Model Portfolio Service

Commentary and Portfolio Updates, Second Quarter 2019

2019 continues to be a surprisingly good year for investors. Admittedly, much of this is the mathematics of the rebound from the very depressed end to last year, but investment markets are showing impressive resilience in the face of very mixed news flow.

The stand out feature of the year so far has been a dramatic fall in bond yields. There has been a significant reassessment of the outlook for global economic growth. Earlier fears of wage-driven higher inflation have been replaced by a conviction that the trade wars will instead have a significant negative impact across the world. The yield on the 10 year US Treasury Bill has fallen from over 3% last autumn to, temporarily, less than 2%. The yield on the UK's 10 year Gilt has halved over the same time period.

Equity investors have not taken fright from this, thus far. To the contrary, they have been heartened by the change from the threat of higher interest rates to the dangling carrot of a lower cost of borrowing. Our Portfolios have benefited from this unexpected, but welcome, tailwind. We suspect though that this is a gust rather than a change in the prevailing wind direction. Lower interest rates need to be justified by lower economic growth, which in turn means current expectations for company profits will be, on average, too high.

We are thus managing our Portfolios with an ongoing degree of caution. The S&P 500 Index, still the bellwether of global equity, has risen by over 15% in the first half of the year. 2019 will turn out to have been a remarkably successful year if the Index achieves nothing more over the course of the second half. Indeed, that is our working assumption. Anything over and above this is a bonus, not an expectation.

The UK equity market has not had a bad year so far, but is lagging behind the majority of the rest of the world. The rationale is simple enough: the prospects of either a No Deal Brexit or a Corbyn-led Labour government are more than enough to scare both domestic and international investors. And us. Having started this year with the belief that UK domestic assets were over-sold and under-priced, we saw an encouraging number of very sharp share price recoveries. We are now in the position whereby these domestic shares are priced considerably higher than six months ago, but also that the risks of No Deal or Corbyn have risen dramatically.

We have responded to this by making reductions to our allocations to UK equities, and commensurate increases to our overseas exposure. The magnitude of the switch has varied across the Portfolios according to the overall equity content, ranging from 2% in the Cautious Portfolios to 5% in the Adventurous Portfolios.

We have typically effected this by trimming each of our UK equity holdings and reinvesting into JO Hambro Global Opportunities, a very high quality global equity fund. We have also fine-tuned our fund exposure and have disposed of our holdings in Standard Life UK Equity Income Unconstrained; the fund has a strong domestic value bias and has failed to perform as we had hoped. We have reinvested part or all of the proceeds from this into Schroder Income Maximiser, a steadier fund paying a higher income. The changes – to both the asset allocation and the specific funds – should be seen as a reduction in the overall risk of the Portfolios.

Jim Wood-Smith

Chief Investment Officer, Private Clients

Important Information