Fund Managers Report 5th April 2018 to 30th June 2018

The political noise around trade wars, Brexit and Eurozone disintegration has only intensified since our last report. Despite this negative backdrop global equity markets have staged a recovery from the lows seen at the end of the last quarter, generating a good positive return around c7%, whilst fixed income has been slightly negative over the same period.

Divergence

The reality is we are seeing a divergence between the strong US economy; the growing but possibly threatened developing world economy; the weak Eurozone economy and uncertain UK economy. In the US, interest rates continue to rise, and the expectations for further interest rate increases have risen. At the same time the US also continues to steadily drain the billions of Dollars pumped into the economy via QE after the crisis. In fact, were it not for the ranting out of Washington we would suspect there would be nothing but admiration for their economic recovery. The difficult issue remains the more structural changes brought about by the growing development of technology (aka Amazonification).

The developing world continues to grow at varying paces. India and China continue their path to become economic giants. The oil price and trade wars are the main issues that threaten growth in the short term. We see the oil price as peaking around this level, leaving the threat of trade wars as the main short term issue.

The economic spring seen in Europe at the start of the year, largely brought about by the global recovery, already appears to be spluttering. Hopes that the ECB would end QE and begin raising rates have reduced to just a slowdown in QE. The improvement seen has been offset by political strife in Germany, Italy and Spain and the automobile sector, essential to the economy, is under threat from both tighter regulation and the main focus of the trade war.

In the UK the Brexit noise continues to irritate rather than impact the economy, the recent corporate noise from Airbus and BMW is more about politics than reality, at the same time political risk has abated. Wages are once again outpacing inflation but as with the US the main issue is the increasingly visible impact of technology in core areas such as retail, as shops are replaced by online. The most important aspect here is about retail rent and this is why we are not exposed to this sector. This is nothing new rather it is the fact that it has become more visible as retailers close a number of stores. We see a real possibility of a further interest rate rise in the UK in the second half of 2018.

Market Outlook

As we concluded our last report we felt things would be more volatile but also positive. We have seen an improvement in equity markets and in the short term we are more cautious for the summer, therefore cash is a little higher. Fixed income continues to be slightly negative and we see no change as the long term dynamic of rising interest. We have reduced exposure to fixed interest bonds and added more floating rate exposure. Our property exposure is now focused on core ethical areas of healthcare, care homes, social and affordable housing and avoid all conventional office and retail property investments as we expect the structure of this market to change.

Portfolio Changes

Where stocks had outperformed following the rally at the start of the period, we trimmed back to keep allocation in line and also to reduce an element of risk from portfolios; this included the likes of Siemens, National Express, SAP and Biffa to name a few.

Although we were reducing the risk exposure over the period, we did initiate a number of new investments. This included FirstGroup as an opportunistic growth investment following some poor numbers and the announcement of a change of CEO; we feel there is the opportunity for the company to turnaround under new management or potentially be taken over. Another investment was Rotala, a small UK bus company that in our minds brings a breath of fresh air and vision to the sector outside of the large players; we see growth potential here and the fact they pay a c4% dividend was also a plus. Another new investment, this time in the renewable sector, was Orsted, formerly known as DONG energy. Orsted have a c25% share of the offshore wind market and there decision to invest in battery technology has us very excited. We also added Renewi who had felt the pain of China's decision to ban the imports of plastic waste from abroad. The stock had taken a tumble but we felt the worst was over and the c4% dividend made it attractive from an income perspective.

We sold out of Omega Diagnostics this quarter following a climb higher in their share price. We had held it for a number of years but had steadily lost faith in the investment. An announcement taken positively by the market was our cue to sell as we did not believe anything had materially changed in the medium to long term. Finally, towards the end of the period we saw Tesla rise as many of the short sellers were squeezed out of the market. We took this as an opportunity to completely sell out of the investment, but we remain extremely interested in the company, however the valuation at its current levels cannot be justified.