Fund Managers Report 31st December 2018 to 29th March 2019

It certainly was a quarter to remember. It began with markets riling after a sharp fall in global equities and investors still threating over rising US interest rates, Sino-American trade tensions, further European economic weakness, the never ending Brexit saga and some weak corporate outlooks (remember Apple). The quarter finished with equity markets almost 10% higher and bond markets 2% higher. Yet only one of the above issues has changed, the market no longer expects higher US interest rates.

A good illustration of the change in perception for US interest rates can be seen in the US yield curve, which shows the return between the short term interest rates which are determined by the US Federal reserve, (in much the same way as the Bank of England does in the UK), and the 10 and 30 year interest rates that are determined by the global bond markets. At the end of the Quarter the US yield curve was inverted, which means 10 Year interest rates were 2.39% versus a 2.50% interest rate.

An inverted yield curve would normally imply that a recession is looming, and there certainly are fears that the strong streak of growth in the U.S. is about to slow or even end. The economic pessimists would argue we have seen the positive effects from the tax changes (and now the higher bills are coming for many), and that full employment and labour shortages will take their toll. Alongside this, the effects of the trade tensions and a slowing Europe will drag down US growth in the future. More specifically to equities, a number of analysts argue that the best days for the rampant FAANG (Facebook, Amazon, Apple, Netflix, Google) stocks are now over and growth declines are being priced in.

On the other hand optimists argue that Sino-American trade tensions are now easing and that once resolved investment decisions put off by uncertainty will come back. At the same time, full employment and tax cuts will continue to drive growth. More specifically to stocks, the argument is that bad news with the FAANG stocks is priced in and a record level of share buy backs and lower corporation taxes will drive earnings higher.

By mid-April the Q1 corporate earnings season will be in full swing as hundreds of companies report results and give outlooks from management. We expect this to be the key driver for equity markets into the summer. As expectations have already been tapered a little, we feel the equity markets are more finely balanced leaving us to be inclined to a neutral to positive outlook for the whole quarter.

At the time of writing the economic data from Asia (both Japan and China) was improving whilst the data from the Eurozone was deteriorating. The UK remains locked in the Brexit civil war which will continue to drag on UK and European growth. Whatever Brexit scenario plays out there will be winners and losers, and markets, like most of the country, just wants an end to the uncertainty. Issues in Europe remain more structural, leaving the fate of the Eurozone economy subject to global swings.

Market Outlook

Although the quarter began with a great deal of uncertainty, both equity and bond markets have bounced back with some strength as interest rate expectations have drastically shifted.

Regardless of economics, a great deal will come down to what companies and managers say over the coming months and therefore we feel markets may well become more volatile. After a strong bounce in the first quarter we feel the equity markets are more balanced again, and without the boost from the bond market, any further growth in equities will have to come from genuine business growth and improved outlooks. We see this as possible, but remain nimble as we head into reporting season.

Portfolio Changes

(These are major changes and may or may not apply to your portfolio)

It was a busy quarter and one in which we sold some longstanding investments in fixed income, reducing bond exposure in portfolios.

We sold the **Places for People** bond across portfolios from moderate risk and higher, keeping it only in the lower risk portfolios. When we first added the investment over 7 years ago it was then the only way to invest in social housing. With the more recent advent of social housing REITS, we have been able to invest directly into the properties. It was also a lower risk bond. As the need for the lower risk bond diminished for moderate and higher risk clients and as we had other investments in social housing, we sold across a number of portfolios.

We also sold another long term low risk holding with the **Network Rail Index Linked Bonds.** We first purchased these in 2009 and they have performed very well over the last ten years. With Sterling now looking to recover from the Brexit lows and other key inflationary pressures waning (oil and gas prices in particular) we see inflation as less of an issue. Given the high price of index linked bonds we saw better value in other investments and sold the entire holding.

We also reduced our property exposure slightly by selling the **Target Healthcare REIT** into strength. We invested in this REIT at IPO in 2013. Also during the period the **MedicX Fund** merged with **Primary Health Properties.**

Equity exposure increased over the period as we added to some existing holdings such as **SAP** and **Biffa** to take advantage of market weakness. We also trimmed **Vodafone, National Express** and **FirstGroup** into the rally.

After a strong rally and a change in their policy on some existing assets we took profit on **Orsted,** also to bring some funds back into Sterling. In the same vein we sold **SABESP** in

Brazil after elections led to a strong rally in the Brazilian market which coincided with a strong US$.

As new investments, we added **Standard Life Aberdeen**, the Scottish fund management group. In addition to a strong investment case and some opportunistic weakness in their share price, and being one of two best in class, we have noted their increased activity in ethical and impact funds. We also added back **Svenska Handelsbanken**, the best in class bank, partly to take advantage of the high level of income and the weakness of Scandinavian banks after the Danske Bank Estonia scandal. Unlike other banks in the region, Svenska expanded into the UK and not the Baltic States and have therefore avoided this scandal. Finally we added a new investment in Steel dust and aluminium recycling company, **Befesa SA**.

Other Changes

After 14 years at Candlewick House, many of you will have noticed we have moved to new offices in the City. Now the whole company is on one floor (and not three) overlooking Devonshire Square, surrounded by the City Skyscrapers. Shortly we will also be moving into a separate corporate entity within King and Shaxson, and become King and Shaxson Asset Management, whilst maintaining the trading name King & Shaxson Ethical. This will change nothing in the way operate or in our relationship with you but is part of a wider reorganisation of London operations.

We will soon have a new web portal available for clients, this will include document storage, so when you log in you will be able to find your valuations, tax reports and other documents saved and stored there. We are keen to be as paperless as possible.

Disclaimer