Adapting Revolution

AUTUMN 2020

Covid-19 – Adapting Revolution

Further changes to your portfolio are imminent as we continually strive to deliver positive returns whilst endeavouring to manage investment risk. Some of you have already been contacted regarding the alterations, for those that have not, we will be contacting you shortly to gain your authorisation to make further tactical changes beyond those we made in the spring.

Firstly, and most importantly I hope you and your families are safe and well. Thankfully through the summer the combination of fiscal stimulus, a reduction in Covid cases, better management of Covid itself with less deaths meant capital markets started to recover. Technology, healthcare innovation and sustainable strategies were all strong performing sectors.

For the risk averse clients, holding gilts meant higher allocations to these themes and this also proved to be a good decision. Assessing what has happened in the past is a lot easier than trying to predict the future especially in the context of investing at the moment as the only thing that has control right now is Covid itself. Be that as it may, the choices we made to increase the allocation to our preferred themes (above) and reduce non-themed based equities, bonds and dividend paying securities worked well.

Richard (CEO) wrote to you all last month outlining the firm's focus in the new normal adaptation and this is something we have taken into an investment context. Six months have passed since the world fell off the proverbial Covid cliff edge, this has given the investment committee time to study how our portfolios have reacted to the dramatic fall from grace in February and March this year and also the fiscal stimulus rebound and subsequent volatility.

The investment committee has asked itself how our client's investments can adapt, knowing what we now know? We asked ourselves two key questions:

1. Could we have done anything differently to generate more return without taking on any more risk?
2. When markets were tumbling, could we have achieved the same downward protection but still delivered more investment return when the markets picked up?

Hindsight is a wonderful thing

It would be easy to rest on our laurels, pat ourselves on the back and say good job done, we made the right calls. It could be argued that we got lucky, Covid played right into the hands of our global trends.

Apart from the obvious and almost impossible timing calls i.e. calling the top and bottom of the market and piling into cash and equities respectively, could we have done any better knowing what we know now and what adaptations can we make to counter any further periods of significant instability whilst endeavouring to generate superior returns to those that we have made should markets rise from here?

Whilst history may not repeat itself, our analysis concluded that adaptations to the portfolios could protect downward pressures as well as the current investment portfolios whilst generating better returns whilst keeping the risk budgets within the bands we use.

For clients that like to delve into the detail, below are the tactical adaptations that we worked on to try and answer the 2 key questions.

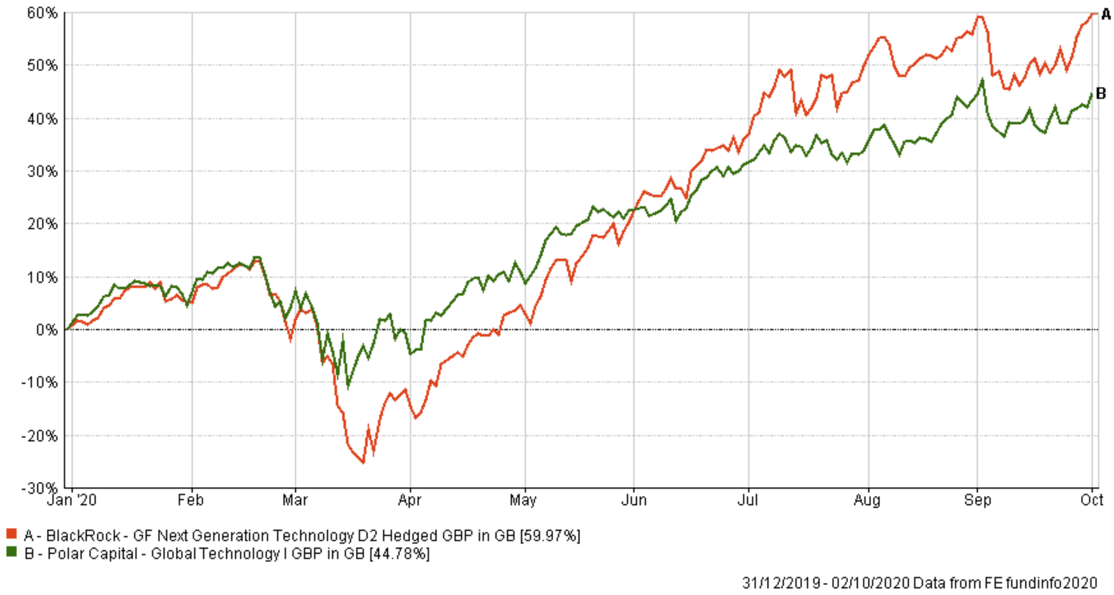
Keynote – *what positive impact could the introduction of next generation technology companies (alongside existing global tech giants) have?*

Up until now we have backed Ben Rogoff and Nick Evans at Polar Capital who manage the $7.3bn Global Technology Fund. They have produced excellent results this year with top quartile performance over 3 months, 6 months, 1 year, 3 years and 5 years. It would be fair to ask why we would even consider diluting our holdings in this fund but if you look under the bonnet and look at the top holdings you see Facebook, Microsoft, Apple, Alibaba, Tencent, Amazon, Adobe, Taiwan Semiconductor and PayPal making up 33% of the overall fund.

These tech giants have delivered super growth since March and some analysts say that the share prices look overvalued whilst others say that there continues to be growth in these stocks. It is difficult to predict in these times so we asked ourselves a different question, we asked whether we could introduce a fund that focuses more on next generation technology and as such reduce the exposure to the giants?

Over the last few months we have been following Tony Kim and Reid Menge, who manage the $909m BlackRock Next Generation Technology fund. We think the introduction of a technology fund that looks to the future rather than the tech giants of today, will provide greater diversification and one hopes a positive impact to investment returns through Covid and beyond. The top 10 holdings of this fund include Tesla, Kakao, Square, Base, Locaweb, Samsung, and Livongo. The individual holdings of the top 10 represent 13% of the fund, we like this as it tells us that they are well diversified and more importantly not one of the top 10 holdings in the Polar fund are in the BlackRock fund so no duplication in the top holdings.

The year to date chart (below) for both funds makes interesting reading. BlackRock is a riskier fund (because of next generation tech) and as such fell more in the Covid crash but through the other side, it generated superior returns to the Polar fund. As such we think BlackRock may well provide a positive impact to your portfolio.



Keynote – *what can sit alongside / replace our gilt play to generate better returns whilst ensuring effective risk management?*

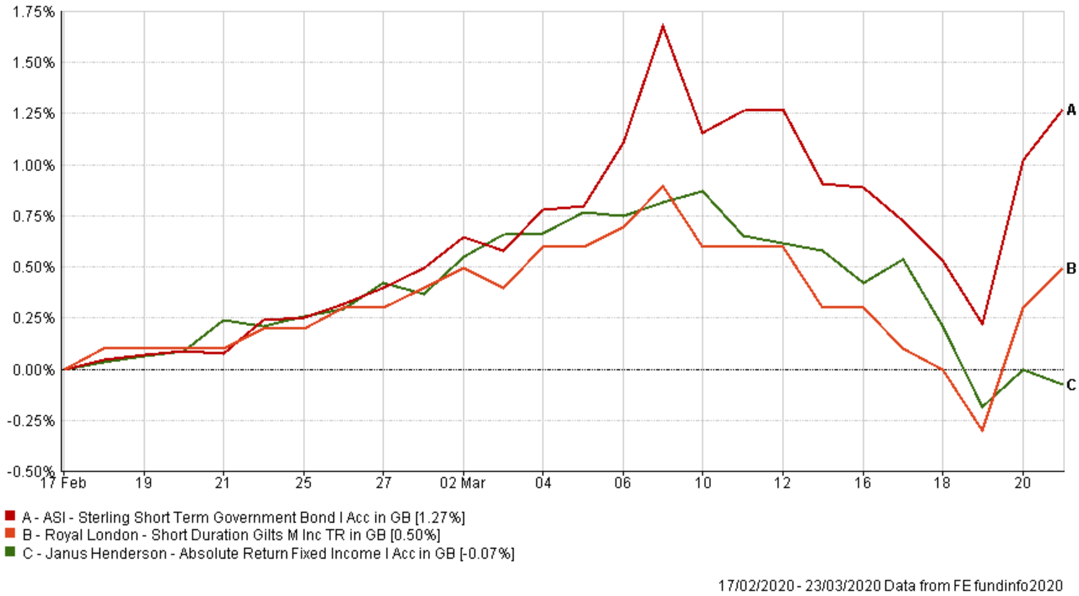
Back in March we reduced corporate bonds and natural income producing funds and moved to a short-dated gilt / government fixed interest focus. This allowed us to increase the equity allocation in our themes without increasing the overall risk budgets. Whilst the gilts returned minimal returns, the increase allocation to our themes resulted in returns significantly ahead of the FTSE100 risk adjusted returns (which we use to measure performance).

Looking back, we have been able to analyse what other fixed interest funds, that have a similar risk profile to the gilt funds we use, performed through the crash? Kevin Adams who heads up the Janus Henderson Institutional Fixed Income Team since 2009, launched the Absolute Fixed Income fund which is now over £200m in fund size.

The Fund aims to provide a positive (absolute) return regardless of market conditions, over any 12 month period. A positive return is not guaranteed over this or any other time period, and particularly over the shorter term the fund may experience periods of negative returns. Consequently, your capital is at risk. The performance target is to outperform the ICE Bank of America ML 3 month Sterling Government Bill Index by at least 2% per annum, before the deduction of charges, over any 5 year period. We have been tracking this fund since launch and think there is 18 month track record most notably through the Covid crash. What we like about adding this fund into the fixed income sector is that it introduces US treasuries as well as other investment grade fixed interest with a risk score of 4 and as such sits alongside the short-term UK gilts risk scores. Performance wise we needed to see how this fund performed both in the Covid crash and beyond this.

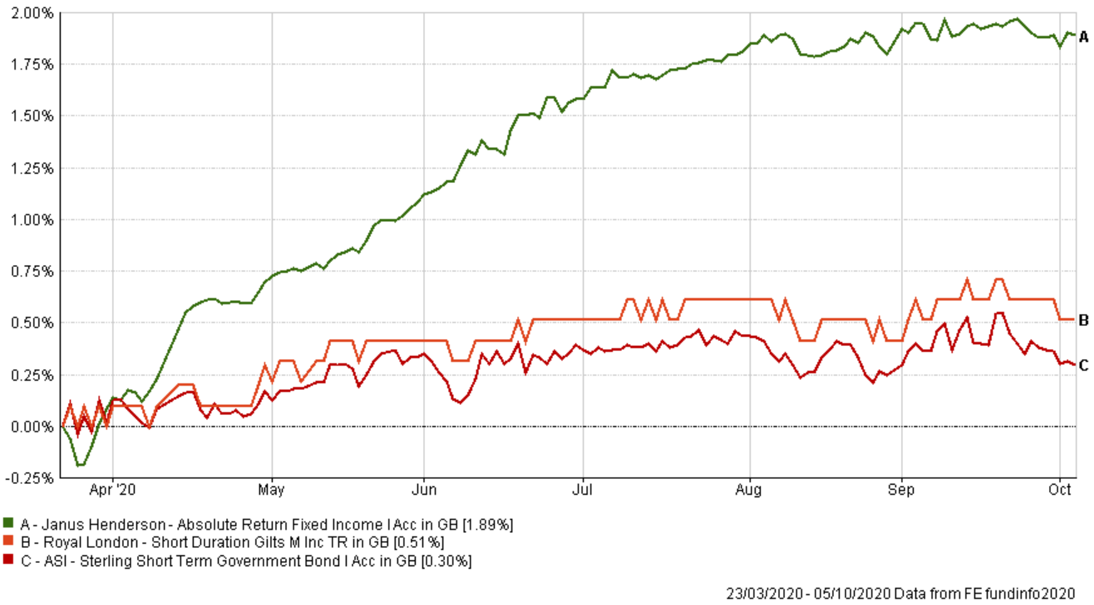
Covid crash chart (Absolute Fixed Income vs Gilt funds used in your portfolios)

The chart below provides reassurance that the fund held up under severe market conditions.



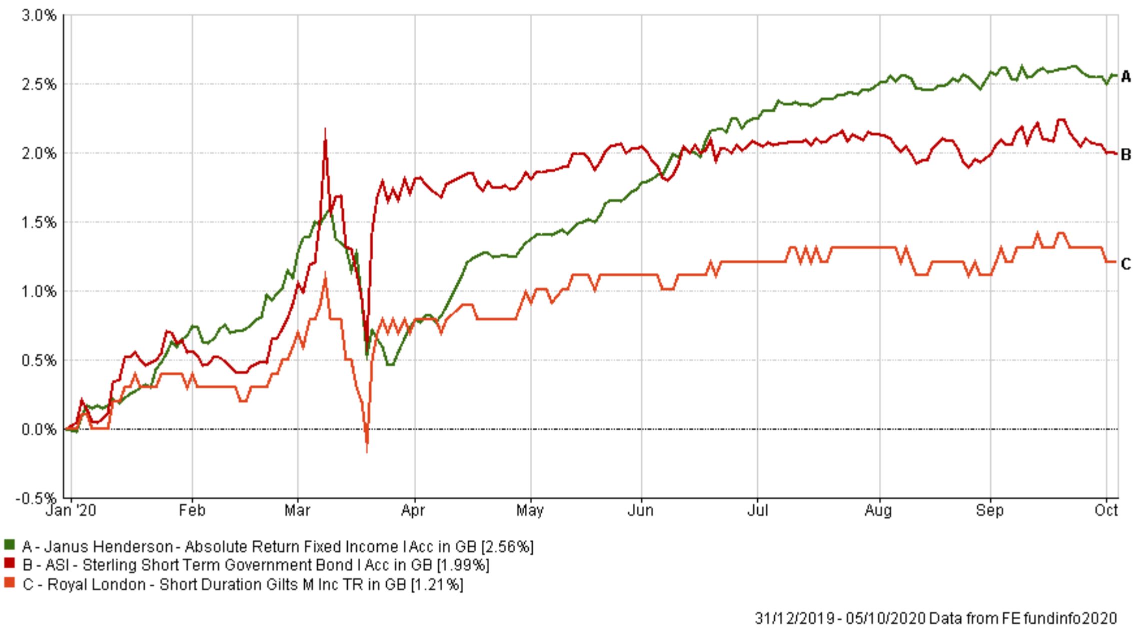
Post-Covid crash chart

This chart shows the enhanced performance of the fund vs the gilts post Covid crash.



Year to date figures

The gilts performed as expected ytd, performing better than 30 day cash rates however the Janus fund outperformed short dated gilts whilst taking the same level of risk and as such we feel confident introducing this into your portfolio.



Keynote – *Can the use of lower risk macro strategies and long/short managers bring an absolute return to the portfolios?*

First of all, what is a macro investment strategy?
A macro strategy is a hedge fund that bases its holdings primarily on the overall economic and political views of various countries or their macroeconomic principles. Holdings may include long and short positions in various equity, fixed income, currency, commodities, and futures markets.

For example, if a manager believes the United States is headed into a recession, the manager may short sell stocks and futures contracts on major U.S. indices or the U.S. dollar. They may also see a big opportunity for growth in Singapore, taking long positions in that country's assets.

How the Global Macro Strategies Work
Macro funds build portfolios around predictions and projections of large scale events on countrywide, continental, and/or global scale, implementing opportunistic investment strategies to capitalise on macroeconomic and geopolitical trends. Macro strategists make forecasts and analyse trends involving factors such as:

- Interest rates
- Politics
- Domestic and foreign policies
- International trade
- Currency exchange rates
- Other factors

Macro funds are considered among the least restricted funds as they generally place any type of trade they choose using almost any type of security.

The research into the macro sector focused on managers that manage their funds with a conservative approach. We were looking for funds that took a level of risk above gilts but not above investment grade bond managers (below risk score 30, remembering the FTSE100 has a risk score of 100). The two funds we would like to put into your portfolio (s) are as follows:

J P Morgan Global Macro
Manager (s) Shrenick Shah, Benoit Lanctot, Josh Berelowitz
Fund size £76m
Risk score 14
Launch date October 2012

JPM looks to profit on systemic and market risk factors and constructs the fund at an asset-class level based on a top-level view of the global markets. This type of global macro fund is considered the most flexible as managers can go long or short with any type of asset anywhere in the world.

It has a 4-star crown rating from FE Analytics, one of the firms we use for fund research. The three managers co-manage the fund and stands at £75m which is small in comparison to other funds in this space, but I quite like that. A smaller more nimble global macro strategy gives the portfolio some dynamism at the lower end of the risk spectrum.

Top 10 holdings

Rank	Change	Name	Top Positions
1		INVESCO PHYSICAL GOLD ETC USD	1.70
2		ISHARES PHYSICAL GOLD	1.70
3		AMAZON.COM INC	1.20
4		MICROSOFT CORP	1.20
5		ENEL SPA	1.10
6		ALIBABA GROUP HLDG LTD	1.10
7		PAYPAL HLDGS INC	1.00
8		ORSTED	1.00
9		LVMH MOET HENNESSY VUITTON SE	0.90
10		IBERDROLA SA	0.90
Total			**11.8**

Its previous years to 2020 have been OK with some periods not doing so well and then others 1st quartile but it is this year we are very interested in with YTD showing very strong figures especially with the risk the fund is taking posting a 14 out of 80 performance. This fund tends to do better when markets are choppy.

BlackRock European Absolute Alpha
Fund manager (s) Stefan Gries, David Tovey
Fund size £436m
Risk score 25

The managers focus on European long/short positions. This means that managers will take positions based on decisions that can make a return if the value of the asset falls as we all as rises. It is a 5-star crown rated fund (FE Analytics) managed by David Tovey (since 2017) and Stefan Gries (since 2013) who also manages Blackrock Greater Europe Investment Trust.

The Fund aims to achieve positive absolute returns on your investment (i.e. an increase in the overall value of the Fund) over a period of 12 months regardless of market conditions. As such, the Fund will not be managed against any European equity index. The Fund will be managed with the aim of delivering absolute (more than zero) returns on a 12 month basis in any market conditions. However, an absolute return is not guaranteed over a 12 month or any period and the Fund may experience periods of negative return. Performance below backs this statement up. By calendar year the only negative year in the last 5 was 2016.

Cumulative Performance (GBX)

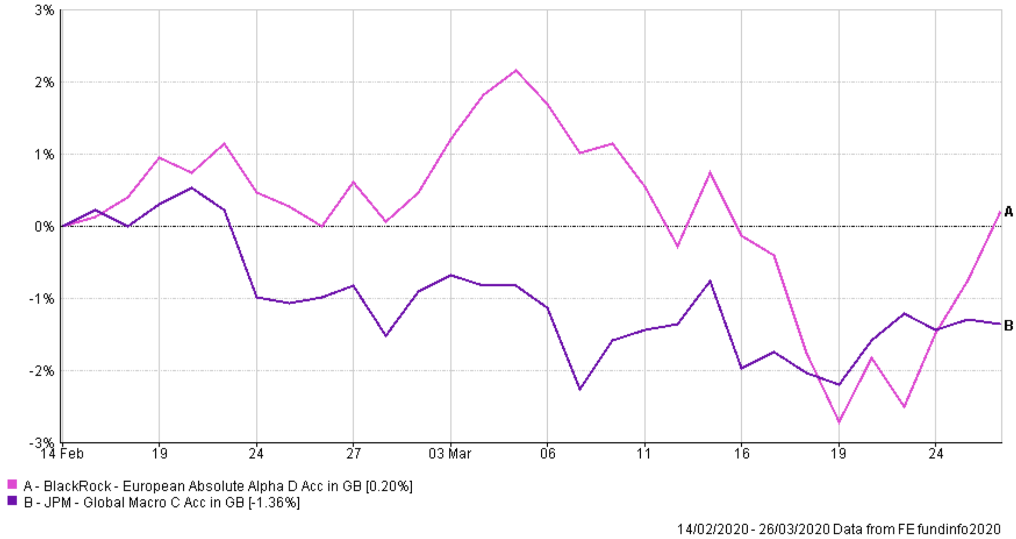
	3 Months	6 Months	1 Year	3 Years	5 Years
Fund	3.94%	8.13%	11.91%	21.02%	24.24%
Sector	1.08%	5.94%	0.15%	0.15%	4.70%
Relative to Sector	2.83%	2.08%	11.74%	20.84%	18.66%
Rank in Sector	8 / 81	28 / 80	5 / 79	2 / 65	3 / 57
Fund Quartile	1	2	1	1	1

Performance through March was strong with a small drop then it really pushed through with a 2 out of 79 in the AR space year to date which is impressive as the fund takes less risk than the mean of its peers, 2019 3rd quartile and 2018 1st. Again, this fund tends to do better when markets are choppy.

Top 10 holdings

Rank	Change	Name	Top Long Positions
1	►	ROYAL UNIBREW A/S	3.30
2	▲	DSV PANALPINA AS	2.81
3	▼	LONZA GROUP AG	2.79
4	▲	RELX PLC	2.63
5	▼	NOVO-NORDISK AS	2.02
6	►	SIKA AG	1.99
7	▲	VOLVO(AB)	1.71
8	▼	BRITISH AMERICAN TOBACCO	1.65
9	▲	EXPERIAN PLC	1.56
10	▼	LAFARGEHOLCIM LTD	1.53
Total			**21.99**

Below are the charts for the Covid crash period and then the recovery with BlackRock recovering stronger with JPM being a steady ship, taking risk levels slightly higher than short dated gilts but delivering significantly more returns year to date.



Summary

What has happened this year one hopes is a once in a lifetime experience, never to be repeated. We have had to adapt our way of life, the way we communicate, and the way investments are managed. Making the decisions earlier this year delivered positive results however being able to look back at the last 9 months and look at how different strategies and managers performed has given us further insight in how we can positively adapt and endeavour to deliver better performance whilst managing any sharp falls as we saw in March.

Below highlights the year to date differences between the current moderate and conservative portfolios (3.1) and the adapted versions (3.3). Please remember this analysis is to assess if the adaptions generate more return with similar impacts when things go wrong (Covid crash). Please also remember that hindsight investing is the easiest way to invest, time is needed to assess whether an adaptation is worth consideration.

We appreciate that future market movements may well not look like the last 9 months but increasing diversification through the introduction different funds and different styles of fund management will offer potentially greater scope for growth.

We will be writing to those affected by the adaptations we wish to make, in the meantime if you have any questions then please contact the investment team or your adviser.

Regards,
Sarah Lockington

VOBIS VIEWS

Let's talk

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