



# INVEST *for* SUCCESS

QUARTERLY BULLETIN

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# *Introduction*

From Managing Director, Sanjay Shah

These are apparently buoyant times in the global economy. Economic indicators are improving, deflation appears to have been laid to rest; data indicates a synchronised global recovery, which should be a fertile environment for companies to grow profits and deliver better returns to shareholders.

However, political risk looms large. The failure of the new US administration to lay out definite plans for fiscal expansion has disappointed investment markets in recent months. The difficulty of getting healthcare reform through the Senate has led many to question whether President Trump will be able to deliver on his promises.

In Europe, the immediate political risk has abated following the election of Emmanuel Macron as French President. Populist parties also made little headway in the Dutch elections. However, the Five Star party is gaining traction in Italy and Brexit still needs to be negotiated. Both have the potential to create short-term volatility in financial markets.

What is an appropriate response to this? We review the second quarter on the following pages and talk through our current views on the global economy and markets. However, if Succession has one message it is that investment should always be a long-term pursuit and few have made money by letting short-term volatility derail a carefully designed investment strategy.

Time in the market is far more important than timing the market. Seeing through the noise and holding your nerve is likely to deliver the strongest returns over time.



SANJAY SHAH


# *Four Levels of Diligence*

Successful investment is critical to future financial wellbeing, and Succession provides innovative and effective investment expertise to meet clients' investment goals.

Succession provides investment solutions - from global fund managers and investment houses, as well as specialist niche investment managers - delivered through our Investment Matrix to match clients' volatility and return targets agreed as part of their plan.

Assessing the quality of investment performance and fund manager capability can be challenging and subjective. That is why we created a four-tier solution, co-ordinated by the Succession Investment Committee.

- Succession works with investment experts to deliver our investment philosophy. The strategy is founded on significant academic research, which emphasises the importance of strategic asset allocation and diversification. Our aim is to deliver investment returns that match clients' long-term goals and aspirations, within an agreed risk profile that suits your clients' attitude to risk and loss.
- We use the expertise of Rayner Spencer Mills Research, a dedicated resource, to monitor the performance of individual funds, as well as the performance of fund managers and the investment houses, against agreed targets for return and volatility.
- The Succession Investment Committee reviews models on a monthly basis. Our committee members possess both the expertise and knowledge to challenge selected investment managers and their activity.
- And finally, individual financial advisers and wealth planners, who best understand and appreciate what clients are seeking to achieve, provide the peace of mind that clients' financial plans are on target.

While past performance can provide no guarantee of future returns, this rigorous approach to investment means clients can be certain that their investments are subject to continuous sophisticated analysis and scrutiny, from an experienced team of experts. 





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# *General Economic Overview*

QUARTER TWO 2017



Global growth has been moving positively through the second quarter of 2017, although it is below trend. The continued economic growth of around 2% has surprised some economists given the level of underlying uncertainty created by political changes and differing central bank agendas.

The US has continued to show growth, but may well be challenged as employment rates have reached all-time highs and little policy progress is being made between Trump and Congress. Europe has been a strong growth area with peripheral countries such as Spain and Ireland delivering better numbers. The Japanese economy has also surprised on the upside thanks in part to a weaker but stable currency. Asia and emerging markets have also benefitted from the general stability of the Dollar in 2017 and its more recent weakness, but concerns remain that this positive momentum has continued beyond a normal business cycle, despite some more positive news on company earnings through 2017. Stock markets have been robust through most

of the year, treating political upheaval as minor speed bumps along the way to higher market levels.

The fears of political shifts and the rise of populist parties in Europe have been on the agenda since the UK vote to leave the EU in 2016, but this has failed to materialise – other than in the UK where the uncertainty was perpetuated following the recent general election. The Dutch and French elections both saw centre candidates overcome any extremes and, although there are more elections this year, the momentum of the populist agenda has been largely subdued. This has meant that European markets have concentrated on the positive economic news in the second quarter





which has helped to drive market values higher with Europe being the strongest performer over the last quarter. We still have Donald Trump in the White House creating uncertainty but his initial policy drive has not found favour with Congress and many of the manifesto pledges may prove difficult to execute.

Concerns have been raised about volatility, or the lack of it, in the last few months as markets have been more resilient to political change, with greater security created by the reducing fear of Eurozone instability, helped by the recapitalisation of Italian banks. The snag is that the absence of volatility may be as much to do with monetary policy being accommodative as with global growth or the robustness of financial systems. The danger therefore is one of complacency, where lenders and consumers assume greater stability and relax their controls in both of these areas creating higher levels of debt. Should economies be seen to be more robust

then investors may have to confront a new reality of higher interest rates and reducing central bank balance sheets, with corresponding effects on a higher debt-laden consumer.

Overall the global economic position looks more stable at the end of quarter two but we are eight years into a positive market cycle supported by accommodative monetary policy, with many investors questioning how long this can be maintained if such policies begin to be unwound.

## **EQUITY MARKETS OVERVIEW**

Markets generally continued with the momentum from the first quarter with all the main indices posting positive returns in Sterling terms, with the exception of the US. In local currency terms the returns were better given the improved strength of Sterling. Most

of the returns were achieved in May, with April and June broadly negative overall. Globally the markets seem to have put aside the political worries that were holding back investors at the beginning of the year, and for many the only real blip has been the UK elections which saw a weakened Conservative party returned to power. Most global markets benefitted from the stability of the Dollar, particularly the Asian and emerging markets where currency fluctuation tends to be detrimental to consistent market growth. Europe was also a beneficiary of stability and of the improvement in sentiment following the elections in the Netherlands and France. One theme to watch for the rest of 2017 is the shift to favour stocks less exposed to the business cycle; the market has seen value stocks underperform in the first half of 2017 and the difficulty now for investors is to continue to justify buying into the growth stock momentum.

# General Economic Overview (cont.)

## QUARTER TWO 2017

### UK



With just over a year having passed since the EU referendum, to the surprise of some, the UK economy has continued to grow, although the rate of expansion has slowed of late. The three quarters after the vote have shown an annualised rate of GDP growth of 1.8%, whilst unemployment has fallen from 4.9% to 4.6%. The headline numbers are less encouraging than they first seem as household consumption accounted for more than four-fifths of the economy's expansion. Perhaps this is not as surprising as it first seems, as the majority of those who voted were in favour of Brexit and therefore got what they wanted, something unlikely to dent consumer confidence in the short term. Business investment made no contribution, whilst net exports detracted.

The most recent data shows prices rising at an annual rate of around 2.9%, but regular wages increasing only by 1.7% and so, a year after the referendum, most households will be worse off. The UK savings rate has already fallen to its lowest level in over 50 years and strong consumption is unlikely to be sustained if it is accompanied by falling incomes. Brexit is also forming a barrier for some firms in terms of capital investment into the UK with a number of financial institutions initiating expansion into European hubs to cover any hard or negative trade deals that may come out of separation from the EU.

Other data is still supportive of continued growth of the economy with unemployment less than 5% and UK

PMI data still positive after the election blip. Consumer spending is however causing some concern as data from companies such as Next suggest it is starting to fall, and Nationwide house price data is also indicating declines in 2017. A number of managers are positioned with an underweight to the UK at the moment.

### US



As the US nears full employment, wage growth and inflation would be expected to increase leading to a rise in interest rates. To date, wage growth in the US has remained muted and different geographic regions and industries are seeing hugely varying trends and conditions, with some companies and sectors, ranging from manufacturing and construction to healthcare and agriculture, warning of a lack of qualified employees. At a time when the unemployment rate is the lowest since the beginning of the century, economies would be expecting a period of accelerating wage and price growth. Other parts of the States are not as buoyant and last year's election was dominated by concerns over poor job prospects in traditional Democrat heartlands which resulted in the election of Donald Trump.

For the Fed, core inflation has remained resolutely below target and hopes for a speedy Republican fiscal stimulus have receded. The latest jobs figures released in early June for the month of May showed hiring undershooting expectations, and growth in average hourly earnings is still no stronger than it was three years ago at around 2.4%. Core inflation has fallen back to just 1.5% in April. A subdued inflation picture has resulted in diverse views in the

media from different Fed members with James Bullard, the St. Louis Fed President, questioning the Phillips curve that links unemployment to price growth as he does not believe inflation is heating up.

One factor behind this more complex recovery has been the uneven upswing in the US jobs market. The traditional industrial heartland of the mid-west has seen much slower median wage growth from 2000 to 2016 than the North East of the country. Many rural and poor urban regions have entrenched unemployment and college graduates have fared much better than lesser educated members of their peer group. In contrast, across large parts of the Northeastern Seaboard job conditions are tight and overall unemployment is now around 4.3% - below what the Fed believe will be the long-term rate of 4.7%.

Valuation continues to be a concern for many investors as the US markets reach new highs. Although the earnings season has been generally positive, certain metrics still suggest that markets are frothy. With PEs at 27-30x and price to book ratios over 3, data indicates it makes sense to look to other areas of the globe where value is more obvious.

### EUROPE



The European economy has seen significant improvement in data over the last 12 months and 2017 has shown that it is now expanding, particularly in many of the peripheral economies that struggled most after the financial crisis, such as Spain. There are still many hurdles to overcome, not least the effect of the

<b>QE</b>	Quantitative Easing
<b>ECB</b>	European Central Bank
<b>GDP</b>	Gross Domestic Product
<b>CBI</b>	Confederation of British Industry
<b>PMI</b>	Purchasing Managers' Index



<b>RPI</b>	Retail Price Index
<b>Fed</b>	US Federal Reserve
<b>ROE</b>	Return of Equity
<b>SOE</b>	State-owned Enterprise
<b>REIT</b>	Real Estate Investment Trust
<b>SDR</b>	Special Drawing Right

Euro which has strengthened in 2017. The Brexit headwinds remain, as does some political uncertainty, but most of the recent elections have seen centrist political parties overcome the populist parties that were threatening the traditional equilibrium. The Italian banks were causing concern but some of this has abated as the Italian government has agreed to pump €5bn into two of the failing banks with €12bn of additional guarantees. In Spain, Banco Popular was also rescued by Santander.

More recently investor sentiment has turned more positive with data from the recent earnings season much stronger, and relative valuations in Europe are better than other areas of the globe, which is another factor fuelling investment in the region's companies. A number of managers have an overweight to Europe because of this growth improvement and the relative valuation of companies compared to other markets such as the US.

## ASIA



The election of Donald Trump as US President initially had a negative effect on Asian markets, but his inability to deliver policy objectives together with a weak US Dollar have helped ease monetary conditions within Asia, and have helped boost stock markets which are now receiving earnings upgrades.

The rate of economic growth in China, while slower than in the early years of this decade, remains in line with government targets, helping both the

Asian region and the global economy. There remain longer-term concerns about the level of debt, particularly corporate and other non-government debt that has been built up, but China is unlikely to see a systemic banking crisis due to its closed financial system. Domestic consumption continues to be strong, supported by continued wage growth. The Chinese currency, the Renminbi, has also stabilised as authorities have stemmed capital outflows.

India should continue to benefit from its young labour force, a factor also true of the Philippines. Inflation levels have generally fallen throughout the region due to lower commodity and oil prices and this should benefit many countries in the region that are net oil, energy, commodities importers. We expect the strong domestic consumption story in Asia to continue for many years to come and believe this remains a region with excellent long term potential for investors.

The Asean region did suffer a sharp setback following the election of Trump, but this year's softening of the US currency should be a benefit at the individual country level. In Indonesia, after a period of subdued growth (Q1 GDP growth was 'only' 4.8%), the economy is also improving, helped by the lagged impact from 2016's commodity price rises. Tax revenues have increased 15% (helped by the world's most successful tax amnesty), lower interest rates (50bp over the last twelve months, when the US Fed has been raising rates), and the government's focus on significantly increased infrastructure spending. Other areas of interest include Vietnam where the economy continues to demonstrate impressive growth, accelerated in Q2 to a 6.2% year-on-year GDP growth rate,

from 5.1% in Q1, despite a weak mining sector knocking 1pp off growth.

## JAPAN



The Japanese economy expanded for four consecutive quarters in 2016, and growth has continued in 2017 with GDP expectations exceeded. The majority of the growth has come from exports, although there are signs domestic consumption is benefitting from a tight labour market. The Bank of Japan believes a tighter labour market will eventually allow the country to hit its inflation target, and in the meantime monetary policy will remain accommodative. Whilst the level of government debt remains high with interest rates at very low levels, Japan should be able to service this debt for some time without any major issues. The Topix has risen around 6% this year and has generally been rising since 2013 mostly based on and correlated to the Dollar / Yen rate but decoupling has now set in, with the Yen Topix correlation falling to 63% from 86% in March 2016.

Valuations remain attractive relative to their history, on both Price to Book basis and versus other markets and Japan is benefitting from an increased focus on shareholder returns and better corporate governance. Dividend pay-out ratios have scope to rise from low levels by international standards. Other market movements may depend on foreign investor sentiment and whether there are more signs that the government and the Bank of Japan's policies can lead Japan into a period of sustained economic growth. A weaker Yen would be of major benefit to the stock market were it to occur.

# *General Economic Overview (cont.)*

## QUARTER TWO 2017

### EMERGING MARKETS

Country effects are often an important factor within emerging markets, and this has been seen recently in Brazil as new President Temer has been caught up in the corruption scandal. In contrast Mexico has rebounded as President Trump's bark has proved worse than his bite. India continues to benefit from the Modi reform program.

Many commodity prices have softened in 2017 and within the region, there are losers and winners but it is generally positive for Asia, especially the fall in the price of oil. The opportunities in emerging markets are becoming increasingly theme-, country- or stock-specific with wide dispersions within the investment universe. The growth of e-commerce at a pace even faster than the West has thrown up some exciting investment opportunities in contrast to the regions more cyclical names.

Valuations versus developed markets remain attractive at headline levels and in the absence of a sharp rise in the US currency, the GEM universe continues to offer excellent long term potential to skilled active managers.

### FIXED INTEREST

The fixed interest element of any portfolio has probably been the most difficult to manage over the last five years, with the continued fall in yields being supported by accommodative monetary policy. The result of this has been that those investors with longer duration portfolios have benefitted significantly in terms of capital appreciation. For most investors the last two years have been most difficult as interest rates in most western economies have been at record lows with negative real rates after inflation is taken into account. With such low rates the consensus view has been that they will move up as monetary policy normalises and central banks reduce bond buying. The US has already begun this path of tightening but are at the moment the only major central bank doing so. For the retail investor such low rates leave little potential for capital appreciation as lower rates seem unlikely, and a conundrum about how to invest the defensive elements of their portfolios if rates move upwards.

There has been no easy solution to this dilemma, but the broader consensus now suggests a coming together of central bank policy with the gradual reduction in bond buying programmes outside of the US and the shrinking of balance sheets by the Fed, which may well then lead to higher natural rates before any interest rate rises. The likely raising of rates in the UK, Europe and

Japan still seems some way off given the level of economic growth and the current inflation levels. For many investors this has meant holding shorter duration assets and this has been reflected in a number of strategic bond fund managers. At the end of the quarter we saw a jump in ten year government bond yields in the US and the UK perhaps signalling a shift in the cycle. Traditional thinking would suggest ten year yields should be around nominal GDP levels, and so there could be further price weakness in government bonds over the next 12 months. The next question is how far yields are likely to rise given the current nature of economic growth and the point we are in the economic cycle. Growth is not expected to be much higher in this cycle so we may well see a lower level of long term rates become the norm, leaving bond investors less exposed than once thought several years ago.

There have been areas of good positive return, including emerging market debt and areas of high yield, where spreads have gradually come in helped by the lack of defaults. High yield debt has always shown a stronger correlation to equities than government bonds and therefore the improved growth outlook is a positive for this asset class. Equally a number of bond fund managers have developed highly diversified portfolios to contend with this type of environment, using instruments such as asset backed securities and floating rate notes.





## PROPERTY



The commercial property market has little to report at the moment with the emphasis on quality ahead of secondary property, and the development of distribution warehousing or the 'Amazon effect' is probably the only area of definite expansion. With the property market relatively inert, the likely returns for investors will be focused on income rather than capital growth. The impact of the UK's vote to leave the EU on the direct UK commercial property market continues to lessen following the initial negative reaction.

As an asset class, the fundamentals for commercial property have not changed with the potential for a continuation of an impact on valuation of those properties, sectors and regions that have experienced the greatest price rises in recent years. This would be applicable to Central London as well. The weakness of Sterling versus overseas currencies has countered this (to some extent) as property becomes more attractive to overseas buyers. Returns are still expected, for the remainder of 2017, to remain reasonable but with absolute returns more muted than recent years. The driver of returns will primarily be income with capital growth limited (in some cases negative) with rental growth becoming a more dominant factor for performance. In a low interest rate environment, the asset class continues to be a solid option for income seeking investors as well as for diversification purposes in

portfolios but the liquidity issues experienced in 2016 still provides cause for concern. The secondary market versus primary property yield gap remains attractive but the selection of the individual property will continue to be important.

## SUMMARY

The global economy has established a relatively stable level of growth albeit below the level needed for outright expansion and this has been reflected in the continued momentum in equity markets. Economies in Europe appear to have turned the corner switching from recession and into growth and emerging markets and Asia have shown strong growth in 2017. This level of stability should encourage investors to look for areas of value but instead there remains an underlying level of caution as many hold relatively high levels of cash and continue to pursue the perceived safer growth stocks rather than those more dependent on the business cycle. There was a brief value rally at the end of 2016 but this has long petered out.

The caution may reflect left over political uncertainty in Europe and perhaps the US with Donald Trump seemingly struggling to get policies approved in Congress. We also face the fact that markets and multiples appear to be very high at the moment with certain markets such as the US, and within that certain sectors such as technology reaching all-time highs after an extended

bull run lasting over eight years. When any set of data starts to pass existing milestones investors question the longevity of the trend and this period is no exception. Another factor being taken into account by investors is the changing stance of global monetary policy. Since the financial crisis this has been highly accommodative across the globe but as central banks start to wind down their asset buying and look to raise interest rates, asset prices should start to be driven more by fundamentals. The typical risk on / risk off pattern that has driven markets for most of the decade has started to break down with correlations now falling after an extended period of increase. This broader dispersion of returns from asset classes will bring challenges and opportunities as normalisation of interest rates and central bank balance sheets takes place. There is no guarantee of this of course, as we may well see further, as yet unknown, events overriding this trend but current policy indicates that investors need to be prepared for this process of normalisation.

In this type of environment it is very difficult to pick out clear areas of value although we can probably point to favouring equities over bonds, and within that European and Asian markets ahead of the US and the UK. There remains no substitute for continuing to hold a broad based portfolio with exposure to traditional areas of investment as well as consideration of alternatives to broaden this diversification. 

**Ken Rayner & Graham O'Neill**  
Rayner Spencer Mills Research Ltd  
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# Great investments to get tech exposure

by **Garry White**

Chief Investment Commentator, Charles Stanley

The technology sector is rapidly growing and innovating. This means it should be an essential part of any investment portfolio. Unfortunately, the UK stock market is short on technology companies, with the sector having just a 1% weighting in the FTSE All-Share. UK investors seeking exposure therefore need to look abroad for these opportunities and collective investments are an ideal way to do this.

Most technology funds are dominated by the larger players. Indeed, the five-largest tech companies in the S&P 500 have a market cap that significantly eclipses the value of Britain's 100 largest companies. These five companies have a market value of about \$2.8 trillion compared with the FTSE 100 total market capitalisation of about \$2.3 trillion. Before looking at ways to invest, let's take a look at each of these technology behemoths

**Apple** - Apple is expected to release its latest smartphone, the iPhone 8, in September – the tenth anniversary of the launch of the original iPhone. The device is, by far, the group's most successful product and is expected to introduce some radical changes. These include a bigger screen, possibly a 3-D camera and other new features. The company has more than \$250bn in cash balances globally and, as part of President Trump's tax reforms, there are expected to be inducements for companies such as Apple to repatriate the money and invest in the US.

**Alphabet** - Alphabet owns internet search engine Google, by far the best product in its class. It is still posting substantial double-digit earnings growth, despite its massive size. The company makes most of its money from advertising. Alphabet has also positioned itself in some non-core markets involving emerging technology. These include artificial intelligence, driverless cars, and fibre networks. European anti-trust regulators have, however, recently fined the company €2.42bn over abuse of its search dominance, so there are risks.

**Microsoft** - Microsoft's operating system is used on most PCs – and its software such as Word and Excel are ubiquitous. However, its "cloud" service, called Azure, is what could be set for big growth. Cloud computing is where companies or individuals pay for internet space to store their own data instead of having their own office servers or large memory on their computers. The company is also good at producing consumer-facing technologies, with a new Xbox console for computer games on the way.

**Amazon** - When Jeff Bezos launched Amazon.com in 1995 it only sold books. But more than two decades after its launch, Amazon can fairly be described as the "everything store". The online retailer makes its own tech gadgets, such as the Kindle eBook reader and recently announced plans to buy US upmarket grocery chain Whole Foods. This is a move into "bricks-and-mortar" stores which is a departure from its usual operations. Amazon also made history, by becoming the first streaming company to score an Oscar nomination for best picture, with the Casey Affleck drama *Manchester by the Sea*.

**Facebook** - An astounding 1.9 billion people actively use Facebook's services every month, with more than 1.3 billion people who use them every day. Last year, the business performed well and generated \$27.6bn in revenue, with the first quarter of this year saw the group reporting revenues of \$8bn. The company also owns Instagram, Facebook Messenger and WhatsApp.

## FUNDSTO PLAYTHEME

The performance of **Scottish Mortgage Investment Trust** has been so strong it entered the FTSE 100 in March 2017. The fund focuses on businesses with sustainable competitive advantages that can benefit from secular growth trends, and has a sizeable allocation to unquoted investments (28 positions), not in venture capital type companies but in mature cash-generative businesses with market caps north of \$1bn.

**Polar Capital Technology** invests in a number of the world's leading technology companies. Manager Ben Rogoff seeks to benefit from a number of emerging themes, including e-commerce, digital marketing, cyber security, cloud infrastructure, digital payments and games software.

Like most technology funds, **Allianz Technology Trust** is dominated by North American companies. Performance continues to be very strong, extending its impressive longer term record. The management team believe the Augmented/Virtual Reality theme "is poised to accelerate" in 2017, as is company spending on Cyber Security. The portfolio is tilted towards smaller, higher-growth stocks. ■

*This information does not constitute advice. When providing advice, or a personal recommendation to an individual, you should take into account the particular investment objectives, financial situations or needs of individuals. The value of investments may fall as well as rise and an individual investor may not receive back the amount originally invested.*

*The information and opinions expressed herein are the views of the author.*

**CHARLES  
STANLEY** 



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While we only provide ethical investment portfolios we still apply conventional investment management techniques and analysis to the portfolios we manage.

The global economy continues to recover and once again we have seen recent upgrades for global growth, including the UK, and as usual they come with caveats of slower growth for the following year, which are then subsequently upgraded. In the big picture we are still seeing the global economic emergence from the financial crisis. In the US the next significant policy move has now been put on the table. This is the US Federal Reserve beginning to shrink their balance sheet (that is to start to take back the money printed by QE).

The UK is approaching the same stage but all is now on hold for Brexit. Japan is reconsidering its options after another spurt of QE, Europe is beginning to benefit from their belated and aggressive QE and we now see confidence rising in Europe as it catches up. Elsewhere China is a little more political and careful as it is a congress year and India remains the most promising frontier market. To us the biggest risks will be around the US Federal Reserve getting their balance sheet shrinking right, so far they have flagged it well and the market is at ease.

The other leading factor is the long awaited tax reform in the US. Like Brexit in the UK, Donald Trump attracts a lot of media attention but the real news has more to do with Congress and there are expectations of tax reform this autumn that could address some long standing distortions in the US corporate and personal tax system.

In the UK, Brexit remains a large uncertainty that can have enormous consequences for both the UK and Europe. Markets and companies can cope with this uncertainty and will act as facts begin to appear. Up until now we have had almost no facts and just an irritating amount of nonsense from the media.

The last nine months has been a good period for global equities, we have seen equity market rise between 14-20% depending on which index is used. A large part of this has been to the benefit of larger global companies that mainly earn their money overseas, so UK focussed growth investments and foreign investments have performed well (about 37% of the combined portfolio, are investments that are either foreign or significant foreign earners).

Subsequently, UK focused ethical income funds for example have underperformed over the period (Henderson UK Ethical Income for example returned 10.9%, F&C Responsible Income 9.88%) and this is the case for income and more defensive shares. About 20% of the combined portfolio is invested in these stocks and this includes investments like the Foresight Solar Fund.

All the data is from Bloomberg/King and Shaxson.

Should you like to know further information on ethical investing please feel free to contact Mark Tomlinson from King & Shaxson on 0773 336 3306 or alternatively [mark.tomlinson@kasl.co.uk](mailto:mark.tomlinson@kasl.co.uk). ■

This information is for general information purposes and should not be considered a personal recommendation or specific investment advice. The value of your investments may fall as well as rise and is not guaranteed.

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# *The pitfalls of past performance within fixed income fund selection*

by **Nick Watson**

Fund Manager - Janus Henderson

We recently visited an independent financial adviser who focused almost exclusively on past performance when selecting his fixed income holdings. This had led the adviser to invest clients in long-dated corporate bonds funds, a high beta approach to credit investing that has performed incredibly well through the QE (quantitative easing) driven bull market. We are not licensed to give advice, but reflecting upon that meeting, we would like to explain why our own approach to fund selection within fixed income differs. The upside for long-dated corporate bonds appears limited to us given the historically low yields on offer and improving economic backdrop.

## **HEADWINDS ARE BUILDING**

We believe the adage that "past performance is not a guide to future returns" is incredibly relevant here. The low growth, low rate, low inflation, and high QE environment that has propelled high duration\* long-dated bonds to current levels is ending. Global growth is positive and resilient, central banks are moving away from near-zero interest rate policies (ZIRP), inflation is normalising, and global markets are starting to look beyond QE for the future drivers of returns. In this environment, the high sensitivity to interest rates that has supported returns of high beta fixed income on a global basis throughout central banks' QE experiment would become a significant headwind to total returns.

## **DANGER AREAS**

We think buying fixed income funds using past performance data as the main input is a very dangerous approach in an asset class that has selective areas of stretched valuations. Rather than looking at absolute returns delivered through an historic period of (arguably) misallocated capital, investors should 'look under the bonnet' and really understand the dynamics of the fixed income vehicle or asset class that they are buying.

We think there are opportunities within fixed income for those investors who are prepared to be nimble and active in the face of continued economic growth and inflation normalisation. This

can take the form of identifying the most appropriate area of the fixed income universe to invest in then, secondly, identifying the best instrument to reflect that view.

## **A TACTICAL DYNAMIC APPROACH**

We have been tactically navigating the fixed income market in our UK-based Multi-Asset portfolios. For example, we increased exposure to US high yield bonds at the start of 2016, as yields rose towards levels historically associated with recession amid concerns about softer US economic data and a weaker oil price. From there, we saw the asset class return c16% by the end of 2016 as oil rallied and economic activity remained resilient, enabling us to take profits and rotate client capital into other areas.

Funds that we currently favour include the AXA US Short Duration High Yield Bond Fund and strategic bond funds such as the TwentyFour Dynamic Bond Fund and the PIMCO GIS Income Fund\*\*. The AXA fund is managed by Carl 'Pepper' Whitbeck and his extremely well-resourced credit research team. The fund offers an attractive near 4% yield with only approximately 40% of market volatility.

TwentyFour and PIMCO offer very different and complementary exposures from their actively managed portfolios. TwentyFour currently favours key positions in European financials, while PIMCO has a more cautious outlook, with exposure to US Mortgage Backed Securities alongside some EM debt and US high yield.

We think that an active and nimble approach to fixed income investing is necessary in an environment of positive growth and normalising economic conditions. We continue to focus on identifying what we believe to be the right parts of the bond asset class and the right funds to implement these views. We truly think this approach provides our portfolios with the best opportunity to deliver competitive risk-adjusted returns throughout a range of market environments. ■

\*High duration = high sensitivity to changes in interest rates.

\*\* NB: while the manager favours these funds, investment is subject to portfolio risk, return, and cost constraints; investment is therefore not necessarily made across all Janus Henderson Multi-Manager and Core strategies. Fund yields may vary over time and are not a guarantee of future yields.

Funds mentioned in this article do not constitute or form part of any offer of solicitation to issue, sell, subscribe or purchase the funds.

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**Janus Henderson**  
— INVESTORS —



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# *A partnership to provide passives*

by **Robert Hardy - Business Development Manager**

Seven Investment Management

In August 2016, Seven Investment Management (7IM) was one of two providers selected to launch risk-rated model portfolios aligned to Succession's own bands of volatility and performance as part of a discretionary fund management (DFM) offering. A year after those DFM permissions were granted, we look at how these models aim to give your clients greater control and comfort.

One of the most important tenets that 7IM believe investors should hold dear is portfolio diversification. Often discussed in terms of baskets/eggs, the aim is to spread your clients' capital across companies, sectors and geographies to help reduce the likelihood of a one-off event affecting all of their holdings. A Californian earthquake might hurt Silicon Valley-based stocks, but have little or no impact on German bonds or the copper price.

It's on that principle that much of 7IM's investing is based. When we launched our passive funds (the Asset Allocation Passives) over nine years ago, they gave clients access to lower cost investments – assets then typically only available to institutional investors – and also served to broaden the number of options.

Diversification was also important with the bespoke Succession models. We wanted investors to access a very wide spread of assets and leverage our own experience. That experience had already seen us expand the range of assets in our models from 12 asset classes to a set-up much more aligned to our funds.

The models now enabled investors to access passive investments with the attendant cost benefits.

The expansion of asset classes meant that assets could be spread across more classes and ensured that we could access alternative investments. This gave the investment team flexibility, accessing options that could serve different purposes in portfolios than traditional assets typically provide, as well as supporting performance across financial markets' cycles.

Following the 2008 Financial Crisis, central banks had to help economic growth and so set about printing money the 21st century way (through Quantitative Easing), which led to a global bond buying spree. This pushed up the price of bonds and so lowered investors' yields. Now, with bonds being issued with longer maturity dates and central banks potentially having to step in and manage inflation through increased interest rates, the situation is less rosy for investors – particularly for cautious and retired investors who tend to have a lot of fixed income investments. Longer dated bonds increase bond holders'

chances of being hurt in a rising rate environment for protracted periods, a risk that rises as interest rates go up.

7IM's breadth of asset classes helps here too as we can avoid asset classes that could damage portfolios and invest instead in assets serving similar purposes – such as the alternatives – in terms of lower levels of correlation across the portfolio, while potentially protecting capital.

Diversification also supports our investment process which aims to deliver more predictable returns to clients over the medium-to-long term. Obviously investments can go down as well as up, but clients should get greater surety about each year's returns over the long term. And when markets do eventually trend south – highly likely given the current rich valuations for many investments – there are assets that are uncorrelated.

7IM's approach to managing money helps Succession wealth planners provide cash flow modelling. The expected returns that 7IM is aiming to deliver can be incorporated in clients' financial plans, allowing them to see that they're on track to meet their goals and aspirations, and help manage the risks attached to investing. This in turn offers comfort because clients are more likely to be looking forward to an enjoyable retirement rather than one that has to be endured. ■

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# Investment Committee Members



## **Simon Taylor**

*Chair of the Succession Investment Committee*

Simon is Platform and Investment Director at Succession Advisory Services and has significant experience in both propositional development and distribution. Simon is also a PRINCE 2 practitioner.

Working within the financial services sector for over 15 years prior to joining Succession, Simon has held key positions at Bluefin focusing on integration and change programmes, St. James's Place and within the retail banking sector. He sits on the TISA Wrap & Platforms Policy Council and the UK Platform Group.



## **Ken Rayner BA (hons) ACII, IMC**

A founding director of Rayner Spencer Mills Research, Ken began his career in the investment industry in 1989, shortly after graduating from Leeds University with a Degree in Economics and Economic History.

Ken sits on the Investment Committee of a number of advisory firms to help them deliver their investment strategies.



## **Ian Shipway CFP**

Ian is a Certified Financial Planner. From an investment perspective, his starting point is to determine the return required to meet client objectives, the client's tolerance to volatility and short-term liquidity requirements.

Ian is a keen advocate of asset allocation and asset class investing and an enthusiastic and early adopter of wrap platforms.



## **Christian Captieux**

Christian is Succession's Compliance Director and is also a member of the statutory board for Succession Advisory Services. He brings considerable experience of platforms, discretionary managed portfolios and other elements of the investment matrix.

He is a Chartered Financial Planner and a Fellow of the Personal Finance Society.



## **Robert MacDonald BA (hons) CFP**

Robert graduated from Edinburgh Napier Business School in 2012. He is a Certified Financial Planner, Chartered Financial Planner and Fellow of the Personal Finance Society. He is the MD of MacDonald & Co Wealth Management and is passionate about financial planning, matched to an appropriate investment strategy, used in conjunction with a robust long-term cashflow model.



## **Nikesh Shah**

Nikesh works within the Platform Services Team where he focuses on key relationships with our existing and new strategic partners and providing Investment Support. Having worked in various Paraplanning roles for over 10 years, Nikesh brings a wealth of technical knowledge - having worked with level 6 Chartered Planners and having obtained the Level 4 Diploma Qualification.

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