



**Summer has arrived!** Welcome to our July 2016 edition of 360. This is our quarterly update on all things financial and we hope you find the articles, reports and commentary both useful and informative.

## Brexit: what next?

Whatever ones political leanings there is no denying that the UK's decision to leave the European Union has thrown up some difficult questions. Reading around the subject, market commentators, private investors, fund managers and analysts have all been eager to have their say and often seem to contradict each other in the process. It would be possible I'm sure to find ten articles supporting entirely polarised opinions on what's to come in the next six months, twelve months or two or more years. The main point on which everybody seems to agree is that uncertainty will remain, probably for at least the next two years whilst the UK works through the exit procedure.

European Equity (shares) markets took a tumble following the outcome of the vote, but since the value of the pound has also fallen sharply against the Euro, their value to UK investors actually increased. The UK economy is expected to slow down. Rating agency Fitch, which downgraded the



UK's credit rating on the Monday after the referendum, warned that UK-based investment is likely to be hit primarily due to uncertainty. The UK's trading relationship with the EU needs to be re-negotiated; the regulatory backdrop of Britain's financial markets has yet to be clarified (although Britain was oftentimes a leader in financial regulation within Europe); and there is increasing political uncertainty regarding the leadership of both the Labour party and the Conservatives, and a potential second referendum on Scottish independence.

As it is uncertainty that is most often the concern for markets, we remain hopeful that as the future picture begins to emerge any short term problems may be replaced by longer term optimism and success.

## In this issue...

### Page 1

- Welcome
- Brexit: what next?
- Global markets

### Page 2

- Investment returns & outlook

### Page 3

- Our ethical portfolios

### Page 4

- UK Commercial Property funds
- Pensions Dashboard

## Global markets and your portfolio

Those of our clients who are currently invested in one of our AWM Model Portfolios will know that we recently made the decision to simplify our process to just five different risk levels with no specific investment term.

The portfolio performance figures to the right provide a reasonable indication of the levels of return each investor will have received over the time scales shown, according to the level of risk taken and whether an ethical investment mandate has been adopted or not.

Description	AWFM Risk Model	Ethical		Unrestricted	
		3m	1yr	3m	1yr
Cautious Risk	1	-0.11%	-0.66%	1.69%	3.88%
Cautious to Moderate Risk	2	-0.05%	-1.90%	2.37%	5.63%
Moderate Risk	3	-0.61%	-3.32%	1.94%	3.76%
Moderate to Adventurous Risk	4	0.73%	-0.10%	1.26%	2.69%
Adventurous Risk	5	2.64%	2.55%	1.89%	2.84%

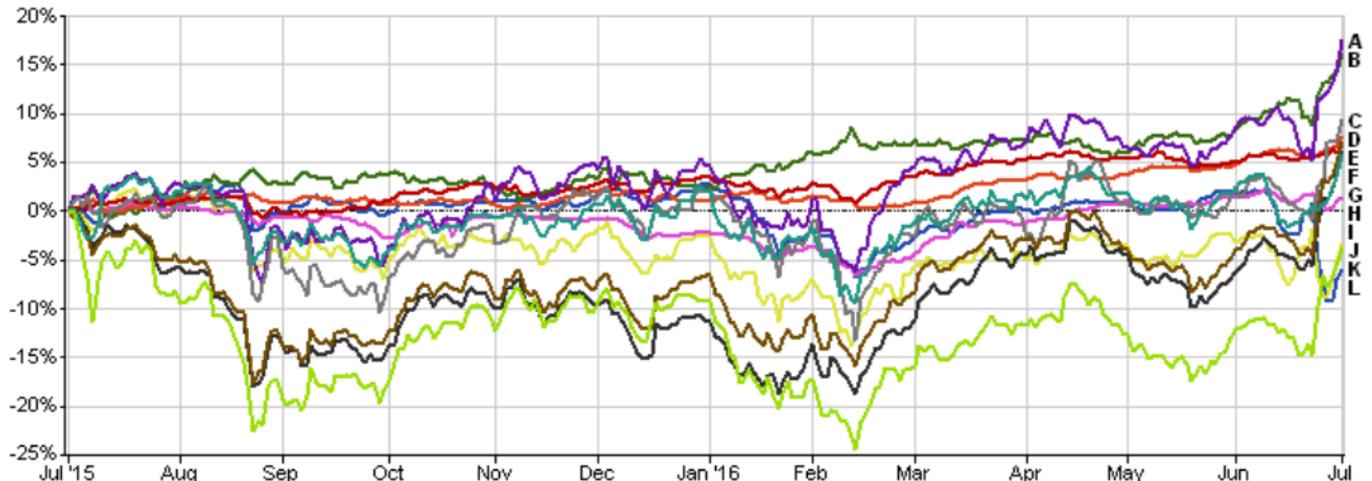
Clients may be surprised to see the returns showing in our unrestricted portfolios over the last year. Not only have these portfolios been relatively unaffected by the UK's decision to leave the EU but they have in fact gone on to show gains following the vote, boosted largely by the overseas holdings and the fall in the value of Sterling. The ethical portfolios have not performed quite as well, largely due to a restriction in choice. We have addressed the relative underperformance of our ethical portfolios later in this newsletter.

*Do not neglect to show hospitality to strangers, for thereby some have entertained angels unawares.*

— Hebrews 13:2, English Standard Version

## Investment returns & outlook

As you can see from the chart below, the last twelve months have produced a very mixed picture in equity and bond markets across the world. In the lower half of the chart, we can see that China, Asia and the Emerging Markets have been very volatile but seem to be on an upward trend since the lows of February. UK All Companies, which mainly includes medium-sized companies, and particularly UK Smaller Companies, have been hit hard by the EU referendum vote, due to their domestic focus and concerns for the strength of the UK economic recovery. At the other end, North American Equities have done extremely well in the latter half of the last year, as have most overseas Equity Markets, largely due to the fall in the value of Sterling against foreign currencies.



UK Government Bonds (Gilts) have been somewhat bloated in cost for some time now. However, as you can see from the dark green line above, they have again had a strong six months, providing an annual return of 16.18%. The 'Brexit' vote has caused a weak currency and a lack of confidence in Equities continues to see Gilts being purchased as a 'safe' option despite their cost, pushing the price up still further. With the prospect of lower interest rates this "bubble" may well continue for some time.

Prices are now so high that the annual yield on a 10-year loan to the UK government has dropped to 0.77% at the time of writing. Given that yields were hovering around the 5% mark from 2000-

2008, and up to 15% in the 70s and 80s, one can only argue that Government Bonds are generally looking ludicrously expensive. The position is even more extreme with German Government Bonds (Bunds), where you now have to *pay* 0.13% for the privilege of lending your money! As such we and many fund managers retain an underweight position in Gilts and an overall underweight position in Fixed Interest assets generally.

At some point growth and inflation will return, interest rates will rise (although they are currently predicted to fall first!) and bond yields should rise out of the basement again. This is why, on the whole, government bonds remain negatively viewed by industry professionals as shown below.

UK Equity Markets were volatile in the lead up to the referendum and took an immediate hit as the result emerged overnight. However, larger companies have fared much better with the weaker pound boosting

<b>P O S</b>	<b>A POSITIVE outlook</b>	European Equity; Japanese Equity
<b>N E U</b>	<b>A NEUTRAL outlook</b>	UK Equity & UK Smaller Companies; Pacific (ex-Japan); Emerging Markets; Property; UK Corporate and Global Bonds
<b>N E G</b>	<b>A NEGATIVE outlook</b>	US Equity & US Smaller Companies; UK Gilts (Government Bonds)

revenue and profits for those companies with an international focus and overseas earnings. The FTSE 100 has produced a positive return of 4.23% over the last month and the FTSE 350 has produced a return of 2.24% over the same period. Medium and Smaller sized companies in the UK have struggled and we are pleased that we took the decision to reduce exposure to this sector in many of our portfolios, a year or so ago. Market sentiment suggests US Equity Markets cannot continue at the prices reached, and there is in our opinion a question mark over European equities for the next few years.

As ever, we continue to recommend a diversified portfolio in order to balance risk and growth potential.

## A comment on our ethical portfolios

The performance figures on Page 1 show a significant discrepancy between our unrestricted portfolios and our ethical portfolios. We have always made it clear that ethical investing does limit our choice of funds significantly, and the choice of companies for the underlying fund manager, and therefore can affect performance. However, we felt it worth going into a little bit more detail to explain this recent underperformance, which can be summarised in the following four points:



- It is our preference to choose funds that carry a good income yield, which provide a valuable income to some clients and useful compounded returns for those who would rather reinvest the dividends. However, the high-yielding funds in the ethical space are somewhat limited; there are, for example, no ethical Global Equity Income funds. Our portfolios are therefore overweight in the UK Equity Income sector as this is where the high-yielding funds are. UK Equities have not performed particularly well over the last year or so relative to Global Equities.
- The Jupiter Responsible Income fund has performed very poorly of late. This is largely due to stock specific issues. We are hoping to introduce a fourth UK Equity Income fund into most of our ethical portfolios but at present the choice remains limited. We are also hopeful that the Jupiter fund's performance will improve.
- Ethical portfolios tend to be overweight in small and medium-sized companies, since larger companies tend to fall foul of ethical criteria more than their smaller counterparts. This is good for long term performance but can lead to short term underperformance. It has been particularly true since the EU referendum result. Larger UK companies with earnings overseas have benefited from the weaker pound, boosting revenues and profits, but due to their domestic focus medium and smaller-sized UK companies have suffered from negative investor sentiment.
- Finally, in our unrestricted portfolios we have recently introduced more “defensively positioned” equity funds which have been of real benefit so far. Again, due to a limited range of ethical funds, “defensive” equity funds are not widely available.

We do of course continue to monitor the arrival of new ethical funds and we may recommend a switch or change in weightings at our six-monthly reviews. It is also important to remember that investing is about the longer term returns, and the longer term returns from our ethical portfolios have still been strong, despite their ethical restrictions. The following chart shows the performance of our medium- or moderate-risk portfolio against its unrestricted benchmark and the sector average:



As you can see, our “Ethical Strategy 3—Moderate Risk” portfolio, shown in blue, has outperformed its unrestricted benchmark (red) consistently over the last four to five years, since we have been running our model portfolios. It is only in the run-up to the referendum and, more markedly since the vote to leave the EU, that it has been pegged back, driven largely by the currency movements and our portfolios’ overweight position in UK Equities, for reasons explained above. Since medium- and smaller-sized UK companies have struggled of late largely due to the uncertainty of the near-future, we believe that as the dust clears and the economic and business landscape takes shape our portfolios will be well-placed to benefit going forward.

## UK Commercial Property funds

As you may have heard in the news, a lot of open-ended direct UK property funds have suspended trading or placed restrictions on withdrawals. The problem has come about mainly because investors have sought to disinvest from property funds. Whilst there are many factors that have caused the negative sentiment towards UK Commercial Property, the primary issue is that investors are seeking to disinvest their funds at the same time. A property fund invests in commercial property, which is not a liquid asset. Thus if too many investors want their money out at the same time, it becomes impossible without selling assets at unfavourable prices.



The commercial property fund held in our AWMF model portfolios, “Legal & General UK Property Feeder fund”, has not at this stage suspended trading but has applied a “fair value adjustment” to the fund’s price of 15%, artificially lowering the value of the fund by 15%. The fair value adjustment is a reversible measure carried out by some property funds in order to protect the investors who wish to remain invested in the fund, who are generally investing for the income yield and for long term capital growth. Clients not invested in our model portfolios may of course have alternative Property funds.

We do not know if there is a UK Commercial Property crash coming. There is widespread agreement that economic and political uncertainty is a major contributing factor in the number of investors wishing to pull out, but lack of actual data on market transactions means this number may not materialise. These moves are at this stage largely pre-emptive, designed to prevent a ‘rush’ on the sector which would bring about a crash. Whatever the case, however, we have held the Legal & General property fund since we launched our AWMF model portfolios in November 2011, and in that time it has produced a return in excess of 40%.

## Pensions Dashboard

Plans are moving forward for a new ‘Pensions Dashboard’, mooted by the Chancellor in recent budget announcements and hoped to be ready for delivery by 2019. The Pensions Dashboard would give members a virtual view of all their pension pots across all pension providers and schemes. This would allow them to find any lost pots and more easily estimate their retirement income.

There is still a lot to be hammered out before work can begin, not least of which is who will be responsible for the building and implementation of this new venture. Economic secretary to the Treasury, MP Harriett Baldwin, has been tasked with championing the dashboard, but speaking in April she was very much promising to “support [the financial services] industry in designing and delivering the dashboard”, rather than the government taking responsibility for it themselves. In a report published by the Centre for Policy Studies (CPS), research fellow Michael Johnson felt the government had “chosen to steer the boat rather than row it”. The think tank called for a new government board to “oversee delivery and ensure that customers’ best interests are served by it”. The fear was that providers with poor performing products or high charges might struggle to keep customers if direct comparison were made more straightforward, and therefore might resist cooperation.



The hope is that customers’ best interests are indeed served and all necessary parties play ball to allow the dashboard to be created at the earliest opportunity. Johnson concluded that the project was “just the beginning”, and should be the first step towards a more comprehensive display of all other aspects of personal finances: bank balances, savings, investments and liabilities. Certainly this would be useful for consumers and would achieve the joint aims of transparency and simplicity. We must wait and see whether such a vision is achievable.

We have of course been doing something similar to this for our clients for a number of years now. Perhaps the government ought to be consulting with us!

**Contact us:**  
t: 0845 60 10 718  
e: [www.awfm.co.uk](http://www.awfm.co.uk)

**Partners:**  
[martin@awfm.co.uk](mailto:martin@awfm.co.uk)  
[jon@awfm.co.uk](mailto:jon@awfm.co.uk)

**Administrators:**  
[nicola@awfm.co.uk](mailto:nicola@awfm.co.uk)  
[edward@awfm.co.uk](mailto:edward@awfm.co.uk)  
[david@awfm.co.uk](mailto:david@awfm.co.uk)

**PO Box 87  
Crockenhill  
Swanley, Kent  
BR8 9AP**

*If you have any questions about this newsletter or your existing investments, please contact us to discuss your situation further.*

*AW Financial Management LLP is an Independent Financial Adviser regulated by the Financial Conduct Authority.  
Information given in this document should not be taken as advice as it is intended for guidance only.*