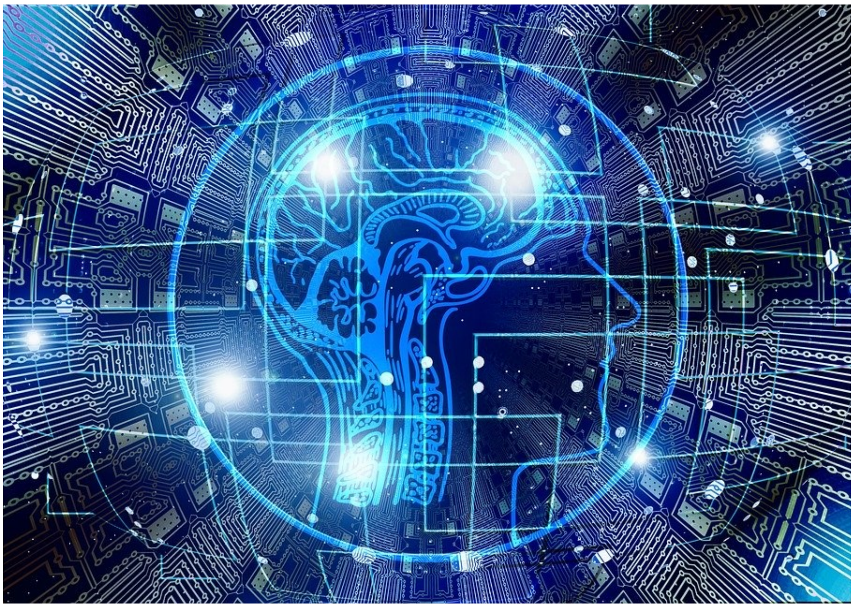


18/08/2020 - 18/09/2020 Data from FE fundinfo2020

SIX MONTHS INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES



18/03/2020 - 18/09/2020 Data from FE fundinfo2020



Over the last six months, the US equity market has seen an impressive return. As the chart on the previous page illustrates the technology sector, represented by the technology heavy NASDAQ index, has been in part responsible for this outstanding performance. Apple, Microsoft, Amazon, Alphabet and Facebook are the top five companies in both the broader based S&P 500 index and the NASDAQ - both of which had recovered to all-time highs. During lockdown, the products and services of these companies have been in high demand and their earnings reflect this. Tesla, which is listed on the NASDAQ, has also seen its price soar as investors seek environmentally friendly cars and energy. At the beginning of September, the technology sector experienced a 'sell off' as investors took profits together, with reports that Softbank had been trading substantial volumes of derivatives of technology companies. The UK equity indices have far lower exposure to the technology sector which in part accounts for some of the domestic market's relative under-performance since March.

The Chinese equity market has produced sound performance as the economy continues to recover, with the COVID-19 virus apparently under control. Consumption has rebounded and industrial output has increased by a greater level than anticipated. The OECD has revised its forecast for global economic growth upwards, as the recovery in China and the US is predicted to be faster than expected. It predicts the Chinese economy to grow by 1.8% in 2020 - the only G20 country likely to see positive economic growth. Companies which derive a meaningful portion of their profits from China have seen their share prices increase lately as a result, with many European companies directly benefiting.

The monetary policies of the major central banks remain supportive of the global financial system and investment markets. The US Federal Reserve (Fed) is projecting that interest rate increases are unlikely before the end of 2023 and seemingly will not tighten monetary policy until inflation has been at 2% pa for some time. Although the US economic recovery has been faster than expected, uncertainty over the spread of COVID-19 and waning fiscal support have led to the Fed maintaining its accommodative policies. The Fed continues to buy US government securities at a pace of $120bn per month. The Fed has revised down both its predictions for 2020 economic contraction (-3.7% from -6.7% predicted in June) and the unemployment level (7.6% from 9.3%) at the end of 2020. The unemployment rate has fallen to a rate of 8.4% which was better than expected. Against this background, a federal stimulus package for the US economy has stalled as the Democrats and Republicans cannot agree on its extent. (The Democrats want an even larger stimulus package).

The European Central Bank (ECB) maintained its accommodative monetary stance at its most recent meeting. The interest rate on the ECB's main refinancing operations, marginal lending facility and deposit facility remains at 0.00%, 0.25% and -0.50%, respectively. While the bank's Pandemic Emergency Purchase Programme remains at a total of €1.35 trillion. Eurozone economic growth has rebounded strongly as economies have come out of lockdown. The ECB has also revised up its GDP growth forecast for 2020 to -8.0% from its June estimate of -8.7% with positive growth of around 5% next year. Inflation remains low at 0.4% pa, the lowest since 2001. The ECB may well have to increase its stimulus programme to get inflation back to its near 2% target.

The Bank of England (BoE) has also kept its monetary policy on hold, commenting after its September meeting that the recovery had been "a little stronger" than expected. The Monetary Policy Committee (MPC) voted unanimously to maintain Bank Rate at 0.1% and its asset purchase programme at £745bn. The BoE expects the UK economy to contract by 9.5% this year and to grow by 9.0% in 2021. The economy has been expanding since May with GDP growing at 6.6% in July. The BoE is also considering negative interest rates but currently there are no plans to use them. Sterling weakened on this news having already been impacted by the uncertainty surrounding the UK/EU trade negotiations.

The Bank of Japan (BoJ) has also left its loose monetary policy unchanged with its interest rate at -0.1% and unlimited purchases of Japanese government bonds to keep ten year yields at around 0%. The BoJ commented that economic growth was picking up although still expects contraction of 4.7%.

The fixed interest market has performed relatively well and if equity market volatility heightens, has the potential for further gains. The central banks continue to support the market with unprecedented levels of stimulus, with their asset purchase programmes providing liquidity and supporting prices. It may well be that these asset purchases are increased if markets see renewed volatility. Investment grade bonds remain relatively attractive and funds with careful stock-pickers have performed well. Whilst yields on developed market government bonds are still low, they are included in portfolios for the protection they offer in times of equity market volatility and are retained for the long term for this purpose. Index linked gilts provide inflation protection. Although at a very low level currently, the enormous levels of monetary stimulus may lead to inflation in the longer term.

Commercial property funds were closed earlier in the year as it was not possible for surveyors to value properties meaningfully during and in the aftermath of lockdown. Recently, it was announced that properties in most sectors can now be valued, so funds may be in a position to re-open. Some funds have announced that they will open, whilst others which have less liquidity and/or more exposure to negatively affected sectors such as leisure and retail may well remain closed for a longer period. Currently there is uncertainty surrounding the office sector in the short term as home working continues, although there is a gradual return to offices. Demand for warehousing/distribution centres remains strong, as use of online shopping is likely to increase further. The funds continue to pay income as rents are paid.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

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OUR VIEW

For Cartlidge Morland clients and other investors in the UK equity market, currently depressed values are a huge disappointment. After all (ignoring currency factors) it is arguably the most defensive of major markets with around 85% of market capitalisation represented by 100 largely multi-national/global companies, generating approximately 70% of their revenues from outside the UK. Although comparatively dull in terms of growth prospects, as observed previously, these companies largely produce stable earnings streams, with a degree of cyclical demand in areas such as global mining. The drugs, alcohol, tobaccos, mineral extraction, oils, finance/insurance and aerospace/weapons systems that largely comprise the FTSE 100 index, are generally reliable earners – whatever view one might take of some of the activities involved.

These companies are far from broken by the impact of the COVID-19 pandemic, although the civil aerospace and hospitality sectors now contain some severely damaged companies. Why then are investors living with a market that in 'total return' is down around 19% since the beginning of the year, having failed to recover more fully from COVID-19 related shock than other markets?

There are three answers to the question. International investors have little faith in the UK's ability to survive the shock of a 'hard' **Brexit.** They believe that in order to stabilise the UK's external trade, the Bank of England may resort to allowing **Sterling** to slide in value, which for overseas investors will have the effect of devaluing their Sterling investments. This is on top of any malaise in UK share prices caused by deteriorating domestic economic conditions. For these reasons, UK assets are viewed as 'toxic' and it is not hard to see why the UK market has trailed the US, although the absence of a dominant **technology/social media** sector is also a highly significant factor.

The FTSE 100 and the domestic market generally continue to represent a massive medium or even shorter term value opportunity. We have been saying this for some time now although we have reduced exposure to some extent in favour of overseas equities to ensure favourable portfolio returns. Eventually, markets will appreciate the relative under-importance of the UK's export trade in goods and the fact that crude oil, petroleum products, gold, motor vehicles, vehicle components, pharmaceuticals and aerospace account for the bulk. Most of the UK's goods exports by value are not especially EU tariff sensitive. The UK will need to

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OUR VIEW....continued

trade outside current EU structures for some time after 31 December 2020, with or without a new free trade agreement, before this lack of sensitivity is fully appreciated.

Tech valuations in the US are frightening but 'lockdown' has only increased global dependence on the 'mega-tech' companies and pointed the way to fresh applications for their technologies. Presently, these companies appear to hold unassailable positions. Exposure is necessary but prudence dictates it should be kept within bounds, even at the expense of return. The rest of the US market appears to represent reasonable to fair value. Europe has much to offer with German equities continuing to offer particular value. Pre-pandemic international trade tensions had driven them down. Global investors are experiencing a bout of Japanese excitement – it tends to happen during times of trouble, as the Yen duly rallies reliably and Japanese equities then appear defensive. When short of fresh ideas, or worried by US valuations, the financial commentariat turn to Japan. It is true that Japan has some attractive opportunities to offer investors – as we have said before. It is often forgotten that it is effectively the world's second largest equity market. Conversely, the Japanese market's capacity to continually disappoint or otherwise to wreck a strong run is unparalleled in a mature market. It is so often a matter of being 'in' and then 'out' at the right time.

Lastly, global financial markets are in early stage recovery from the greatest economic seizure in modern times – by this we mean an unprecedented plunge in global economic activity. In economic terms this has been cathartic and some companies will emerge definite winners – and to a considerable extent, the US mega-techs already have. Others will benefit from the weakening of key competitors as the global economy rapidly expands to previous heights. The path may not be smooth owing to the uncertainties of COVID-19 infection rates but excluding the very short term, the path will most certainly be upwards and we are therefore very much living in a 'risk-on' environment at this point in the cycle.

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