HARPSDEN

WEALTH MANAGEMENT

November 2018 Commentary

Macro Overview

"To trade, or not to trade, that is the question.

Whether it is nobler in the mind

To suffer the slings and arrows of outrageous Regulation

Or to take arms against a sea of tariffs

And by opposing end them"

(*In debt to Mr W. Shakespeare*)

I only had to change three words from the opening of Hamlet's (non) soliloquy to sum up the current environment. The US on China and to a lesser extent Japan and Europe; the U.K. with Europe and vice versa as well as trading sanctions currently imposed on Russia and Iran.

What has become clear is that the attacks on current trade mechanisms are affecting business confidence, investment and hence growth around the globe. Regulation in the form of new emissions standards also severely impacted European automobile production last quarter thus dampening overall GDP growth as the sector accounts for around 9% of total output, according to Capital Economics.

The British Chamber of Commerce reported that hiring intentions are at a twenty five year low due to Brexit and labour shortages. This is coincident with the number of EU residents working in the U.K. falling 132,000 year on year, the fastest drop on record. Mark Carney told the Commons Select Committee in mid November that, "As we have got nearer to the point of withdrawal that has had a more material adverse impact on some companies' investment plans".

Although not uniformly so, there have been many more examples of slowing economic momentum of late than signs of re-acceleration or even stabilisation. These include the Chinese Purchasing Managers Index falling to a multi-month low of 50 (above 50 denotes an expanding economy whilst below 50 means contraction); European Retail Sales volume contracting by 0.2% versus growth of 0.2% expected; Germany cutting GDP forecast to 1.8% from 2.3% on Trade War spill overs and lack of skilled labour; the fall and downward revisions in US New Home Sales; UK Manufacturing slowing at the most pronounced rate in two years and our Retail Sales volume declining for the second successive month.

However, just to complicate matters for Central Banks, wage inflation has been continuing to tick up and will continue to do so until some point after unemployment starts to rise. For example the US experienced the highest hourly pay increases in a decade at 3.1% and here in the UK wages rose 3.2% year-on-year excluding bonuses (the fastest rate since 2008), whilst in Japan the 1.4% jump in regular pay was the highest since 1997.

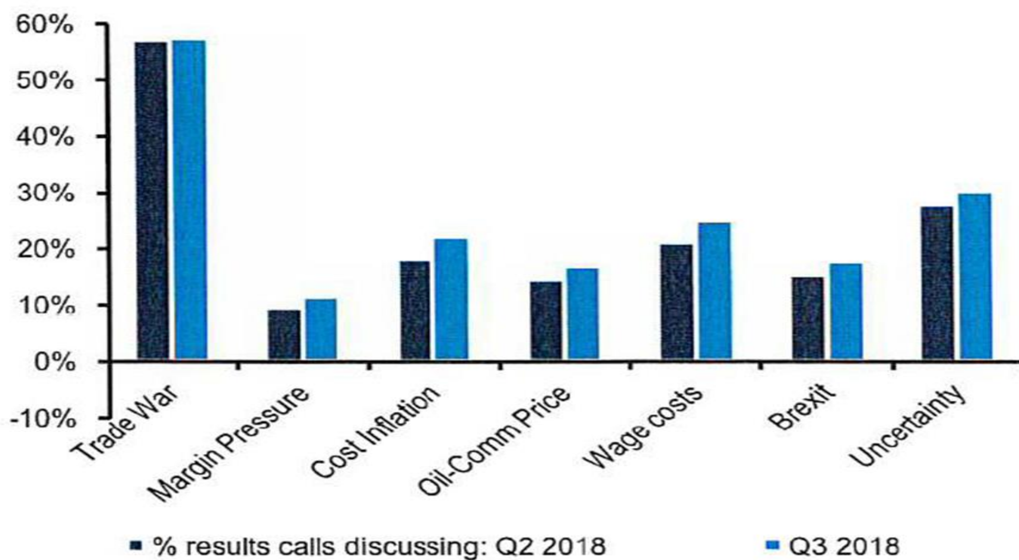
The pressure on Central Banks is made clear in some of the pronouncements. In early October Federal Reserve (Fed) Chair Powell said they were "far from neutral" (implying several more rate rises to come) but only a month later both the Atlanta Fed Chair and Richmond Fed vice Chair said Federal Funds (interest rates) might not be too far from neutral. In Japan, despite the economy actually contracting in Q3 after a series of natural disasters, the Bank of Japan (BOJ) head said Japan "was no longer in a stage where decisively implementing a large scale policy to overcome deflation was judged as the most appropriate policy conduct." This implies Japan is going to continue to wind down their massive financial asset purchasing program. Recently the BOJ became the first Central Bank among the G7 to own financial assets valued at over 100% of GDP.

Markets

Equities have been very weak across the globe as the US, particularly Technology related shares, have 'caught down' with their global peers as excessively optimistic expectations have not been met and it has finally dawned on investors that Technology will be one of the sectors hardest hit by both tariffs and impending regulation. Meanwhile Domestic facing UK shares have continued on their protracted downward path.

Corporate Bonds have also sold off a little whilst Oil has entered a bear market amidst general industrial commodity weakness. Traders in oil are concerned about both higher inventories and impending new shale supply in the US, in addition to potentially lower demand due to decelerating global growth. They have also witnessed Mr Trump put pressure on Saudi Arabia to ensure OPEC doesn't curtail production further.

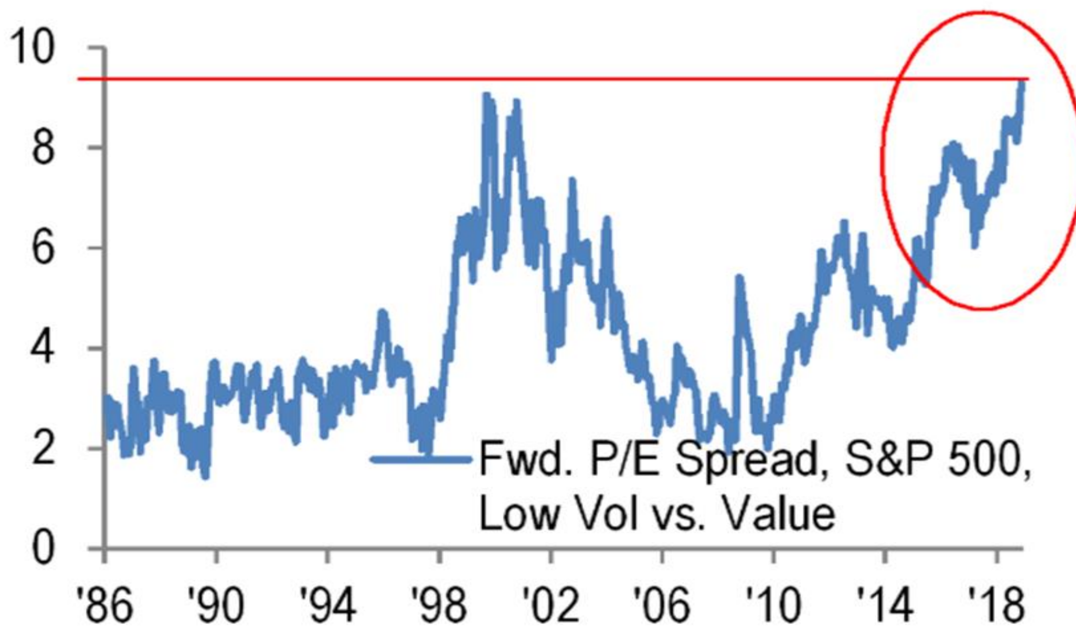
Several companies, from Chinese Internet behemoths, to South Korean conglomerates, to Caterpillar, to Semiconductors, to German autos mentioned trade bickering as contributing to profit guidance being below expectations.



Such excuses held no sway with investors and shares were generally punished. This is likely to continue until some clarity is given and therefore investors have retreated into traditional safe havens such as Staples, Healthcare and Utilities, despite the fact many such companies have more challenged growth prospects than they did before.

JO Hambro UK Equity Fund, on the other hand, has a more cyclically exposed portfolio as the team has found value in the restructured Commodity companies and Banks. Their Fund, which has compounded dividend growth at 9% for over a decade, now boasts a prospective yield of 5% with, in their opinion, more growth to come. This is just one example of where valuation is being ignored in favour of safety.

The Chart below from JP Morgan highlights how far investors have herded into perceived safety:



As we highlighted in our previous reports, we have also been reducing cyclicality year to date (we even sold some JO Hambro UK Equity Income in Q1) but there will be a point soon where the slowdown has been discounted and it will be time to reload on well run Funds with more cyclical exposure. This will be done gradually and with reference to our risk parameters.

Sterling has not fared as badly as expected in this widespread risk off-period with an added Brexit kicker. It has fallen a couple of percent against the bellwether safe havens of the Yen and the Dollar but is actually up a touch against the Euro. It fell by more than double this amount in six weeks from May to mid June in that sell off. Sterling is cheap against most other currencies on Purchasing Parity now but we cannot ignore the potential for further downside if markets take a dislike to political developments.

The table below depicts the change in price of selected asset classes since 27th September to 28th November 2018.

FTSE 100	-7.2%	**Euro : £**	-0.7%
S&P 500	-8.0%	**Euro : US $**	-3.4%-
CAC 40	-10.1%	**Yen : £**	+2.1%
DAX 30	-9.1%	**US $: £**	+2.8%
Hang Seng	-4.0%	**UK 10 Year Gilt Yield**	-22 basis points
NIKKEI 225	-8.1%	**US 10 Year Bond Yield**	unchanged
Brent Oil	-25.8%		

All prices are in local currency.

Activity & Positioning

We have been busy since our Q3 2018 Commentary but this is hardly surprising given the volatility within financial markets.

Immediately following our Q3 Commentary in October action was taken to mitigate potentially negative consequences of Brexit (despite some U.K. equities being cheap – more later on this) and tightening global liquidity. This involved a reduction in U.K. Equities (and Japan for RJIS Growth clients) and unwinding our hedge against Euro weakness. This latter trade is purely a Risk mitigation measure taken to insulate clients from an anticipated further fall in Sterling in the event of a market adverse outcome transpiring. Unusually for an investment manager, we hope this trade doesn't work out as we are likely to gain more on equity appreciation than we will lose in Euro depreciation if a market positive solution is found! However, in such precarious times, loss mitigation is at the forefront of our thinking and we had no qualms about our actions.

We have long said volatility is our friend as it throws up opportunities. This bout has been no different and it wasn't long before we were able to buy some assets at levels meaningfully below where they had been trading just a few weeks before. We added small positions in each of India, Japan and the U.K. and in the US switched out of our Short Duration High Yield Bond Fund into an equity fund after the latter had suffered one of the most severe bouts of underperformance in the manager's career.

Our view remains that compounding dividends are the most certain way of chalking up long term returns and that U.K. and European Government Bond yields in general are 100 basis points too low. Therefore we retain a meaningful if not full weight in equities whilst continuing underweight bonds.

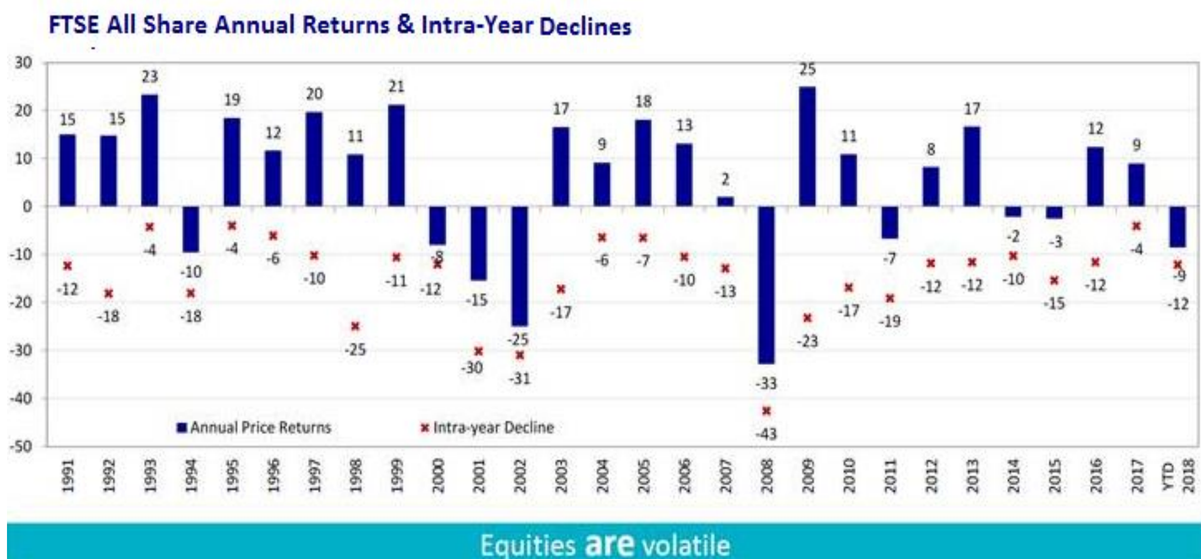
However, as discussed above, we are cognisant of the dangers emanating from both a tightening liquidity regime and a more fractious political environment and will therefore be continuously monitoring what is discounted in asset prices and use periods of volatility to take advantage of anomalies to the benefit of clients. This will involve selling in periods of excess optimism and snapping up bargains when investors become overly pessimistic.

RAYMOND JAMES

Harpsden Portfolio Strategy	Bought	Sold
90% Equity	5% Blackrock Cont Euro 3% Polar Capital North American	5% Blackrock Cont Euro Hedged
Growth	7.5% Blackrock Cont Euro 1.5% Jupiter India 1.5% Neptune Japan Opps 4% Polar Capital North American	7.5% Blackrock Cont Euro Hedged 2% RWC Nissay Japan Focus 1.5% Artemis Income 2% Allianz US Short Dur High Yield
Income & Growth	7.5% Blackrock Cont Euro 1.5% Jupiter India 1.5% Montanaro UK Income 1.5% Neptune Japan Opps 4% Polar Capital North American 1.5% Schroder European Alpha Income	7.5% Blackrock Cont Euro Hedged 6% Artemis Income 2% Allianz US Short Dur High Yield
Income	2% Polar Capital North American 1.5% Schroder European Alpha Income	3.5% Artemis Income 2% Allianz US Short Dur High Yield
0-35% Equity	4% Blackrock Cont Euro	4% Blackrock Cont Euro Hedged
Ethical	Nil	Nil

Conclusion

As we have mentioned several times before, 2019 will be the first year since the Financial Crises that there will be a net tightening of global liquidity from Central Banks. That alone will keep volatility elevated, even without the contributions from political leaders around the globe. The chart below, however, shows that intra year drawdowns are not unusual, even in years that equities are up strongly over the full twelve months.



Source: AXA IM, FTSE All Share Price Return in GBP. Data as at 14.11.18. Intra year decliens in the above charrt are the max drawdown during each year.

However, the excessive optimism of January is now but a distant memory and market valuations are a lot cheaper because profits have grown as share prices have fallen. Furthermore, as US companies are now sharing the pain with their Chinese counterparts, there is an increased chance China will be engaged in a less mutually damaging manner.

It is only natural that the global economy (ex-US) has been slowing from the catch up rate of 2017. We clearly outlined this prospect in January and if I am honest I am a little surprised by how investors seem to have been caught unawares by this inevitable occurrence. However, many are now extrapolating it straight into a recession. Already China and South Korea are taking measures to stimulate the economy, as are we. The US is the economy that is likely to slow the most next year simply because its large stimulus will be wearing off at the same time the lagged effect of eight interest rate rises kick in.

We need to remember that both Asia and Europe are just three years out of a prolonged tightening cycle and the global industrial economy only came out of a deep commodity led recession in 2016. So there are few excesses in the real world outside of the long standing debt overhang, which most politicians and economists outside of the Germanic countries believe can be optimally reduced via faster growth and moderately higher inflation. The recent fall in oil prices will also help prop up the global economy, as long as it doesn't go so far that it curtails capital spending.

If real wages keep rising then I am of the belief that populism will fade (unfortunately the opposite also holds) but this will play out over time.

I have therefore not changed my long held view that mid single digit returns can be garnered over time amidst an environment with higher volatility than we would like. However, as the chart above demonstrates, volatility is part of investing and we shouldn't let it throw us off our long term course. Many equity markets, including the UK, now trade below their long term average valuation levels and so we will remain on the lookout to pick up bargains as they arise.

Cash will be retained until we can find value in Bonds and Alternatives. The latter will be used sparingly in instruments that do a specific job in a relatively less risky manner than equities.

P.S. I have deliberately not dwelled on Brexit and taken a more global perspective as there is such a wide range of positions both within and across political parties that the outcome is impossible to analyse. We recognise the cheapness of U.K. domestic facing shares but can't add until we have some clarity on the outcome.

Best Regards,

Ian Brady
Chief Investment Officer

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Current Asset Allocation – Raymond James

Asset class	Growth %	Income %	Income & Growth %	0-35% Equity %	90% Equity %	Ethical/SRI %
Property	**0**	**0**	**0**	**0**	**0**	**0**
Cash	**13.25**	**23.25**	**17**	**15**	**3**	**20**
Fixed Interest	**3**	**16**	**10**	**32**	**0**	**20**
High Yield	0	3	0	6	0	0
Index Linked	0	0	0	0	0	0
Corporate/Strategic	3	13	10	16	0	20
Government	0	0	0	10	0	0
Equities	**75.75**	**52.75**	**66.25**	**37.5**	**90.5**	**60**
UK	30.25	31.75	26.75	19.5	38	41
North America	17	9.5	13	0	20.5	0
Europe	9	5.5	10.5	4	8	0
Asia (excl Japan)	7	2	4.5	3	0	6
Japan	8	4	9	3	14	0
International	0	0	0	0	0	13
Emerging	4.5	0	2.5	0	10	0
Global Low Beta	0	0	0	8	0	0
Commodities - Gold	**1.5**	**1.5**	**1.5**	**1.5**	**1.50**	**0**
Absolute Return	**6.5**	**6.5**	**5.25**	**14**	**5**	**0**
	100%	**100%**	**100%**	**100%**	**100%**	**100%**

Important Information/Risk Factors:

Past performance is not a guide to future performance and investment markets and conditions can change rapidly. Investments in equity markets will be more volatile than an investment in cash or fixed deposits. The value of your investment may go down as well as up. There is no guarantee you will get back the amount invested. If you fund invests in overseas markets, currents movements may affect both the income received and the capital value of your investment. If it invests in the shares of small companies, in emerging markets, or in a single country or sector, it may be less liquid and more volatile than a broadly diversified fund investing in developed equity markets.

The views expressed herein should not be relied upon when making investment decisions. The article is not intended as individual advice and if you require advice or further information you should contact us.