Swallow Financial Planning

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INVESTMENT NEWS

Asset Allocation Update

Whilst we advocate choosing predominately passive investments, asset allocation represents between 80% and 95% of the total return of a portfolio. We therefore believe that we can provide real added value by concentrating our efforts in this area. The following comments offer our current market views.

Overview

Ever since that fateful day when Gordon Brown announced the end of "Boom and Bust", just a few weeks before the worst economic crisis we have seen since the war (2008), commentators have been reticent to suggest that the cyclical nature of asset values is no longer an issue.

With over 10 years since the last equity crash, we are long overdue a correction. Having said this, the current boom period we have enjoyed has only seen modest rises in the capital value of assets compared with previous booms. We may not have reached the end of this cycle after all, with a number of years possibly still to come.

The best overall summary we can come up with is that we are in "late cycle", which in Game Of Thrones speak, means "Winter Is Coming"!

Exchange Rates

With our equity weightings being heavily international, it is worth noting that many of the funds we use are denominated in different currencies. Most are not hedged, meaning that returns will be affected by changes in the exchange between the UK and whatever the foreign currency is (usually US Dollars).

If you believe Sterling will strengthen significantly against other currencies, this approach will have a negative effect on returns. Our view is that with Brexit on the horizon the reverse is more likely.

UK Equities

The recent sell off has made UK equity values more attractive with equity yields being significantly above cash returns.

UK Corporate expenditure is down pre-BREXIT and BREXIT is clearly the major concern over the coming months. This makes us light UK and we get more reticent about putting new cash into the UK market the closer we get to the 29th March 2019 with no sign of a deal in sight.

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International Equities

As I shout at the radio each morning in response to another biased or simply ridiculous interview it is hard to remember that BREXIT is a local issue on the international stage. At best the UK is 8% of global GDP and the remainder of the world will be little if at all affected whether we have a hard Brexit, soft Brexit or no Brexit. We are heavily over weight international funds for this reason.

US Equities

Back in June most thought the US market expensive. At 17 x earnings, you could argue fair value or expensive. The fun is going to start in November if Trump loses his majority in the House of Representatives and in effect becomes a lame duck president.

European Equities (Excluding UK)

We think Europe will be affected by a poor UK BREXIT. Maybe not as much as the UK but affected nonetheless. If the UK gets away without continuing to subsidise the EU then the next question is who will take our place?

Again, we are cautious European shares compared with other developed countries.

Japan

We have never been keen on holding Japanese stock in isolation although they are adequately represented in world passive indices. Short term, the Yen's strength isn't helping them any.

China

China is in a relative slowdown at present. The trade war with the US isn't helping much either although the rhetoric from the Whitehouse seems to be somewhat exaggerated when compared with what is actually happening.

Other Emerging Markets

The rise in US interest rates hits EM countries who predominately use the dollar as a trading currency. There is a wide divergence in EM country performance however at their current prices the equities look reasonable compared with elsewhere.

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Commercial Property

We continue to diversify our commercial property recommendations, reducing the larger funds in favour of smaller funds, moving away from high street retail and trying to buy outside London. We are also allocating towards different lease types.

We continue to believe that long term commercial property is a valid income investment even if capital growth is limited. When we consider the alternative income providers of fixed interest and cash we believe our approach remains reasonable.

Fixed Interest

We remain negative fixed interest as we have been for a number of years now. Whilst there is an increased chance of a correction to markets we favour cash over fixed interest.

Longer term we feel a combination of fixed term cash deposits and lower risk long lease rental commercial properties is a better risk reward option than fixed interest stock.

Diversification

When markets are uncertain our aim is to expand client portfolios to include different elements which may perform better within the economic and stock environment we can see ahead.

Factor Considerations

At this stage in the economic cycle we are emphasising value and minimum volatility stock although the recent performance of the minimum volatility index has been anything but placid!

Sector Considerations

Many clients will now hold collectives which specialise in healthcare, automation and robotics funds. The reasoning here is that we believe these will be long-term growth sectors which should perform well in most markets

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Gold

We have been hedging into a physical gold ETF rather than a precious metal funds which invest in the mining companies. This is (in our view) a lower risk hedge however the physical gold fund will not perform as well as the geared producers, should markets rise significantly.

To date, gold has been static or has fallen by perhaps 5% which reflects the fact that markets have been buoyant. In some respects, we hope that this will continue to be the case but we still believe gold is a good hedge against a market correction.

Summary

Our last bulletin has proved correct thus far, i.e. the markets are stagnating / falling with FTSE for instance now being 6% down over 12 months. The gross yield of the FTSE is however around 4.2% which reflects the income risk premium of being in assets. We remain invested but with heavier degrees of cash dependent upon client circumstances.