CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

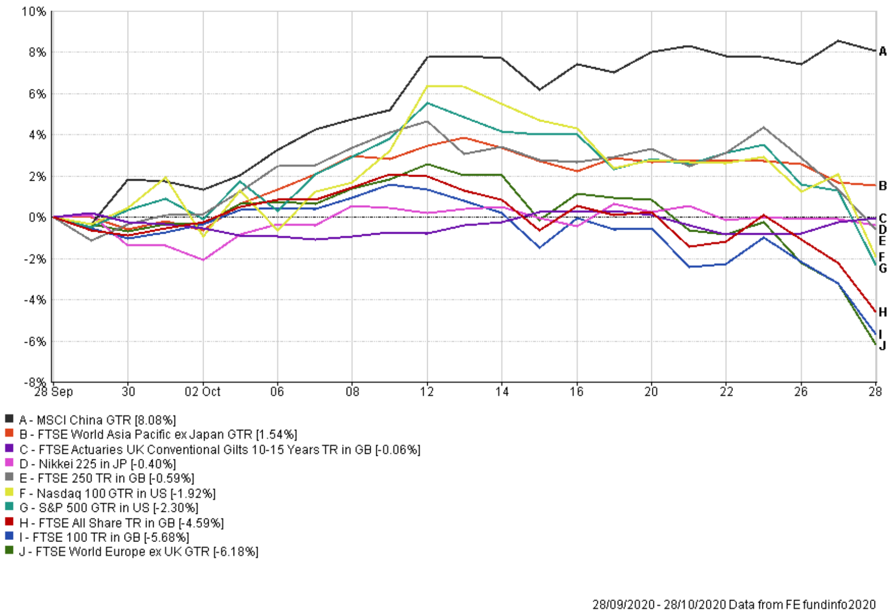
INVESTMENT COMMENTARY

29 OCTOBER 2020

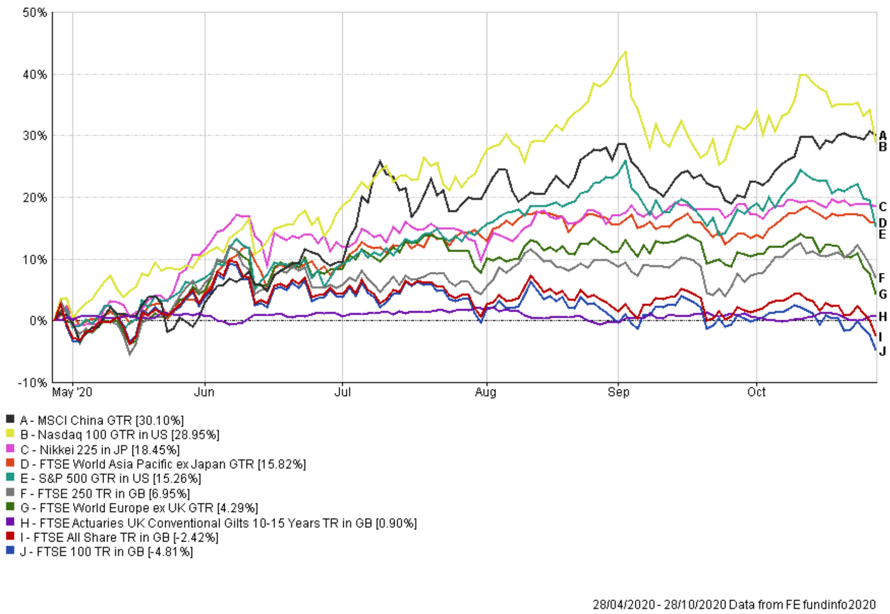
OVERVIEW

Equity markets have fallen sharply in recent days as Covid-19 virus infections have risen steeply in Europe and North America. Since September, restrictions in Europe have tightened to try to control the spread of the virus. France has announced a return to lockdown nationally, Germany is to enter into a softer version of a national lockdown whilst other countries continue with varying degrees of localised restrictions. The impact on European economies will be severe - especially for the leisure, hospitality and travel sectors. However, with the ongoing actions of central banks and fiscal initiatives proving supportive, together with most economies not locking down completely, equity market drawdowns of the gravity seen during the first wave of the pandemic, seem less likely. Many South East Asian countries have controlled the virus more successfully and their economies have reopened, with equity markets performing relatively well as the charts below show. Investor sentiment has also been affected by uncertainty relating to the outcome of the forthcoming US elections and a UK/EU trade deal. The search for successful vaccines appears to be reaching its conclusion with the hope that vaccination programmes will commence late 2020/early 2021. Vaccination coupled with quicker and more extensive testing should be positive for economic recovery and equity markets.

ONE MONTH INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES



SIX MONTH INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES



Economic indicators point to the manufacturing sector continuing to expand, albeit at a slower pace in October than September in the US, Europe and the UK. Despite the slowdown in manufacturing, the UK saw new export orders rising at their fastest rate since February 2018 - with demand increasing from the US and China, as well as stock building in the EU ahead of the end of the Brexit transition period. The services sector is still growing in the US and the UK but is contracting in Europe. Japan is experiencing contraction across both the manufacturing and services sectors. Tighter Covid-19 virus restrictions are likely to see further slowdown and perhaps contraction in some economies. Retail sales in the UK were strong in September, although consumer confidence does appear to be declining as regional virus restrictions are imposed. The US employment figures continue to improve whilst in the UK, the unemployment rate rose to 4.5% in the three months from June to August 2020 from 4.1% in prior three month period. The furloughing scheme has been altered and it may be that unemployment increases further as a result. In contrast to the uncertain economic growth prospects for Western economies, China saw its economy grow at 4.9% in the third quarter as the country is less affected by the pandemic.

Given the resurgence of the Covid-19 virus and no uptick in inflation, central banks are likely to keep interest rates low and monetary policy accommodative to support financial markets. The European Central Bank (ECB) has indicated that it is likely to extend its bond buying programme in December to support the eurozone economy. The Bank of England (BoE) has asked banks how prepared they are to cope with negative interest rates i.e. the banks pay the Bank of England to hold deposits. The intended economic benefit is that the banks would then prefer to lend the money, rather than deposit it at the BoE, so supporting the economy. Having adopted negative interest rates, it might prove difficult to return to positive rates later.

As well as rising virus infections, US equity market sentiment has been affected by the inability of Congress to agree a financial stimulus package ahead of the US elections. Additionally, there is uncertainty over the results of the Presidential and Senate elections. Polls indicate that Joe Biden is likely to be the next US President, with the Democrats holding power in the House of Representatives and the Senate - although polls can be wrong. If the Democrats gain a clean sweep, then policies aimed at regulating businesses further and higher taxes could depress investor sentiment. A Trump win would see renewed trade friction with China. A big fiscal stimulus package is likely whoever wins. A definite winner will be far preferable to the contested election result Mr Trump is promising if he loses, as that would will only prolong the uncertainty.

Government bonds continue to provide portfolio protection during periods of equity market volatility. Over the past few days, yields have fallen as investors have become concerned about the impact of the second wave of the Covid-19 virus. Central banks' quantitative easing programmes have been supportive of government bonds during the pandemic, as governments have issued massive amounts of bonds to fund their fiscal packages. The central banks have bought the bulk of them – acting as lender of resort to their host governments, rather than their banking systems in this particular crisis. Although inflation is currently low, there is some concern about the inflation rate ticking up which has put pressure on longer-dated bonds, although supportive of inflation linked bonds. Whilst interest rates remain at such low levels, yields on short-dated bonds are likely to remain relatively low. There has been a record amount of new issuance in the sovereign and corporate bond markets. Usually such high issuance would be viewed negative for bond markets. However, it appears that a lot of the cash being raised is being saved as companies manage their balance sheets. With many companies suspending/reducing dividends, it would seem that bond holders are being prioritised during the crisis, from which investment grade bond prices benefit.

Some commercial property funds have recently re-opened, as surveyors confirmed that they could once again provide meaningful valuations - which had not been the case earlier in the year. Many funds still face liquidity issues due to relatively high exposure to the retail, hospitality and leisure sectors and remain closed. The respective fund managers continue to raise cash in their funds with the aim of reopening their funds. The funds are still receiving rents from their tenants and the income arising is paid out to investors.

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

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

Markets generally expected a spike in COVID-19 infection rates as national/regional lockdowns eased but not a 'second wave' of the gravity the statistics suggest across Europe, US and Latin America.

Our view was no different to the consensus; whilst expectant of a 'spike', we considered the severe economic consequences of the first socio-economic 'lockdown' would deter the introduction of a second. For the time being, national chancellories appear able to spend hugely and impulsively with impunity. The central banks conjure up the money to buy their governments' own sovereign bonds – with no effect on inflation, no need to trouble global investment markets, nor cause any ripple in the oft cited 'deep pools of capital' they represent.

The long-promised vaccine would be a game-changer for the global economy, as would eventual realisation that the world and its economy must learn to co-exist alongside pandemics of the COVID -19 variety. Improved testing and better medical treatment will all contribute to a resumption of normality.

The present environment dictates greater diversification of both risk (to conserve capital) and the search for opportunity (to provide income and capital growth). Our portfolios presently have greater overseas weightings than usual. We have reduced UK equity exposure in favour of increased diversification in global equity (shares) and credit (bond) markets. Portfolios are therefore more diversified in their holdings and currency exposures. The UK equity market has continued to struggle in the short term, not only due to the Covid-19 crisis but also uncertainty surrounding the future of a trade deal with Europe - as well as the cyclical nature of the main UK equity index. The FTSE 100 index includes many banking, mining, oil and retail sector companies. The UK equity market should begin to outperform as and when a new economic cycle starts. However, we are still likely to see rising unemployment and business failures ahead of a sustained global recovery. We continue to hold a range of UK equity funds including those investing in high quality growth companies, but also some investing in the cyclical sectors which offer good value currently.

As always if you have any concerns please contact your usual Cartlidge Morland Partner/Director/Consultant.

OUR VIEW….continued

Whilst the yet unknown result of the US elections leads to short-term uncertainty, the US equity market still reflects the exceptional innovation of the economy with high quality companies. Technology companies have led strong US equity market returns but there are other solid companies which offer attractive longer-term potential but are currently not favoured.

European funds contain many companies which are internationally facing with strong market/branding positions in the growing emerging markets. Despite short-term challenges in domestic European markets, longer term these funds should deliver attractive returns.

We are up-to-weight and sometime beyond normal weighting in exposure to Asia Pacific and emerging market equity funds which have benefited from better management of the Covid-19 crisis and a weaker US dollar.

Commercial property funds have proved problematic over the past year due to liquidity and valuation issues. We had reduced property exposure over the past ten years since the 'great financial crisis' so that portfolios which had normally contained around 8-10% commercial property are down to 5-8% weightings. We have held commercial property funds as they diversified portfolios away from equities/bonds, whilst providing solid income streams. We consider the asset class a long-term hold – although presently at an under-weight level. Exposure will be trimmed a little further, but we will retain holdings for their very specific qualities.

We indicated last month we were in a 'risk on' environment; despite the recent falls in asset prices, we see this market weakness as an opportunity to invest for the longer term. The global economy and therefore corporate earnings/dividends should grow rapidly as the virus is controlled and lockdowns ease in 2021. Investors must rely on the expertise of the professional fund managers to avoid holding too many long/short term corporate casualties.

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