Advanta Wealth Portfolio Review

Spring 2019

London
130 Buckingham Palace Road,
London SW1W 9SA

Glasgow
121 West Regent Street,
Glasgow G2 2SD

Contact
+44 (0)203 668 7480
info@advantawealth.co.uk

Contents

Market Review

Following the significant falls in equity markets at the end of 2018, the first quarter of 2019 provided respite for investors with the global equity market showing a strong return and fixed income producing good, positive returns. The main catalyst for the change in fortune seemed to be US Federal Reserve comments regarding a prolonged pause in US interest rate policy. This has led many commentators and the market to expect the next move to be an interest rate cut. This change in rhetoric has alleviated some of the crucial concerns in the market such as the slowdown in global economic growth and the ongoing China/US trade tariff negotiations.

The events within markets at the end of 2018 illustrate that investor emotions hold significant sway in performance. The culmination of these factors seen investor sentiment turn, the result of which was a sharp fall in equity prices. Sentiment can best be described as a herd mentality within the markets, a feeling or emotion towards a certain market or security which can result in an upswing or downturn in prices. Crucially, these movements are not motivated by business performance. Maintaining our conviction in the composition of our models at the end of 2018 has allowed us to benefit from the market recovery.

Whilst the issues outlined above remain the key focus for investors, over the longer-term there are some other risks which do not significantly influence the short-term global growth picture. One of these is how late in the economic cycle it is, and what any eventual downturn will be like. In Europe meaningful political reform remains problematic as populism but not anti-euro sentiment continues to attract support, this continues to create uncertainty over the long-term picture for Europe in the years to come. In the US, politics remain unstable. The Mueller report into president Trump's election activity was inconclusive in certain areas leaving more investigation to take place. Trump's erratic behaviour is also not good for market stability, estimates suggest the US government shutdown took away 0.13% of growth for each week that it lasted.

The improvement in market returns so far this year has been surprising. At some stage the late cycle concerns will re-emerge as the US economy will undoubtedly slow this year. China is in a structural slowdown and, once its economy stabilises, it is unlikely to keep adding further policy stimulus as deleveraging remains a priority. For many fund managers it has become difficult to distinguish feelings and emotion from actual business performance as so many asset classes correlated at the end of 2018. When markets move in unison it is very difficult for fund managers to differentiate portfolios and market returns, but in an environment that is delivering increasing volatility, we believe there is greater scope for active managers to outperform. The key factor is for portfolios to diversify, and whilst this may sound like a broken record in these quarterly reviews, we stand by its importance, and the need to emphasise it when possible.

Equity Overview

The slowdown in global economic growth is evident within markets. The International Monetary Fund (IMF) has reduced their growth predictions and a recent Purchasing Manager Index (PMI) survey has suggested a widespread contraction in markets, or at least in Europe and China. That said, 2019 has seen a more positive reaction from markets following the dramatic falls in late 2018. As is often the case, we saw an over-reaction in markets to negative information and investors quickly saw opportunities arise from falling valuations.

We are more cautious about markets in general but recognise that global growth is still positive and led by an expanding US economy. Although we appear to be late in the economic cycle it does not follow that a recession will ensue, as recent data from JP Morgan points out nine out of the last twenty global slowdowns have not been followed by recession. Markets are of course unpredictable and could tread water or gradually move up during 2019, rather than enter a period of negative returns as experienced in 2018. Volatility is certainly more apparent and will likely form an increasing part of our experience of investing as we move away from quantitative easing.

US

The threat of trade disruption has not been as painful in the US as it has been seen to be globally. The US has a stronger domestic economy and a more independent economic framework. The US has been growing strongly enough for the central bank to raise rates over the last two years and although the predicted rises in 2019 were one of the reasons for the selloff in the final quarter, the Federal Reserve has listened to the global economy and softened its approach since the beginning of the year.

President Trump is and remains an unpredictable factor but his policy making period has now been restricted by the mid-term elections last year. Although there are many positives from US data, such as employment and consumer confidence data, there are some negative signs that should be monitored closely. The effects of the tax cuts in 2018 are reducing and there is increasing unease in the housing market as well as wage demands starting to creep up. There is some belief that a stronger inflationary environment in the US may well be a benefit for the economy and that the Federal Reserve may be more relaxed about the rate increasing above the 2% target. The US is the leading economy on the planet, and therefore is the one to be watched in terms of trends, although we are moving more closely to a point where the Chinese economy shares this role.

Europe

Whilst the UK is embroiled in internal and external Brexit negotiations, Europe also has its own regional issues to contend with. After signs of recovery in 2017/18 Europe is slowing again and it is not just the obvious candidates that are stuttering this time, Germany is also showing weakening data with recently released figures showed it only narrowly avoided falling into recession in quarter four 2018. Many of the issues in Germany are related to manufacturing with January showing a surprise drop in industrial production, linked to the trade war issues between Europe, the US and China. Asian demand for German exports has dropped, particularly related to the auto market. The other major European economies have not escaped this, but they are less exposed. France has its own issues as President Macron tries to wrestle them away from restrictive employment contracts, whilst increasing the tax take. The smaller economies have only recently started to recover and remain fragile with Italy the most problematic of these given its weak political environment and banking and borrowing problems. There are some bright spots however, with Ireland showing substantial economic growth and Spain also recovering well.

UK

The IMF forecast for growth of the UK economy has recently been downgraded for 2019 to 1.2% based on a number of factors related to the effects of leaving the European Union. The recent delays have already affected the inward investment in the UK economy by companies, with the UK now at the bottom of the pile for investment levels in the developed economies. However, several managers are positive on UK equities as valuations are lower than for some time ahead of any solution to Brexit. In this environment it is expected that GDP will grow at a rate of between 1.0% to 1.5% this year, modestly below trend. Ultimately the key to UK economic expansion is the resolution of the Brexit issues which continue to affect normal trading and investment expectations.

Advanta Wealth

Asia

The mainstay of the Asian economic region is China, where growth expectations are between 5.5 and 6.5%. Whilst this is falling, the rate of growth remains well above most other economic regions. There is confidence that fiscal and monetary stimulus will be in place after the meeting of the National People's Congress and that this will find some traction, especially if a trade deal between China and the US is completed. China itself is still seeing strong domestic consumption as, outside of auto sales where the ending of a tax incentive last year has distorted the numbers, retail sales growth is still running at around a 10% growth rate. The issues in China are probably causing investors to be more cautious than is necessary at this point but any signs of a likely US / China trade deal will ease investors' concerns.

The strongest growing economy in the region is India, but elections are coming up and a clear majority for the incumbent Bharatiya Janata Party (BJP) under Modi seems less likely. That said, any new party or coalition is probably going to tread the same path as Modi, so there is less concern globally about any change. Elsewhere, fundamental structural and demographic advantages give the region some impetus and a stable or weakening dollar is a positive change.

Japan

Slowing economic growth affects Japan in the same way as many other countries and Japanese growth is expected to be around the 0.5-1% mark in 2019. Fiscal and monetary stimulus continues to support the economy as well as a robust labour market, which is likely to support domestic demand. With inflation still very low, the Bank of Japan is unlikely to adjust rates in the short-term, driving savers towards more equity participation. Stock valuations are below historic trends so investors believe there are good opportunities longer term in Japanese stocks.

On the policy front, Japan continues to make progress in corporate governance, tourism and free trade, and has improving relationships with many countries. Shinzō Abe is likely to become Japan's longest-serving prime minister since the birth of the country's parliamentary system in the 1880s. This stability is in stark contrast to the problems besetting many other countries.

Emerging Markets

Emerging Markets, as with Asia, is dominated by China. Elsewhere, the conditions for growth remain strong with population growth and an expanding middle class increasing the power of the consumer. With over 140 million new middle-class consumers entering the Chinese market alone each year there is huge scope for expansion in the region. Frontier markets are growing in momentum with Korea and Vietnam gaining investor interest as manufacturing hubs.

Fixed Interest

The recent change in tone from the Federal Reserve has been a positive sign for investors in general and signalled a period of stability in rate expectations. The recent inversion of the US yield curve, when longer term rates move lower than shorter term rates, is often cited as a precursor of recession, and has been a reasonably accurate predictor of this over time. It is possible for the outlook to become more positive if conditions improve, and this is helped by current rate stability, but we will need to also see stability in company earnings and profit margins.

In the UK, a soft Brexit could lead to the Bank of England raising rates later in the year, given such moves have been on hold recently. In Europe and Japan the chance of rates rising from their negative positioning is unlikely as economic prospects have declined. Investors are once again drawing comparisons between Europe and Japan, as the European Central Bank (ECB) appears to be struggling to normalise policy.

Given developed market rates are on hold for the time being, it seems most opportunities are in the areas of higher yield and emerging market debt. Corporate credit also seems to offer more opportunities at present, however; this is no without its risks. The issues that face corporate debt holders are firstly, the increasingly crowded position in credit, and secondly concerns about credit market structure and liquidity which has not been tested since the financial crisis.

Property

UK commercial property market returns have continued to moderate compared to the previous few years. The ongoing Brexit uncertainty has led many investors to reduce or sell out of their property allocations, which has put pressure on capital values. A disorderly Brexit may have particularly negative connotations for the London property market and many UK fund managers are reducing or avoiding Central London property, although it has continued to be supported by overseas investors.

The area of distribution / logistics / warehouses remains popular due to the demand for last mile delivery, same day delivery, click and collect etc. but this has pushed up purchase prices and driven down returns. The retail sector continues to struggle with profit warnings and financial difficulties announced by an increasing number of companies, as internet shopping continues to take market share, so fund managers need to be very selective.

Liquidity levels within commercial property funds remain above average in many cases, which is a longer-term fall-out from the EU referendum result and the subsequent investor feelings towards the asset class. This may continue for some, particularly with the Brexit uncertainty, which will impact absolute returns. If fund managers can generate any returns in addition to the natural income this will be a very positive outcome.

Portfolio Amendments

For our Spring 2019 review, in conjunction with RSMR, we are recommending the following changes to the Advanta Wealth Model Portfolios:

North American

The current allocation towards the Fidelity Index US fund is changed to the Vanguard US Index fund. The Fidelity Index US fund is a component of all model portfolios and the recommendation is to switch out of this fund in its entirety. In addition, we recommend that we equalise the allocation towards the newly introduced Vanguard US Index fund and the existing Merian North American Equity fund across all model portfolios.

Vanguard US Index fund

The Vanguard passive philosophy is emphasised not just through the funds but through the company structure and ownership. They have a unique mutual structure which aligns their interests with those of investors and drives the culture, philosophy and policies throughout the Vanguard organisation worldwide. Their large-scale operation helps to keep costs down, resulting in low fees, and provides ample crossing opportunities, which has resulted in strong tracking performance relative to their competitors.

We are recommending this fund switch as the Vanguard Index is much more representative of the US market as it tracks the S&P Total Market index, comprising over 3,700 companies compared to the Fidelity Index which tracks the S&P500, comprising the top 500 companies in the US by market capitalisation. When included in a portfolio alongside the Merian North American Equity Index, the Vanguard Index is a more suitable complement as it is less correlated than the Fidelity Index US fund.

United Kingdom

The replacement of the Franklin UK Mid Cap with the Merian UK Mid Cap across all portfolios. The Franklin UK Mid Cap is a component of all model portfolios and the recommendation is to switch out of this fund in its entirety.

Merian UK Mid Cap

The fund is based on running the portfolio from both a bottom up and top down perspective. The idea behind the approach is to have a process that can outperform over different phases of the market. There is now greater conviction in the stocks held as can be seen from the larger position sizes of individual names. Richard Watts, the manager since 2008, is happy to take stock risk in names he fully understands and is happy with a lower turnover approach than in the past. This approach has generated excellent returns in recent years. The strength of the flexible investment process and strong stock picking skills fully justify an RSMR rating on a fund which can be considered a core holding within the mid cap universe.

Emerging Markets

Within the Moderately Cautious model portfolio, we are recommending that we substitute the allocation from Fidelity Emerging Markets to JPM Emerging Markets Income. The emphasis within JPM Emerging Markets towards quality when focusing on high yielding stock is more appropriate for this risk category.

JPM Emerging Markets Income

This fund is a strong proposition for lower risk investors seeking exposure to emerging markets. It is also an option for investors seeking to diversify their source of income from equity markets. The fund leverages the strong Emerging Markets & Asia Pacific ('EMAP') Equities team at JPMAM which comprises investment professionals including portfolio managers and analysts across eight locations around the globe. RSMR rated the fund in December 2016 and they continue to have high conviction in the approach and the team.

Advanta Wealth Portfolio Schedule

Investor Style		Low Risk		Low Medium Risk		Medium Risk		Medium High Risk		High Risk	
Model Portfolio		Cautious		Mod Cautious		Moderate		Mod Adventurous		Adventurous	
Fund Name	ISIN	New Weight %	Change %	New Weight %	Change %	New Weight	Change %	New Weight %	Change %	New Weight %	Change %
Schroder European Alpha Plus	GB00B7LDKR32	2%		2.5%		3%		3%		3.5%	
BlackRock Continental European	GB00B3S9LG25	2%		2.5%		3%		3%		3.5%	
JPM Japan	GB00B235RG08	3%		4%		5%		6%		7%	
Fidelity Emerging Markets	GB00B9SMK778				-3%	2%		3%		3.5%	
First State Asia Focus	GB00BWNGXJ86			2.5%		2.5%		2.5%		3.5%	
BlackRock Asia	GB00B7VS8S56									2.5%	
Newton Asia Income	GB00B8KT3V48	3%		2.5%		2.5%		2.5%		3.5%	
Fidelity Index US	GB00BJS8SH10		-3.5%		-5%		-8%		-6%		-5%
Merian North American Equity	GB00B1XG9G04	3.5%		5.5%	-0.5%	6%	2%	6%		5%	
Vanguard US Equity	GB00B5B71Q71	3.5%	3.5%	5.5%	5.5%	6%	6%	6%	6%	5%	5%
Lazard Emerging Markets	GB00B24F1G74							3%		3.5%	
Fidelity China Consumer	GB00B82ZSC67									2%	
Ballie Gifford Pacific	GB0006063233					2%		2%		3.5%	
JPM Emerging Markets	GB00B5M5KY18			3%	3%	2%		3%		3.5%	
Newton Global Emerging Markets	GB00BVRZK937							3%		3.5%	
Non UK Equity		17%		28%		34%		43%		53%	
Franklin UK Mid Cap	GB00B8K8HH50				-3%		-5%		-7%		-8.5%
Investec UK Special Situations	GB00B1XFJS91	2%		3%		5%		7%		8.5%	
L&G UK Index	GB00BG0QPJ30	6%		5%		6.5%		7%		8.5%	
LionTrust SF UK Growth	GB0030028871			3%		5%		7%		8.5%	
Fidelity Enhanced Income	GB00B7W94N47	4%		4%		4.5%					
Merian UK Mid Cap	GB00B1XG9482			3%	3%	5%	5%	7%	7%	8.5%	8.5%
UK Equity		12%		18%		26%		28%		34%	
SLI UK Real Estate	GB00BYPHP536	3.5%		4%		4%		2%		2%	
VT Gravitas UK Infrastructure	GB00BYVB3T96	3.5%		4%		4%		2%		2%	
Property		7%		8%		8%		4%		4%	
Growth Total		36%		54%		68%		75%		91%	
BlackRock Corporate Bond	GB00B4QC3311	7%		7%		7%		5%		3%	
Legg Mason Brandywire Global Fixed Income	IE00BSZLQJ44	8%									
Jupiter Strategic Bond	GB00B4T6SD53	5%		6%		7%		5.5%			
L&G All Stock Gilt Index	GB00B8344798	6%		4%		3%					
L&G All Stock Index Linked Gilt	GB00BG0QNY41	3%									
Allianz Gilt Yield	GB0031383283	6%		4%							
Baillie Gifford High Yield Bond	GB00B1W0GF10			3%		3%		3%		3%	
M&G Global Government Bond	GB00B7Q0Q826	5%		3%		2%		3%			
Artemis Strategic Bond	GB00B2PLJR10	7%		7%		7%		5.5%			
L&G Global Inflation Linked Bond Index	GB00BG0QPQ07	3%		3%							
Fixed Income		50%		37%		29%		22%		6%	
Royal London Short Term Money Market	GB00B8XYYQ86	11%		6%							
Physical Cash		3%		3%		3%		3%		3%	
		100%		100%		100%		100%		100%	