Fund Management Monthly Commentary

Covering the month of June 2020

June Market Update

Margetts' monthly diary discusses major economic and market developments that occur over the month. It is written by the Fund Management team.

Most IA sectors saw positive returns during June. The best performing sectors were IA Asia Pacific ex Japan (8.55%), IA Global Emerging Markets (7.82%), and IA Europe ex UK (4.36%). The weakest sectors were IA Japanese Smaller Companies (-1.19%), IA UK Gilts (-0.13%), and IA Short Term Money Market (0%). Fears of a second wave of Covid-19 caused a wobble in equity markets, dragging them down from recent highs and interrupting the previous broadly upward trend form March's lows. Bond markets travelled a long way to ultimately a standstill, continuing to show uncharacteristic levels of volatility for an intended "safe" asset.

June saw over 10,000,000 total Covid-19 cases reached worldwide, and over 500,000 total deaths. The USA remains by far the worst affected country, but the western European countries, which were the closest behind the US, have been overtaken by a number of emerging market economies. Brazil has emerged as the epicentre of the disease in Latin America, having reached 1.4 million recorded cases and over 60,000 deaths. The attempt of President Jair Bolsonaro to underplay the severity of the virus appears to have backfired badly. Peru, Chile and Mexico also suffered large rises in cases. Russia and India also continued to see large daily increases in total cases. There were significant case spikes (on a relative basis) in some major cities where the virus had previously been quelled, including Seoul and Melbourne. In the UK, Leicester became the first city to have to return to lockdown conditions as cases spiked. This form of localised lockdown is likely to be the norm until a vaccine is found.

The surge in new infections in the US and globally was not followed by a rise in new deaths. This could mark the new reality and indicate that either the virus symptoms are getting less severe, the treatment of new cases is getting more successful, or the economies affected have more favourable demographics. Another factor adding to this divergence is the number of new tests made daily. Most virus carriers are asymptomatic, and hence do not require medical treatment. At the start of the pandemic tests were not widely available and, in most cases, only people who were admitted to hospitals with severe symptoms were tested. Now most countries pursue the test and trace strategy, where testing is rolled out to the wider population, and many asymptomatic cases are picked up.

While the search for a vaccine continues apace, during trials the UK found that an existing immunosuppressant steroid, Dexamethasone, could reduce deaths due to Covid-19 significantly, with the potential to save 1/3rd of patients on ventilators, and 1/5th of patients requiring oxygen. The drug is cheap, at c.£5 per day, and is out of patent, which means it can be manufactured worldwide. A number of other new drugs have now entered the human trial phase.

With the US elections in November creeping ever closer, Joe Biden continues to lead comfortably in the polls, largely via not campaigning. History is against Donald Trump as the incumbent, with no sitting US president achieving re-election with a recession occurring in the two years ahead of the election except for Calvin Coolidge in 1924. The rush for states to reopen their economies, in the hope that the US recession can be negated before the vote, appears to have been premature, with many southern states seeing a resurgence of Covid-19 cases. Many states chose to reverse their planned re-openings, which is likely to set the US back significantly in GDP resurgence.

June highlighted the agony and ecstasy of US mega-cap stocks, with Tesla surging past $1,000 a share to become the world's largest car company by market cap. Facebook, in comparison, suffered a setback as many significant advertisers withdrew from its platform, expressing concerns over the lack of moderation of hate speech and misinformation.

Coming out of the lockdown first gave the Chinese economy an advantage over peers, driving the valuations of the Asian equity markets higher. With nearly no new cases reported, China's consumer spending is gradually returning to pre-Covid-19 levels, jobless claims are falling, and the industrial production is edging higher as well. The recovery experienced in China could suggest a pathway for other developed markets and indicates that consumers who have experienced a supply shock, not being able to spend despite demand remaining in place, are now eager to spend.

The end of June saw the official deadline to extend the transition agreement between the UK and the EU pass without an extension request from the UK. In practice the UK and EU could agree an extension at any time up to the end of the year, as has been noted in previous diaries. The risk of a WTO terms Brexit from an economic point of view have been lessened considerably by Covid-19, which leaves the EU with arguably less leverage than when the Withdrawal Act was agreed. Our expectation is that a partial deal of some kind will be reached covering the majority of trade concerns before the year is out, with trickier areas due to take longer to agree on.

China passed its controversial Hong Kong Security Law at the end of the month, leading to the United Kingdom reiterating its offer of a path to citizenship for c.3m Hong Kong residents. Between this legislation, and the concerns over Huawei's involvement in 5G networks, global tensions may escalate. The United States-Hong Kong Policy Act, which means the US treats Hong Kong as a separate trading entity from mainland China, is likely to come under intense scrutiny.

Wirecard provided a timely reminder that market participants are not always as sophisticated as we might like to believe. This company has managed to remain within the blue-chip German Dax Extra despite widespread reports of fraud and missing billions since 2019. The sudden collapse only occurred when the company admitted $2bn was missing and other revelations regarding profitability have followed. This stock is a member of the fashionable fintech sector and provides evidence that investors are overlooking basic fundamentals in their enthusiasm for growth stocks. With the multi-year surge in growth stocks generally and lagging of value counterparts, this does suggest the trend might have stretched too far.

Strategy

We are regularly buying on dips and selling on rises to gain advantage from the current market volatility through timely re-balancing decisions.

It is our view that long dated bonds are unattractive due to yields on many of them trailing well below inflation targets, while inflation pressures are rising following the release of fiscal and monetary Covid 19 stimulus. We prefer short dated holdings which are less sensitive to yields rising and provide a better risk/return profile.

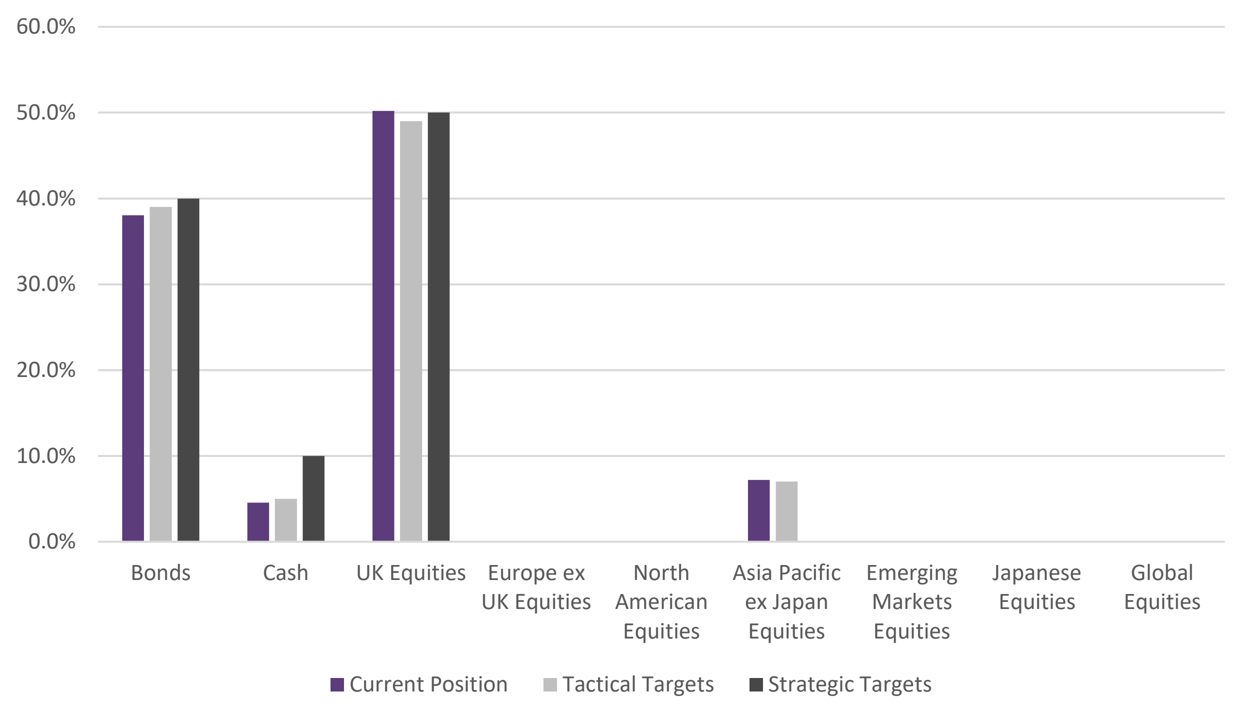
Allocations to equities are above neutral levels as we believe equities are attractively priced at the moment and have upside potential in the short term if Covid-19 risks diminish. We have some concerns regarding some growth stocks but recognise that momentum remains strong, therefore we are maintaining diversification of both value and growth styles.

Weightings to the US are below benchmark levels as Covid-19 could drag on their economic recovery despite US equity markets recovering most of the earlier falls. Asia and the UK look more attractive to us, especially the UK if Brexit negotiations reach a deal before the 31st December 2020 deadline. The allocation to Europe is neutral, although prospects have improved for this region as Covid-19 progress is encouraging and evidence of a more unionised approach has emerged in the form of the €750bn bailout programme for affected countries.

Margetts Risk Rated Funds

The below charts show the current positions of the funds, the tactical (short term) targets, and the strategic (long term) allocations. We aim to keep the current positions in line with the tactical targets from week to week. The differences between the tactical and strategic targets reflect the views and convictions of the Margetts Investment Committee.

Providence



There were no changes made to asset allocation and/or fund selection in June.

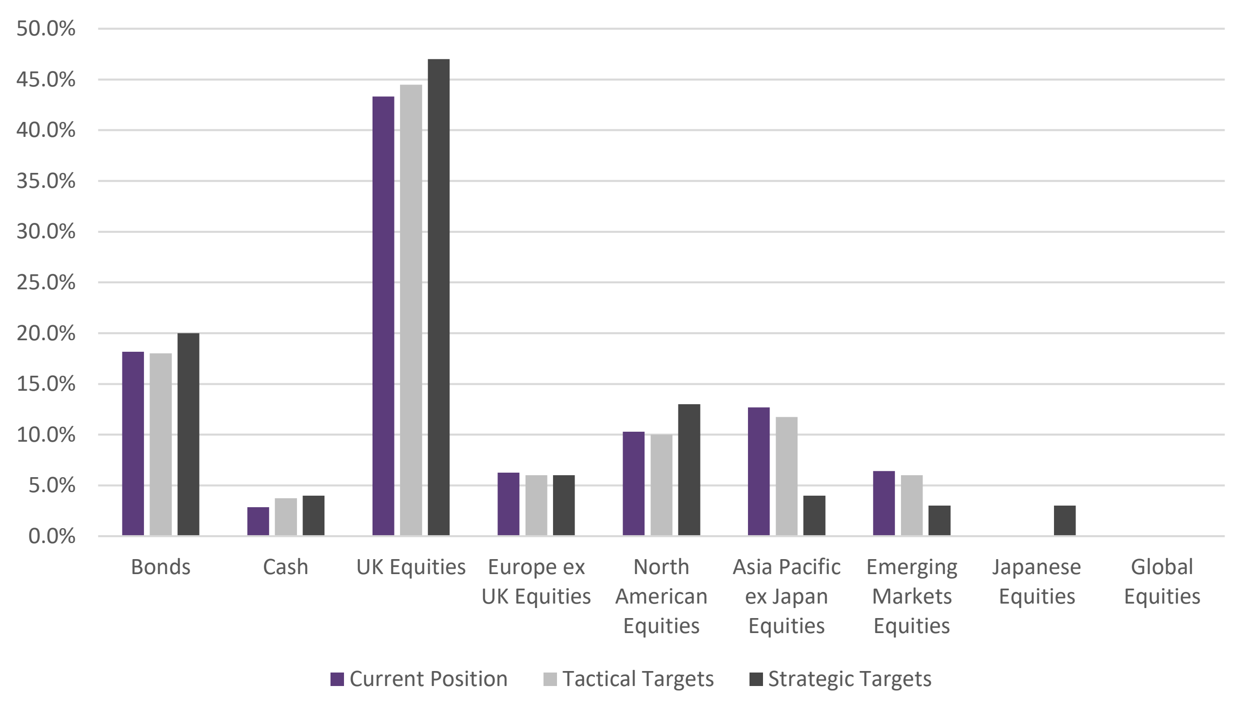
Providence lagged the IA Mixed Investment 20-60% Shares sector by c.0.8 percentage points over the month.

Most underlying UK holdings were ahead of the IA UK Equity Income sector over one month, with large-cap UK equities outperforming their smaller-cap peers.

The Legal and General Asian Income Trust strategy lagged the IA Asia Pacific ex Japan sector over the month. However, its returns were positive in absolute terms during the period, which creates a positive allocation effect, given the overweight allocation to this region.

Longer dated bond funds outperformed shorter dated holdings during the month and all provided a positive absolute return. The strongest performer was the BlackRock Corporate bond fund, ahead of the IA £ Corporate bond sector by c.0.3 percentage points.

Select



There were no changes made to asset allocation and/or fund selection in June.

Select was slightly ahead of the IA Mixed Investment 40-85% Shares sector over the month.

Within Asia ex Japan, the strong performance of the BlackRock Asia fund worked in equilibrium with the relatively weaker performance of the Schroder Asian Income fund during June. The BlackRock Asia strategy has a higher allocation to China, which began its recovery ahead of other markets.

All underlying bond holdings were broadly in line with their respective sectors over the month. The committee were pleased to note the improved performance of the Royal London Short Duration Global Index Linked Bond fund, which has strengthened as sterling has strengthened against the dollar due to its sterling hedge.

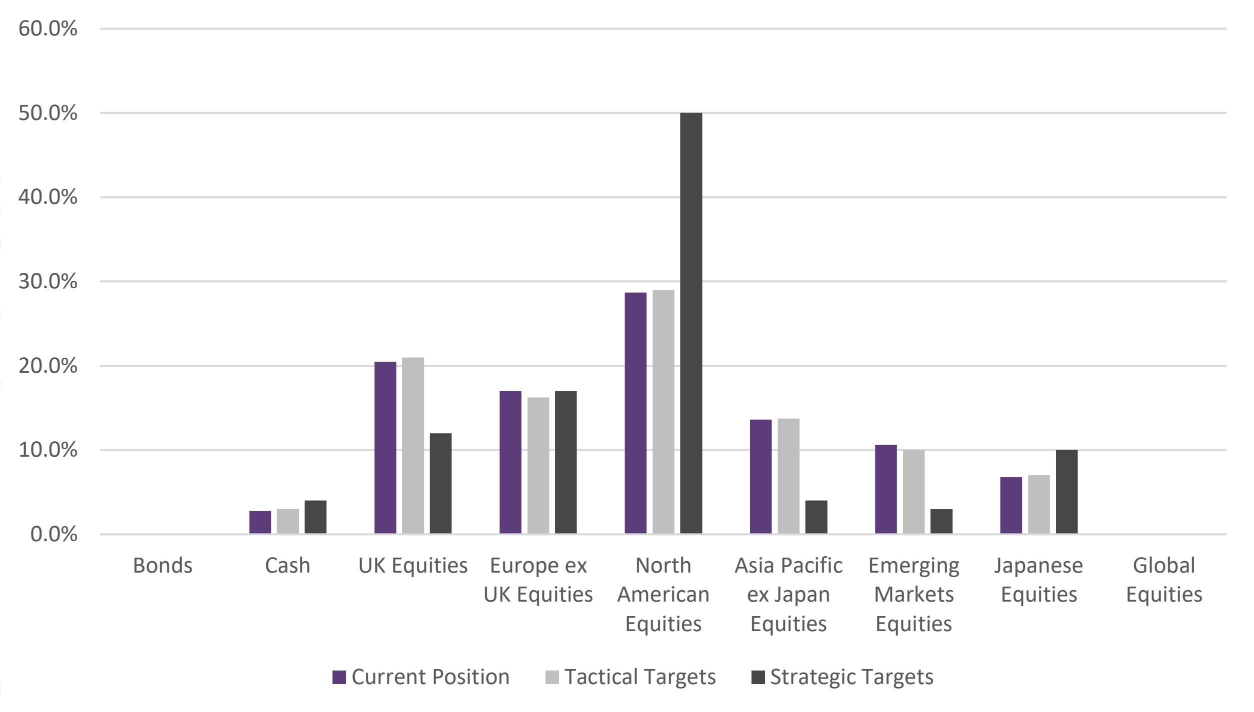
Emerging as the strongest relative performer within the portfolio during June, The UBS Global Emerging Markets strategy outperformed the IA Global Emerging Markets sector by c.2.8 percentage points in this period.

The Vanguard US Equity Index fund was slightly ahead of the IA North America sector over one month, balancing out the performance of the Fidelity Index US fund, which was slightly behind.

The only underlying European fund was in line with the IA Europe ex UK sector in June.

All but one of the underlying UK holdings were positive in absolute terms, with the large-cap strategies outperforming during the month.

International



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International was just behind the IA Global sector during June.

Within Asia Pacific, the Baillie Gifford Pacific strategy continued its strong performance in June, counterbalancing the weaker relative performance of the Legal and General Asian Income Trust strategy.

The underlying Japanese holdings mirrored this, as the strong performance of the Baillie Gifford Japanese fund offset the relatively weaker performance of the Schroder Tokyo fund. The hedged Schroder Tokyo fund suffered due to weakening sterling against the yen during the period.

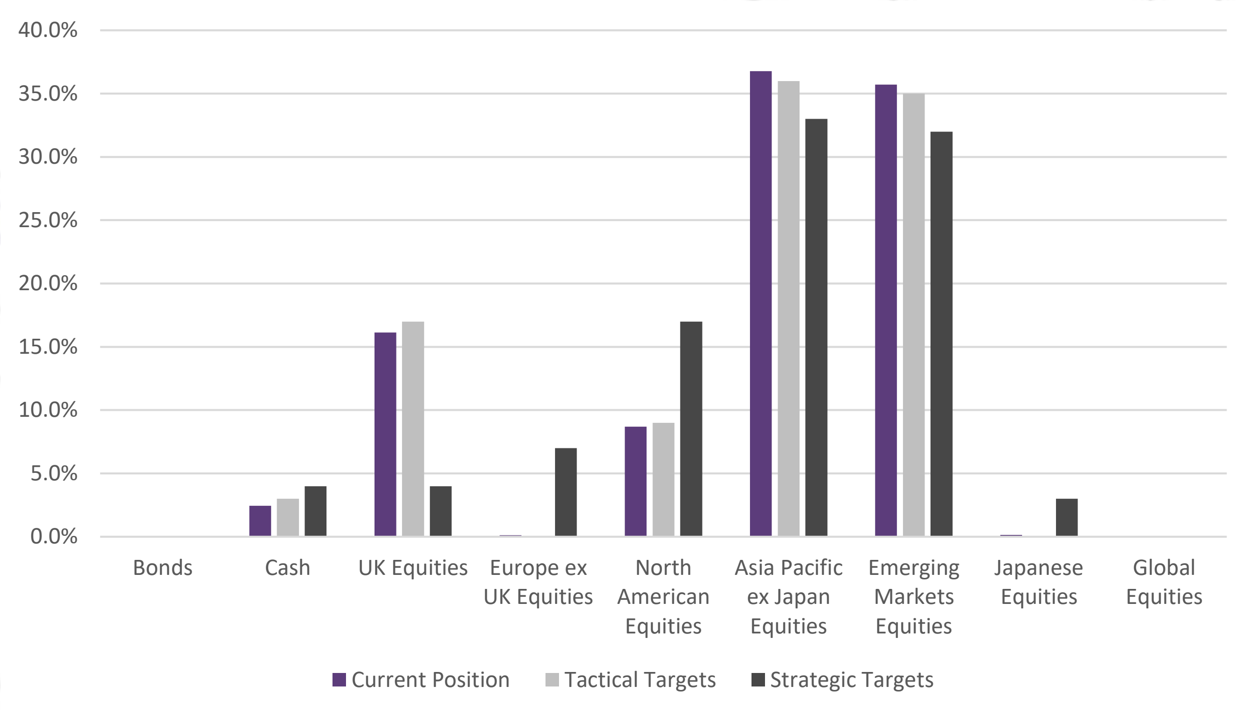
Both underlying Emerging Markets strategies were ahead of the IA Global Emerging Markets sector over one month, with the Threadneedle Global Emerging Markets fund providing the highest relative return within the portfolio during this period.

All underlying US holdings were broadly in line with the IA North America sector over one month.

All underlying European holdings outperformed the IA Europe ex UK sector during June. The Committee were pleased to note the improved performance of the JPM Europe Dynamic fund, which surpassed the sector by c.1.9 percentage points during the period.

Similar to Providence and Select, underlying holdings with a large-cap tilt outperformed within the UK.

Venture



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The strongest performer within the Risk Rated range over June, Venture surpassed the IA Flexible Investment sector by c.2.8 percentage points.

The majority of underlying Asia Pacific funds were ahead of or in line with the IA Asia Pacific ex Japan sector over the month.

Within Emerging Markets, all but one underlying holding outperformed the IA Global Emerging Markets sector during June. The Threadneedle Global Emerging Markets strategy was the strongest performer in the portfolio over this period, ahead of the sector by c.3.4 percentage points.

The underlying US holding performed in line with the IA North America sector over one month.

In the UK, underlying holdings with a large-cap bias outperformed against the mid-cap holding.

Important Information

Please note that the contents are based on the author’s opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change. It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested especially in the early years.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

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For any information about the company or for a copy of the company's Terms of Business, please contact the company on 0121 236 2380 or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR

You can e-mail us at admin@margetts.com