

Fund Watch

Q2 2020

Fund Watch uses our team’s process to highlight the past quarter’s developments in the fund world. It is fact-based and uses performance analysis techniques which form part of our investment process. All data is from Lipper for Investment Association (IA) sectors and is calculated in total return terms in sterling for periods ending 30 June 2020.

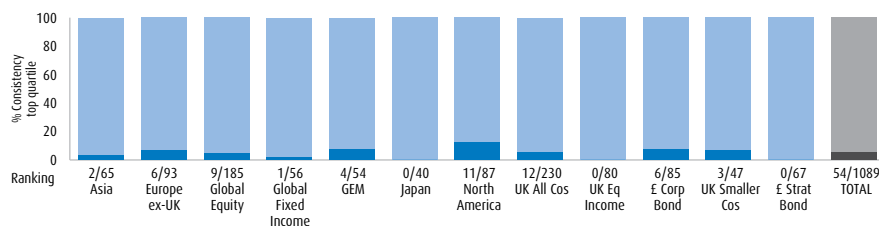
This quarter’s report includes the following analysis:

- The BMO Consistency Ratio – highlighting the surprisingly limited number of funds beating their peers on a regular basis.
- Tops and Bottoms – the ultimate winners and losers over the quarter.
- Sector Skews – the best and worst of the 39 IA sector averages.
- Risky Business – a look at the leading funds for combining first class longer-term returns with the lowest levels of volatility.

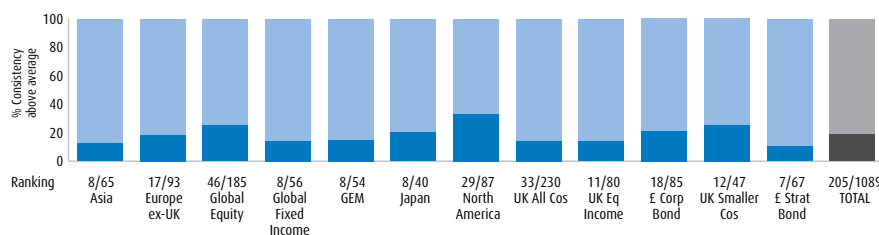
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Past performance is not a guide to future performance. Stock market and currency movements mean the value of investments and the income from them can go down as well as up and you may not get back the original amount invested.

Top quartile performance rolling 3 years: 5.0%



Above average performance rolling 3 years: 18.8%



Source: Lipper, 31-Mar-20 – 30-Jun-20, percentage growth, total return.

The BMO Consistency Ratio

Here we conduct a review of the 12 major market sectors, filtering out only those funds that are consistently above average in each of the last three 12-month periods, and those consistently top quartile. In the 12 main sectors researched, there are currently 1,089 funds with a 3-year track record.

- The BMO Consistency Ratio for top quartile returns over three years (to the end of Q2 2020) rose to 5% (3.9% last time) with 54 of the 1,089 funds achieving this feat. This ratio was above the usual historic range of c.2-4%.
- The IA North American sector was the most consistent for top quartile returns with 12.6% of funds making the cut (this number has been high for the last two quarters). It was followed by the IA Emerging Markets and IA £ Corporate Bond sectors, which had 7.4% and 7.1% of funds making the grade respectively. The IA Japan and IA UK Income and IA £ Strategic Bond sectors failed to deliver any funds that achieved this level of consistency.
- Lowering the hurdle rate to simply above median in each of the last three 12-month periods saw 205 of the 1,089 funds delivering above median returns consistently. This means this less demanding ratio rose to 18.8% from 15.7%.
- All 12 main IA sectors contained funds that met the less demanding above median consistency hurdle. The most consistent sector on this measure was the IA North American sector with an impressive 33.3% of funds performing above median for 3 consecutive years. The IA UK Smaller Companies and IA Global Equity sectors were the next best with 25.5% and 24.8% respectively achieving the target, with the IA £ Strategic Bond sector the least consistent with 10.5% of funds achieving above median consistency hurdle.

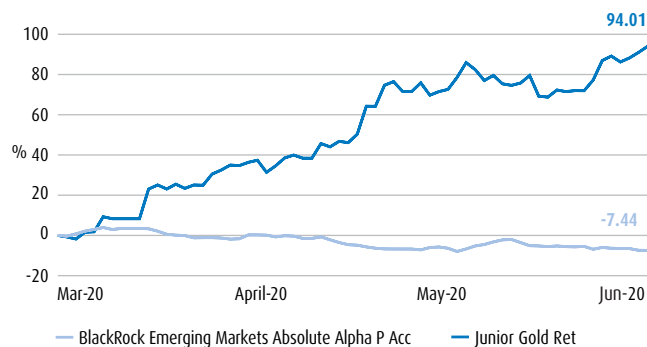
BMO comment

- The roller-coaster that has been the first two quarters of 2020 has drawn to a close and not a moment too soon.
- Q2 2020 brought with it the inevitable rebound from the lows of the first quarter as markets factored in a recovery of some sorts from the World's major economies. The astonishing speed and volume of response from central banks and governments spurred a surge in animal spirits from investors, with the long-awaited rotation into more cyclical unloved companies gaining traction for a time, only to fade as the comfort blanket of safety at any price reemerged.
- The consistency figures for the 3 years to the end of Q2 rose to levels not seen since we started running these statistics in 2008 for both top quartile and above average consistency. This is exceptionally interesting at a time of such change in the world economy, with the theme of safety and paying up for the privilege of certainty a trend that prevails.

Tops and bottoms

Identifying the best and worst performers of all funds in the quarter across all 39 IA sectors.

BlackRock Emerging Markets Absolute Alpha P Acc v Junior Gold Ret



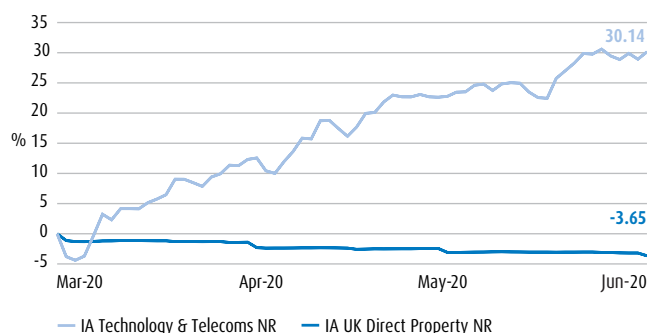
Source: Lipper, 31-Mar-20 – 30-Jun-20, percentage growth, total return.

- The £23m Junior Gold run by Angelos Damaskos returned a staggering 94% as the top performer in IA universe this quarter. Investing in primarily small and medium sized companies the fund seeks investments in specialised early stage gold and precious metal extraction ideas. Gold is often seen as a safe haven investment of choice in times of uncertainty and this more speculative area of investing in the theme often benefits after the initial move into the asset class.
- The £5m Blackrock Emerging Markets Absolute Alpha fund was on the wrong side of the market for the second quarter. The ability to take long and short exposures to the market was their downfall in a strong quarter for returns in pretty much all asset classes, with a net short in technology undoubtedly a painful trade.

Sector skews

All IA sectors bar UK Direct Property made positive ground in the second quarter, rebounding from the dramatic falls of Q1.

IA Technology & Telecoms NR v IA UK Direct Property NR



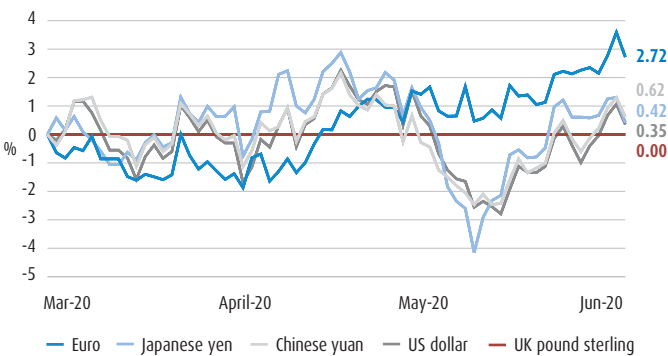
Source: Lipper, 31-Mar-20 – 30-Jun-20, percentage growth, total return.

- The IA UK Direct Property sector was the worst performer falling 3.7% with the IA Short Term Money Market sector next worst rising two whole basis points. Perhaps cash isn't always king.
- Of the UK equity sectors the IA UK Smaller Companies sector was the best performer gaining 19.9%. It is worth noting this sector is still down 16% in 2020 so far. The UK All Companies sector rose 14.3%, but again is still off 18% YTD. The IA UK Equity Income sector returned +11%, but is still -20% for the first 6 months of 2020.
- In bonds all sectors made positive ground, led by the IA £ High Yield fund which gained 11.7%, with the IA Strategic Bond fund returning 7.9%. Worthy of note is the year to date return for the IA Strategic sector which is +0.7%. The IA £ Corporate Bond fund gained 7.4% in the quarter while the IA UK Gilt sector sat at the back of the pack returning 2.7%. The IA Global Bond sector returned 6.3% in comparison.
- The IA Targeted Absolute Return sector gained 4.6% in the quarter. In the year to date the sector is now down 2.8%.
- Looking at the Mixed Asset IA offerings, the IA Mixed 40-85% Shares sector was the strongest performer rising 13.2%. The IA Mixed Investment 20-60% Shares returned 10.3% ahead of the 7.6% gain from the IA Mixed Investment 0-35% Shares.
- The IA Global Equity sector rose 19.2% against a return of 14.2% for the IA Global Equity Income sector. The focus of funds in income producing sectors on companies paying out dividends, which in many cases has been compromised through the COVID crisis, continued to hamper their ability to progress relative to their growth fund cousins.

Currencies

Q2 2020 was a more muted affair in the world of currencies, particularly relative to other assets though the end results mask intra quarter volatility. The Euro stands out in its strength against Sterling, however the next stage of the negotiations around Brexit in the second half of the year have the scope to introduce more volatility from here.

Currencies relative to sterling



Source: Lipper, 31-Mar-20 – 30-Jun-20, percentage growth, total return.

Risky business

Can you have your cake and eat it? Here we search for funds with good risk characteristics and establish which funds offer the holy grail of low risk and high returns. For this purpose, a longer time period is required, so we look back over three years to the end of the quarter.

- Measured to the end of Q2 2020, yet again no fund achieved the perfect mix of top of the sector 3-year returns with bottom of the sector 3-year volatility. This mix seems to be becoming ever more elusive. The Waverton Sterling Bond Fund came close achieving 98th percentile risk, and 3rd percentile return however. There were no funds with top decile returns and bottom quartile risk over the three years to the end of the quarter. A simplistic observation could be that you have been able to make good returns in these years, but you may have had to weather more volatile performance to achieve it. The middle ground is becoming a crowded place – to achieve long term excellence patience is a necessity.

Looking Ahead – What next in 2020

- To try to accurately predict how the second half of the year's market moves would be a fools errand I would argue, but what we can do is observe a number of factors that could shape the direction from here. Q1 was shockingly bad, Q2 shockingly good given the poor economic fundamentals so from here the facts are going to matter more.
- We are not done with Covid-19 yet. The 'new normal' is still to be worked out but as a species our success is as a result of our ability to adapt.
- Politics IS going to get more important from here. The end of the transition phase of Brexit and the US presidential election are looming and the long-term implications of both outcomes should not be underestimated.
- Good luck out there on many fronts. As investors your eye should be on the long-term prize, not the next month, quarter or even year. This is a long cross-country marathon, not a sprint on a level playing field. Pace yourself and your expectations in the coming months and trust that there are some fantastic opportunities that are going to be presented to fund managers in times such as these.

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