WARNER MATTHEWS
ASSET MANAGEMENT

WM diaries

Welcome to the inaugural addition of the quarterly Warner Matthews newsletter. We hope to bring to our clients the salient topics that help shape our financial and tax strategies. This will be an insight into how and why we position your assets the way that we do. We aim to keep this short but relevant, covering our thoughts on significant economic events combined with documenting investment and tax planning initiatives. We won't always get it right, but we strive to maintain a transparent means for our clients to look under the bonnet of our investment process.

Asset Allocation musings:

Taking inspiration from Marvin Gaye's eponymous song, "*What's Going On",* there appear to be many issues investors are grappling with of late. Whether it be revisiting the hunt for yield dilemma, US equity markets touching record highs, trade spats, possible political overhaul in the UK, the Brexit impasse- the days of "sell in May and go away" appear to be consigned to history! In this newsletter we will primarily focus on our Investment strategies, however future quarterlies will incorporate holistic financial and tax considerations.

What's on our Minds:

How we think about low yields (or negative yields)

Last quarter the US 10yr bond yield inverted below its 3-month counterpart – our investment nous tells us that the warning signals on future US economic growth are flashing red. Recent economic data releases also support this standpoint. What does it say about investor mentality when investors are prepared to invest in bonds with negative yields as seen across Europe? It begs the question why investors are prepared to accept a guaranteed loss when their bond matures?

These themes underscore our concerns that too much money is chasing a shrinking pool of attractive assets in search of income. We too see the benefit from having exposure to bond investments. However, we are wary of the overcrowded feel about this sector. Our preferred method for our clients has been to steadily build into your portfolios a Gold position. Traditionally this has been a well-supported asset class in times of waning confidence and political uncertainty, which in today's climate seems to suitably chime. As a rule of thumb, Gold tends to rise as the US dollar falls, although this concept is being tested at present as both are strengthening versus other asset classes.

Unintended consequences of Brexit on your Investments:

When we first started compiling data for the newsletter over the summer it's hard to imagine how fast the political divide would evolve. And yet our basic rationale remains unaltered: how a Brexit plan that suits both the Conservative Party, Parliament and our colleagues in Brussels will emerge from the debris. What is undeniable is the impact it is having on the UK economy. It feels as if every day we witness another high street warning. Thousands of retailers have closed up shop in the last 12 months and it's the uncertainty that has had a helping hand.

Our apprehension is more nuanced – the impact sterling weakness can have on your portfolios and hence the importance of having a diversified portfolio. Diversification across asset classes and geographic exposure enables your investments to take advantage in times of home currency weakness. Consequently, where possible we aim to ensure your investments are sufficiently diversified.

The ongoing weakness in the pound is now entrenched in investor's psyches. With our contrarian hats on we are more inclined to consider the other side of the equation, i.e. a recovery in sterling and how to ensure you can benefit from this move. We are cognisant that there is a large part of the UK equity market that is now so unloved that equity valuations are extremely compelling. Opportunities are presenting themselves and with our investment experience we have a number of avenues by which to take advantage as the phoenix eventually emerges from the ashes.

Equity Market recovery and how we extrapolate:

On 10th July the S&P 500 surpassed the 3,000 level during market hours and reached an all time high. This should be positive as where the US leads others should follow. However, there are reasons to be more circumspect. Investors were buoyed by the US Federal Committee Chairman Jerome Powell's decision to cut US interest rates for the first time in 10 years. Should this be cause for celebration; we suspect not – US economic data is mixed at best. Despite interest rates being below long-term averages, the economic recovery has been at best tepid and inflation refuses to pick up. This is clearly frustrating the man in charge of the US monetary policy…

One news item caught our attention which augmented our worries. We note with a hint of schadenfreude that Richard Branson is looking to list Virgin Galactic – his space odyssey. Given the lack of timescale as to when he will be able to put anyone on the Moon, the market's appetite for this new listing we suspect will be destined to remain earth bound!

Looking at the US with a fundamental hat on, the equity market appears to be overheated based on conventional valuation metrics (Cyclically Adjusted Price Earnings ratio (CAPE)). Whilst what you end up paying (valuation) should be an investor's ultimate protection against losing money, it is not always an accurate predictor on timing. As the saying goes: *Markets can stay irrational longer than investors can stay solvent*! With that in mind we always caution against looking at markets with a short-term lens. Investors should recognize that over the long-term equities and bonds will outperform cash, especially in today's low interest rate environment. Our commitment to selecting managers who can generate steady not spectacular returns we believe should smooth out the likely gyrations as we sense there being a tepid feel about future stock market returns.

Fund Intelligence:

Lessons to take away from Woodford: Fear not we won't rehash the headlines, but we want to share some of the insight we've built on in the last 30yrs of investing in funds. Firstly, the importance for a manager to stick to their knitting. We know that when a manager deviates from his chosen investment path, it may well mask bigger problems. During the most testing environments the ability to stick to the prescribed process is vital. Secondly, understanding the operating matrix which a manager is bound by, in simple terms, are there the checks and balances to prevent too much independence? What parameters will a risk team ensure the fund managers adhere to? Thirdly, the intangible element of fund manager humility. Do they have the support systems in place to allow them to cope with the stress of the job? Taking a line from one of our favourite poems (Rudyard Kipling's *If*) – *if you can meet triumph and disaster, and treat those two imposters just the same, yours is the earth and everything that's in it* - that applies to most things in life and especially running a fund.

When a fund changes its manager do we follow suit: Jupiter European Fund - Jupiter announced over the summer that after over 18yrs at the helm Alexander Darwall would be launching his own fund management vehicle and handing over the reins of most of his mandates to a recent team hire. Interestingly this draws parallels to Neil Woodford's decision to part company with Invesco Perpetual to set up stall on his own. We thought we would share some of the considerations that we face in this situation. Firstly, what is our expectation of how the Jupiter European fund will look like in 12months time (is it a case of continuing where the previous manager left off or will the new team stamp their own mark)? Secondly, is it a viable option to switch over to Darwall's new outfit? If so, what are the key considerations? Thirdly, should we switch to another European fund and if so, what are the alternatives? Do we hold other European funds that match the style and process of Jupiter's? Our inclination in this instance was to adopt the third option – a decision we are happy to discuss further at length should you feel the need!

This report is for informational purposes only and should not constitute investment advice. Past performance is not a guide to future performance. No investment is suitable in all cases and if you are in doubt you should contact us. Market and exchange rate movements can cause the value of an investment to fall as well as rise, and you may get back less than originally invested. The views expressed are based on information believed to be accurate at the time of writing but no assurances are given.