GDIM Discretionary Fund Managers

Issue 2 - April 2018

Investment Market Review & Outlook

After seemingly taking a year off, volatility firmly returned to markets in the first quarter of 2018. As January turned to February, stock and bond markets fell in unison on fears of more US interest rate increases than was previously assumed, and worries of a descent into a US-China trade war pushed markets down further in March. If the investment environment is now one of more skittish investors, higher interest rates and falling bonds, where should we look for returns?

Investment Committee

Mark Denley | David Ellis | Simon Rees | Tom Sparke | Michael Bretherick | Craig Hilton | Benjamin Benson | Siobhan Cordery | Sean Pledger | Chris Adams

UK Economic Data

2017/18	RPI (%)	CPI (%)	Unemployment (%)	GDP Growth* (%)
October	4.0	3.0	4.3	-
November	3.9	3.1	4.3	Q4 +0.4
December	4.1	3	4.4	-
January	4	3	4.3	Q4 +0.3†
February	3.6	2.7	-	-
March	-	-	-	-

**Based on percentage change on previous quarter* *†TradingEconomics Estimate, 2018*

Economy

After a brief New Year flourish, stock markets experienced their most significant fall in over a year at the end of January, sparked by better than anticipated wage growth figures from the US, prompting fears that the Federal Reserve might raise interest rates quicker, or more sharply than anticipated. This led to both equities and bonds falling almost uninterrupted for around a fortnight.

Fretfulness was exacerbated later in the quarter as President Trump confirmed that tariffs will be imposed on steel and aluminium imports. This was met with threats of retaliatory action from the EU, which may include additional levies on US goods such as whisky, jeans and motorcycles (goods which specifically hurt the Mid-West, where Trump's support is strong). Chief Economic Adviser Gary Cohn resigned over this issue and was replaced by Larry Kudlow, a former Wall Street economist and, more recently, a financial commentator for CNBC. Further to this, more punitive tariffs were announced by the President to block trade imports in certain goods, mainly from China. The effects of these will be very low in practice, and therefore seem to be largely symbolic.

Inflation figures in the UK moderated to 2.7% (CPI) in March, a seven-month low, mainly driven by lower food and fuel costs. Wage growth is slowly recovering, up to 2.6% annually, and could move above the rate of CPI if this continues its fall, ending the year-long period of shrinking 'real' (inflation-adjusted) earnings. The Pound was mildly weaker against most major currencies over the period, but was boosted by an agreement with the EU on the potential transitional period after the UK officially withdraws next year.

European economic data continues to be in line with higher activity, growing earnings and a sustainable expansionary path. This is despite uncertainty in Germany as Angela Merkel struggled with a lower majority, but achieved a coalition to maintain the status quo as Chancellor.

Japan's central bank decided to maintain its quantitative easing (QE) programme as inflation is still stubbornly below the 2% target. The country is now in the minority of regions that are still actively stimulating their economies with asset purchases as the US and Europe are withdrawing these policies. The Yen moved up marginally versus the pound, partly due to its 'safe haven' status in times of higher uncertainty.

Asian and emerging market investments showed a large degree of divergence over the first quarter, with Brazil and Russia rising significantly. Our current most-favoured nation, India, weakened following a serious fraud in the banking sector and the introduction of a long-term capital gains tax on equities.

Fixed Interest

Sovereign bonds from most regions, especially the UK gilts fell almost without pause for the first six weeks of this year. Despite some recovery, these assets remain below the level at which we entered the year. Our dislike for highly interest-rate-sensitive bonds has led us away from gilts for some time now and as such the majority of our fixed interest holdings fell far less and continue to provide superior performance, as they did last year.

While we believe that high-quality, low-yielding assets, such as gilts and treasuries, will not be profitable assets in the short to medium-term, we also do not subscribe to the view that there is a serious risk of a long-term deterioration in their value. If inflation remains subdued, the yields on US debt treasuries may start to appeal at around 3% and there should be many institutions willing to buy them at these levels and in large numbers. This effectively caps the degree of capital loss and may create a trading range that we could use as a guide to find opportunities for value.

We have been pleased with the performance of our chosen assets in the fixed interest parts of our portfolios as they have shown a high degree of resilience to weakness in the broader market.

Equities

The first months of 2018 were far from the progressive, fruitful ones we enjoyed at the end of the previous year. With the exception of some bright spots in emerging nations such as Brazil and Russia, major equity markets struggled to retain their lofty positions with the most significant ones to fall including India, UK and Continental Europe.

Assets related to technology fared very positively over the period as a whole, despite a significant hit in March from the revelations that Facebook may have misused users' data. Our UK equity positions are small in relation to our peers, but our selected funds outperformed the indices in a poor period for these assets. Similarly, our European holdings did better than their counterparts overall and our US selections performed significantly better than the S&P 500 index.

Our higher quality bias in Asia helped our returns over the quarter even as our over-weight position in India detracted from performance on a broad basis. The weakness in India has stemmed from the initiation of a long-term capital gains tax, which has dampened appetites for investing, but we anticipate a pick-up in the new tax year (6th April). Despite this short-term setback, the forwardlooking indicators of growth are overwhelmingly strong for India and we continue to hold large positions here to benefit from this over the medium to long-term.

Japan's equity markets were poor in the first quarter and the Yen mildly appreciated versus the Pound (as is typical in times of market stress), both of which were mildly negative for portfolios. Our selected funds did better than most, but the region's high correlation with the fate of the US meant that the overall path was negative. Nevertheless, economic data was robust and Governor Kuroda, of the Bank of Japan, was reappointed to his post, meaning stability and a continuation of the current stimulative policy for the country.

A far from positive start to the year, but not a disastrous one, with many of our portfolios remaining ahead of their respective benchmarks. There are many positive indicators to look to on a global basis and we remain confident that equities will do well this year, driven by improving earnings in the vast majority of markets we invest within.

Property

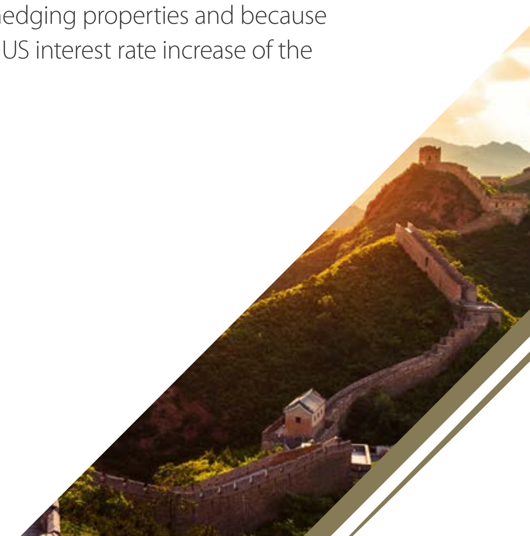
In a continuation of very steady progress, our direct domestic property fund, run by Columbia Threadneedle added close to 1.5% over the quarter. High quality commercial buildings have been carefully selected for the portfolio, which has very little exposure to Central London an area that may be badly affected by a less than positive Brexit.

Changes in retail habits in the UK – mainly a shift to online – have driven up the value of retail warehouses, particularly in logistically advantageous locations, and put pressure on high street spaces, which are suffering from a lower footfall. The evidence of a shift in the nation's shopping priorities is shown by some key statistics – Kingfisher (owner of brands such as B&Q and Screwfix) has closed 25% of its UK selling space and Dixons Carphone has closed 200 stores, while Primark has opened two new stores on Oxford Street.

Commodities

After the news of agreed cuts to the supply of oil by OPEC last year, to bring the price close to its five-year average, there have been more cuts than originally planned and the price of crude oil has risen back to above $60 a barrel as a result. We watch with interest as two of the nations that are most sensitive to the price of oil, India and Japan, are well backed by our Investment Model Portfolios.

Gold has come back into focus for a number of reasons lately: its safe-haven status in volatile markets, its perceived inflationary hedging properties and because it has rallied after every US interest rate increase of the last couple of years.



Conclusion & Outlook

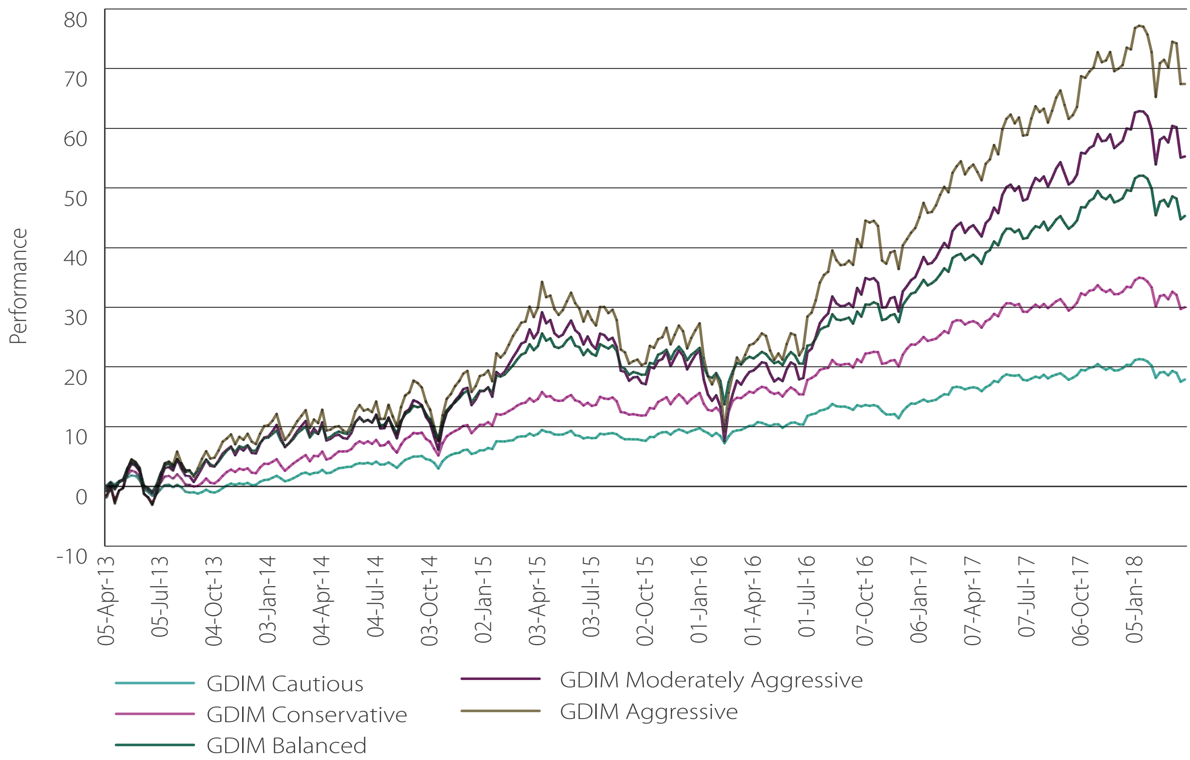
Despite a disappointing start to the year, it is worth noting that the market falls were prompted by what was a genuinely positive number: improving wage growth in the US. Coupled with similarly positive news coming from earnings in the US, Europe, Japan and other parts of Asia, we think that the potential for a high level of equity returns remains strong.

With the possibility of two, or even three, more interest rate increases from the Federal Reserve before the end of the year we are aware of the risks that are present in bond markets and are acting accordingly. We refuse to write off bonds as a source of return just yet, but we may have to search a little harder.

Clearly, this quarter has brought a number of new geopolitical and monetary concerns and the swings in equity and bond markets have been more frequent and more extreme already. It is essential that we retain diversified portfolios with carefully considered positions in areas we believe in, and avoid those that may cause more difficulty than they can provide in returns.

GDIM Investment Committee
April 2018

Five-Year Performance of GDIM Investment Model Portfolios



These figures are representative of GDIM's 5 Whole of Market Investment Model Portfolios, initiated on the 17th April 2009 and re-balanced in-line with the latest portfolios whenever changes were recommended. Graph shows performance over 5 years to the 30th March 2018. Performance does not reflect trading in actual accounts (and is therefore gross of all management fees, except fund charges). Data provided by Financial Express 2018. Past performance is not representative of future returns. Capital may fall as well as rise and you may not get back the full amount invested.

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