Vista

Rowan Dartington

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Inside:

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Market rebound or economic recovery?

The inscrutable conflict struggle between top down gloomy economists and the bottom up exuberance of equity markets has played out through the second quarter of this year and will hopefully resolve before the end of this year. In the meantime, we caution against confusing a rebound in markets for an economic recovery. In working towards this resolution, we will continue to battle the pandemic, endure the US Presidential election campaign and watch the UK leave Europe with or without a deal. 2021 promises to be a very different year, but we can only hope that it will make more sense than this less than perfect vision of 2020.

In January this year, before COVID-19 was properly on our radar, the IMF forecast global growth to be +3.3% in 2020. That was swiftly revised down to a fall of -3% in the April edition of their World Economic Outlook and then again in June. When the April forecasts hit the news wires they caused quite a stir, aggressively marking down growth prospects and representing the first analysis of lockdown from an independent supranational agency. The World Bank and then the OECD followed in Q2 representing increasingly dire markdowns to economic activity until finally the gloomiest forecasts yet were presented in the IMF's third attempt at -4.9%. The more economists learn about lockdown the less they like it.

When we compare the top down, worst recession in living memory, with the bottom up company analyst Earnings Per Share (EPS) forecasts, the conundrum becomes clear.

Analysts are expecting the financial impact of lockdown to hurt corporates, but not as badly as the last recession in 2007/8 (Figure 1). Admittedly analysts have a history of being too optimistic about the companies they follow and too slow to take on board poor news flow. When we compare the EPS growth forecasts to the ISM manufacturing survey of US companies, the similarities are undeniable (Figure 2). Growth expectations from the bottom up correspond well. Not only that, but expectations are not as sour as they were at the last recession. Top down economists are seeing more of a COVID-19 growth roadblock than corporates and analysts.

Figure 1: US Analysts' consensus EPS growth forecasts

Source: I/B/E/S, Refinitiv, Rowan Dartington Research

Figure 2: US ISM Manufacturing PMI versus Consensus EPS growth

Source: I/B/E/S, Refinitiv, Rowan Dartington Research

Policy makers have already made Herculean efforts to stop the wheels falling off, perhaps best seen when looking at the substantial intervention from both fiscal and monetary policy. Using IMF estimates, they suggest that the change in global government debt this year is likely nearly twice that seen in response to the last recession and deficits are likely to be twice as large. Not only that, but the liquidity provided from the US Federal Reserve (Fed) has been both massive and timely. Policy makers have already more than crisis and there is likely to be more required.

The Fed's balance sheet (effectively the money it has printed for Quantitative Easing (QE)) was shrinking as a proportion of GDP right up until

Q1 this year. COVID-19 forced dramatic monetary and fiscal action from central bankers and governments that has been unprecedented in peace time. That said, these measures have, so far, been about providing liquidity and keeping employees attached to their employer. All necessary and laudable policy aims, but what next? Unless economies can start to grow again soon, companies are going to face a solvency crisis, and the unemployed quickly become unemployable.

The direct evidence on US large corporate failures seems reassuring with rates of bankruptcy no higher than its usual mid cycle range. More than that, the BBB credit spread, which spiked above 300 basis points as the lockdown began, has since narrowed considerably. Credit spreads have, in the past, provided a useful leading indicator on corporate stress and bankruptcies. Taken at face value, the prospects for corporate solvency seems to be improving. The Fed's bond buying program, however, includes corporate debt which is forcing yields down and narrowing spreads against treasuries.

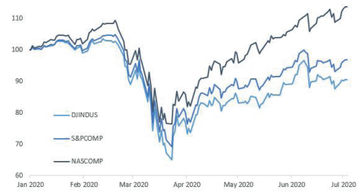
In the same way that the yield curve has become distorted and is no longer a reliable signal of prospective growth, credit spreads have been artificially compressed as part of QE. A more simplistic way of looking at solvency would be to ask how likely are companies to survive a second or indeed a third lockdown? New COVID-19 cases are rising at an alarming rate. Fauci's warning of 100k daily COVID-19 cases seems perilously close.

The politicisation of PPE in the US has been abhorrent, and President Trump is now suffering for that, amongst other things, in the polls. The implied probability of Joe Biden winning over President Trump has been gaining momentum since May. A lot can happen between now and the election, and President Trump has form winning on a late surge, but as things stand, his campaign is not in good shape. Joe Biden is now regularly raising more funds than his Republican counterpart, and the equity market seems to have grown comfortable with a possible blue win.

Tech is likely to remain a winner into the new cycle (Figure 3) but the possibility of a Biden victory may have implications for healthcare and infrastructure.

With the radical Green New Deal now history, a more centrist set of growth policies may prove acceptable for capitalists. Healthcare companies may continue to do well in an expansion of Obamacare, although a more radical, "free at the point of use, NHS" style agenda, while not unthinkable after COVID-19, may prove too much for markets. Trade policy is unlikely to change much, however, the frosty relations with China seem inevitable no matter which party wins this autumn.

Figure 3: US Equity Markets Indices



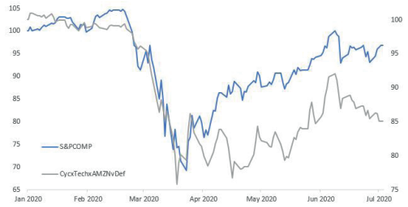
Index/performance (%)	30/06/2019 to 30/06/2020	30/06/2018 to 30/06/2019	30/06/2017 to 30/06/2018	30/06/2016 to 30/06/2017	30/06/2015 to 30/06/2016
DJINDUS	-4.13	9.71	11.76	19.4	5.22
NASCOMP	33.78	10.16	26.01	29.39	1.77
S&P 500 COMP	6.87	9.75	13.71	17.16	3.31

Source: Refinitiv, Rowan Dartington Research

There are, however, some worrying signs beneath the surface. The receding cyclical/defensive ratio (Figure 4) suggests that broader market gains are not being underwritten by companies geared into prospective growth. Without that, the equity recovery looks fragile and central bank related. Equities have to be priced for perfection, anything short of that risks a further pullback in valuations. While we have been pleasantly surprised by recent market moves and economic news flow, we remain cautious.

It is easy to misinterpret signals or to over emphasise the wrong things. Amidst the volatility, however, it's worth remembering that a rebound in markets should not be confused for an economic recovery. We have much further to run yet.

Figure 4: US cyclical versus defensive (ex tech) against the S&P500



Index/performance (%)	30/06/2019 to 30/06/2020	30/06/2018 to 30/06/2019	30/06/2017 to 30/06/2018	30/06/2016 to 30/06/2017	30/06/2015 to 30/06/2016
S&P 500 COMP	6.87	9.75	13.71	17.16	3.31
CycxTechxAMZNvDef	-15.89%	-3.76%	8.85%	10.60%	-6.36%

Source: Refinitiv, Rowan Dartington Research

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The value of investments may fall as well as rise purely on account of exchange rate fluctuations. Past performance is not indicative of future performance.

Tim Cockerill

Investing in ESG in a downturn

I can see blue sky and sunshine from where I sit, no clouds and no aircraft vapour trails. Only occasionally do I hear a car on the road, it's beautifully quiet and the birds sing without having to compete with the noise of everyday life. COVID-19 has brought the world to a standstill, well almost.

A major pandemic had long been predicted but when, where and how it would strike was impossible to say. It seemed to be the stuff of TV serials, not real life. People I've spoken to have commented that today is what life must have been like in the 1930s and 40s; shopping locally, no cars and much more community spirit. It seems we love to look back to a time when our communities and society were strong, which largely got washed away in the drive for globalisation and individualism. COVID-19 is taking a terrible toll and will leave a very deep and lasting impact on us, but I'm optimistic it will also lead to many positives. Perhaps we are getting a glimpse of the shape of things to come as the world moves towards a sustainable economic future.

Staying clean

There have been numerous media reports about the drop in pollution – satellite images from around the world show air quality is much improved. Here in Bristol pollution levels have fallen by 40% (National Centre for Atmospheric Science), and the air is noticeably cleaner – most of which is down to a reduction in traffic. This plays into a major theme running through ESG investing - the decarbonisation of the economy.

A visible aspect of this is the electric vehicle replacing combustion engines. The drive to electric vehicles is very much under way, but this period of lockdown could well add extra impetus to this move. Power generation is another area where change is progressing well. In 2019, 75% of new power capacity built worldwide was renewable (International Energy Agency), and with the UK experiencing nice weather recently, some households on renewable tariffs are being paid for the power they generate. Whatever the economy does the sun still shines and the wind still blows.

ESG resilience

A question I've been asked a lot recently is whether ESG investments have performed better than those without an ESG mandate. There have been numerous reports indicating this is the case, one from MSCI indicated a marked out-performance, and it's not difficult to see why this might be. Oil and gas is a major sector that ESG funds tend to avoid and with the oil price having fallen so sharply, -35% year-to-date, it's not been a good sector to be invested in. ESG funds can also be light on their exposure to consumer stocks and airlines, areas that have been hard hit in this market sell-off.

Looking at positives, it's also reasonable to assume that the quality of corporate governance in stocks that are held in ESG funds is high and as such makes them more robust in difficult economic conditions. Sectors which have been quite resilient have been technology and healthcare, two areas in which ESG funds find a lot of stocks. They both benefit from recurring revenues, potentially making their business models more durable.

However, I feel that it is too early to really draw firm conclusions. Only when markets and the economy begin to recover will it be possible to say whether ESG has outperformed, but the early signs certainly look encouraging.

It has been fascinating to see how some stock prices have moved. I've already mentioned renewable energy and one easy way to get access is through investment trusts. These are physical assets, with secure long-term income streams that require relatively little hands on day-to-day management (a positive in lockdown).

During the panic sell-off their share prices fell but have since recovered quickly. Whilst there are a number of factors at play, it hopefully reflects the quality of these assets which are very useful building blocks in ESG portfolios.

> "The world moves towards a sustainable economic future"

Looking to the future

The damage to the global economy will be extensive and people will need and want to get back to work as quickly as they can. Many will have been made unemployed and not helped by the gig economy in which worker rights are few. Whilst Government support packages are designed to help businesses through this period, just how well they will work we simply don't know at this stage. The economy, I think, has the propensity to bounce back strongly, but it is also an outstanding opportunity to use financial support packages and central bank help to push for more sustainable business models and to invest in environmental sectors.

In time, as we emerge from lockdown as COVID-19 recedes, I am hopeful that ESG will become more centre stage for investors - a key aspect of it is 'social'; how companies interact with society and treat their employees, including those in the supply chain wherever they are in the world, and this is very much under the spotlight. One thing COVID-19 has done is bring people together - life has been put ahead of the economy. If these sentiments continue, we may be witnessing a fundamental change in what society values most.

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Your ESG questions answered

We are often asked questions about Responsible Investing. Here are a few of the most frequently asked questions answered.

1. What's the difference between Responsible Investing and ESG?

Responsible investment is an umbrella term that covers, funds with labels such as 'environmental, social, governance' (ESG), sustainability, stewardship, ethical, green, responsible, climate change. The common factor is a mandate that directs the investment manager to seek out companies whose services and products are helping to tackle the many environmental and social issues the world faces.

2. Why invest responsibly now?

The impact our choices have on society and the environment has never been greater than it is today. Everything we do, from the food we eat to the types of products we buy and the way we travel has a consequence on the world around us. As well as adjusting our lifestyle, changing the way we invest our money is one way to help change the way businesses behave. Investors can collectively push an industry in the right direction by investing in companies that are taking positive action – and avoiding those with harmful practices.

3. Have you seen an increase in demand for responsible investments?

According to the Investment Associations, the market continues to register record inflows into ESG focused funds, even during the recent market sell-off in March this year, when billions of pounds were being pulled out of equity markets, ESG focused funds witnessed £113 million of net inflows.

Donald Maxwell-Scott

TECHNICAL INVESTMENT MANAGER

Taking advantage of volatility

As we move through the Summer season and are midway through the tax year it's a good time to review your finances. It is financially advantageous to have your finances in order by the end of the tax year, to consider using any unused allowances left and ready money to deploy at the start of the new tax year.

A good example of this is utilising your capital gains tax allowance, currently £12,300 per year. If you have investments outside an ISA that are sitting on small gains, then these could be sold down so you can use up your current year's allowance. Remember, with tax allowances you must use them or lose them.

Like most people, since the start of the year my portfolio has decreased in value thanks to COVID-19. However, rather than despair with the loss of value, it is important to look at the positive a decrease in value could do to your portfolio. For example, most investments are now sitting on smaller gains, or even a loss. This ultimately means an investor can sell down and transfer more assets as a proportion of their portfolio to their ISA or SIPP. As well as crystallising a loss which can be used to offset gains elsewhere, if the same investment is made in an ISA then any subsequent recovery in the value of an investment will be sheltered from income and capital gains tax.

Many people underestimate the cost of leaving your finances to later in the year, or even the last day of the tax year. To illustrate the difference in acting sooner rather than later, the table shows the difference in the value of an ISA if invested on the first day of the tax year (6 April) compared to if invested on the last day of the tax year (5 April).

As ISAs were introduced in 1999, the table runs from the 1999/00 tax year up to the end of 2019/20, the end of the last tax year. You will note the large drop in value in the 2019/20 tax year, which was the largest drop in absolute value over this time period. However, it was only the third largest fall in percentage terms. In the tax year 2002/03 the FTSE 100 fell 24.5%, and in 2008/09 it fell 29.3%, but in the tax year 2019/20 it fell 24.2%.

Tax Year	Allowance	Beginning	End
1999/00	£7,000	£7,116.90	£7,000.00
2000/01	£7,000	£12,590.86	£13,243.30
2001/02	£7,000	£18,785.68	£19,699.00
2002/03	£7,000	£19,463.03	£21,868.81
2003/04	£7,000	£32,155.23	£33,572.79
2004/05	£7,000	£44,754.43	£45,373.69
2005/06	£7,000	£65,365.84	£64,306.98
2006/07	£7,000	£79,146.52	£77,332.54
2007/08	£7,000	£83,019.40	£81,525.37
2008/09	£7,200	£63,776.09	£64,830.28
2009/10	£7,200	£91,289.45	£64,830.28
2009/10	£3,000	£107,216.54	£83,918.51
2010/11	£10,200	£126,011.43	£100,261.35
2011/12	£10,680	£134,313.00	£109,196.80
2012/13	£11,280	£165,160.69	£135,152.85
2013/14	£11,520	£196,186.24	£161,593.73
2014/15	£11,880	£211,499.34	£161,593.73
2014/15	£3,120	£221,294.00	£181,619.29
2015/16	£15,240	£218,983.17	£183,383.14
2016/17	£15,240	£289,851.18	£242,176.64
2017/18	£20,000	£317,566.47	£268,206.83
2018/19	£20,000	£365,483.22	£310,387.54
2019/20	£20,000	£292,311.93	£255,366.87

Source: FE Analytics 2020

Index Percentage Growth (%)	30/06/2019 to 30/06/2020	30/06/2018 to 30/06/2019	30/06/2017 to 30/06/2018	30/06/2016 to 30/06/2017	30/06/2015 to 30/06/2016
Index : FTSE 100 TR in GB	-13.80	1.56	8.73	16.92	3.80

These figures are only examples and are not guaranteed - they are not minimum or maximum amounts. You can not invest directly in the FTSE. What you will get back depends on how your investment grows and on the tax treatment of the investment. You could get back more or less than this.

> "Many underestimate the cost of leaving your finances to later in the year"

On reviewing this I was shocked at the difference this can make to the overall value of an ISA over a long period of time. A difference of almost £37,000 just by investing at the start of the tax year when compared to investing at the end.

We can extrapolate this further. Over the above time period, on average, the FTSE 100 has an annualised return of 2.75% each year. ISAs have been going 23 years, and assuming they continue for another 23 years, what will be the value in the tax year 2044/45 and what would the difference in value be if you invested at the start of the tax year compared to the end?

In the 2044/45 tax year an ISA could be worth £1,192,907. However, if an investor had continued to invest their allowance on the last day of the tax year their ISA could be worth £1,106,630 – they could be £86,277 worse off.

Of course, past performance is no indication of future performance, and it assumes the ISA allowance remains at £20,000 but as always, tax rules are subject to change.

Considering the subscriptions to the ISA have been the same in both scenarios, this does illustrate the power of investing in the markets sooner rather than later. And, it is important to factor in that in the above table there were two recessions (possibly three) that effectively halved the markets. This would have suited investing at the end of the tax year, and in fact, if you look between the tax year 2000/01 and 2002/03 (three periods of negative growth) it was better to invest at the end of the tax year.

Nevertheless, as markets have generally gone up over time, the conclusion is that having more money sooner in the market has been more beneficial than waiting.

While the conclusion isn't surprising, what is, is the difference it could make to investment returns.

Past performance is not indicative of future performance.

The value of an investment may fall as well as rise.

You may get back less than the amount invested.

The levels and bases of taxation and reliefs from taxation can change at any time. The value of any tax reliefs generally depends on individual circumstances.

The information contained does not constitute investment advice. It is not intended to state, indicate or imply that current or past results are indicative of future results or expectations. Full advice should be taken to evaluate the risks, consequences and suitability of any prospective investment. Opinions provided are subject to change in the future as they may be influenced by changes in regulation or market conditions. Where the opinions of third parties are offered, these may not necessarily reflect those of Rowan Dartington.

Guy Stephens
TECHNICAL INVESTMENT DIRECTOR

The forgotten

> "US elections, trade wars and Brexit"

The recent preoccupation of the media with all things COVID-19 related has pushed other major market influences to the back of investor minds over the last three months. With markets having priced in an economic recovery from the virus, it is sensible to look forward and return to these issues which are still ever present in the background.

The first of these is the dreaded Brexit. We seem to be travelling down the same road as we did in 2019 with a looming deadline ahead of a possible no-deal cliff edge hard Brexit. We detect a certain degree of market fatigue with the whole saga although, it has continued to undermine the sterling against other major currencies and deter global investors from the UK equity market. The UK equity market underperformed world indices for much of 2019 and before that. 2020 to date has been no different and this underperformance has continued which has to be partly due to Brexit uncertainty (Source: FE Analytics).

There is probably also some influence from the UK's handling of the COVID-19 pandemic and the numbers of deaths which have been the highest of any developed economy outside of the US (Source: John Hopkins University). Other measures have also shown that the expected economic hit to GDP is likely to be the highest in the UK (Source: OECD), but this does need to be put into context regarding the structure of the UK economy and the high proportion of service industries such as retail and leisure. That said, compared to countries like Germany, the UK has suffered and there will be serious questions to answer in the aftermath regarding the government's responses and strategy. It is one of the few occasions where there are directly comparable experiences which will put those in power on the backfoot. We are some way away from the next election, but this will likely reappear in five years' time and could be crucial.

As to where the Brexit negotiations end up, the end of June saw the deadline for an extension request to the transition period which ends on 31 December 2020.

Prime Minister Boris Johnson has ruled this out and we believe the markets are largely discounting this as a negotiating position. Even if we did get to the middle of December without a deal, the EU are unlikely to refuse an extension given the likely chaos that would follow. As we have previously said, it is likely that a framework deal can be agreed preserving the status quo with various detailed trade agreements to be worked through in the years ahead. A protracted exit, which could take many years to complete, is quite possible. In the meantime, if bi-lateral trade deals can be agreed with other nations where talks are supposedly taking place, such as Japan and the US, then we may see a more positive outlook from the perspective of an international investor, but this is all conjecture at the moment.

The other ongoing market influence is the approaching US Election and wrapped up with this is the trade war with China. The immediate risk of market unfriendly policies from a Democrat President has been reduced by the nomination of Joe Biden, a relative moderate compared to Bernie Sanders. The markets could probably take this in their stride without too much upset as he would likely take a less combative approach to China. President Trump's desire to keep the equity market buoyant is heavily influencing his approach to China because he knows that if he aggressively blames them for COVID-19 and ratchets up the trade war, this will cause weakness in the equity markets. However, he also needs to deflect forthcoming Democratic criticism of his handling of the virus pandemic and his weak support for Black Lives Matter in order to appeal more widely to voters. This contradiction is why the polls are putting him firmly in second place and most pollsters are predicting that the election is Joe Biden's to lose.

So, 2020 is going to be a year of two halves, the virus followed by a return to familiar pre-virus influences. As investors this will influence the winners and losers of the future with those most able to adapt being the most successful.

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