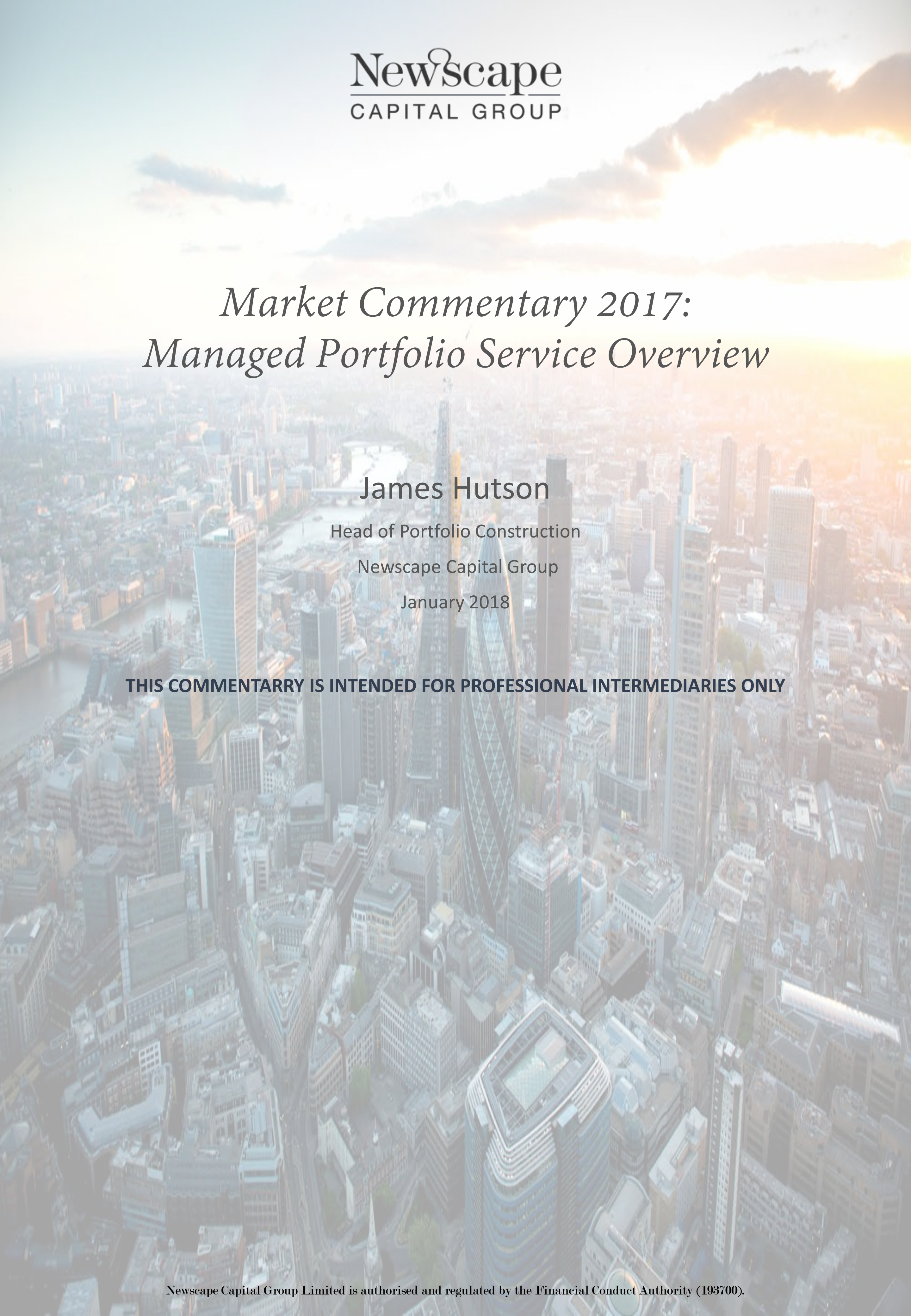

Newscape
CAPITAL GROUP

Market Commentary 2017: Managed Portfolio Service Overview

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Markets performed well in 2017, following the steps of a solid 2016, and we are pleased to say that this was echoed in the performance of our own portfolio offerings. However, following such a strong year across most asset classes, we need to be mindful of this strength as we move into 2018. Our Investment Committee remains vigilant and the management of risk continues to be our priority.

The fixed income bull run has been approaching its end-game for some time; the likelihood is that yields will now begin, or indeed continue to rise from here, as inflation picks up and central banks continue to tighten monetary policy whilst closing the doors on quantitative easing. Although we do not expect a rapid jump in interest rates, we have been preparing for this eventuality for some time. In terms of fixed income, we began to cut our exposure in late 2016, and this approach continued throughout 2017. We like to think of it as cutting away at a tree from the root upwards. Indeed, we started by closing out all exposure to government bonds in October 2016. Through 2017, we reduced exposure to investment grade corporate debt, and towards the end of the year we started to turn down our exposure to high yield debt. As yields look set to rise further, we will be looking to lessen our exposure. For starters, we have begun the process of reducing the duration on the high yield part of our fixed income book, which diminishes the risk of default as well as the volatility of this asset class. We expect to lower our risk in the fixed income space through the course of 2018, as well as continue searching for innovative ways of accessing debt exposure in this rapidly changing environment.

During the previously mentioned asset class reduction, we also looked at the Alternative Investment asset class allocation as a base for the funds that we were releasing. Specifically, we have continued to favour Artificial Intelligence and Robotics.

InIt is an important new investment category for both now and the future. Indeed, we coined the phrase “AI=AI”: Alternative Investments = Artificial Intelligence. In our view, this new sub-asset class remains somewhat in its infancy and the potential for solid future gains. It remains positive as existing technologies only improve and the new ones evolve quickly.

Anyone who has ever invested in commodities will be aware of the volatility that this asset class has the potential to deliver. Being on the wrong side of it can be very painful. This is the reason why we developed a tendency to favour cleaner alternatives over time, particularly, water. Whilst not considered as a traditional commodity in a market sense, it is certainly the most important commodity on the planet: the global population continues to expand aided by improved health, which resulted in an increased life expectancy. Consequently, the purification of water, its supply logistics and infrastructure stand as an excellent opportunity for investment. We have been long term investors in the Pictet Water Fund, which has delivered an excess of 110% total return over the last 5 years. The story remains unchanged, and we remain committed to investing in this profitable and, in our view, moral asset class.

On the traditional equity side of the game in developed economies, we have experienced a strong “growth” style market through 2017, with some spattering of “value” style patches along the way. Whilst large global technology companies have driven much of the momentum in 2017, we remained conscious of the fact, that this “growth” driven bull run may have increasingly run its course with valuations at all-time highs. While we are long-term believers in the importance of technology in our portfolios, we have, nonetheless, taken steps to mitigate some of this risk. We have managed that by introducing exposure to a “special situation” investment vehicles. This blends well into our theme that value managers or stock pickers will play an increasingly important role in our quest to maximise returns, as we move through the next year.

At a geographic level, USA macroeconomic data has served to impress, and Mr. Trump is certainly taking advantage of that fact, even if the credit for it isn't entirely down to him. Nevertheless, the solid economic improvement seen across the board has helped to drive US markets higher over the last 12 months. However, as mentioned above, the power of the technology firms has been a major factor in this strength and in our view, is now at a potential risk for the shorter term. Furthermore, with Sterling rising further, there is even a bigger reason to be underweight in the dollar or, alternatively, be hedged into pounds. Consequently, we remain underweight in the USA. For the time being, such positioning seems to be set to stand in 2018.

On that note, we have continued to adopt a neutral view in the UK and Europe. In terms of the former, our neutral stance has been driven by the uncertainty of a messy Brexit, partly offset by reasonably benign macro data. If anything, we have held a preference for Europe over UK, but tempered our exposure in the face of various political events and the rise of the populist government movements. Transitioning into the next year, Brexit will be on top of our minds and we will not be rushing to change our current stance until we have a greater understanding of the impact caused by the exit plans. With Europe having experienced a solid bull run up to date, we have seen little reason to take more bullish position here. On that note, our developed regions of choice are Japan and Asia Pacific, and we maintain an Overweight position in both cases. Our main investment thesis here is that the region stands to be a major beneficiary of rising global inflation, as well as an epicentre of manufacturing and production.

Turning to the Emerging Market economies, we have yet again seen some striking swings over the course of 12 months. That said, while Chinese growth might be slowing down as it re-allocates from being an export economy to a more balanced domestic export economy, while still showing an impressive economic output. Indeed, the latest reporting season was ahead of expectations across the board.

India may have had its hiccups through the year, but as a long-term investment, the region presents a compelling case. On balance, we are comfortable in carrying a neutral position to begin with in 2018, but remain ready to add to this as opportunities presents themselves.

To summarise, 2017 was a great year in terms of investments, but we need to carry an increased element of caution in 2018. We aim to further look for new and inventive ways to achieve bond exposure, whilst continuing to manage and reduce risk. We want to remain cautious on the equity side. The market rally taught us to look for ways to mitigate against a reversal of this momentum and, of course, a strengthening Pound. UK domiciled Value funds are certainly one of the options we will be considering whilst achieving this. The Far East also looks likely to be a relative winner into next year, and this aligns nicely with our continued bullish stance on robotics and new technologies in our Alternative Asset class holdings.

At Newscape, we offer a range of risk-adjusted multi-asset portfolios which aim to capture the above strategies. These portfolios use a Strategic Asset Allocation (SAA) which aims to optimise total return at a set level of risk. The SAA is then overlaid with a Tactical asset Allocation (TAA) which leans on the experience of our Investment Committee and its top down asset allocation process. These asset allocations are then fulfilled with active and passive collective investment funds (OEICS, Unit Trusts, Investment Trusts, ETFs) using our thorough quantitative, qualitative and operational screening processes. The portfolios are available on a wide range of wrap platforms. Furthermore, the Cautious and Growth portfolios are now available in UCITS form.

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