Investment Review

Q4/Full Year 2020

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Contents

1. Summary

Most of us will be glad to see the back of 2020, which turned out to be one for the record books in so many ways. Overall FPC clients have achieved strong and above expectation investment returns last year, with positive performance across most asset classes, which is surprising given the economic backdrop.

• Asia Pacific shares led the way with full year returns of +18.7% (in GBP) after a strong Q4.

• North America shares returned +14.1% supported by technology focused companies.

• The UK performed poorly -9.8% but fared much better in Q4.

• UK gilts and corporate bonds again showed positive returns as interest rates remain low.

With two important risk events, the UK-EU withdrawal agreement and the US elections, now in the rear-view mirror, and with the vaccine roll-out gathering steam, 2021 looks both quieter (thankfully) and more positive.

There are concerns that some areas of the market appear fairly fully valued, but this may well be justified given that interest rates remain at historic lows and inflation expectations are, for the moment, still low.

It will be interesting to continue to follow the impact of climate change on the asset management industry, particularly as the UK will host the COP26 summit in November. We will be communicating with FPC clients shortly regarding how we consider this very important area within our investment process.

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- This investment review contains information and opinion and does not constitute advice.
- The information is provided in good faith and is believed to be accurate, but as some data is provided by third parties this can not be guaranteed.
- Past returns should not be seen as predictors of future returns.

2. Market Performance

The table below shows the major asset class performance over the period:

Asset Class	Index	Q4	2020
Asia Pacific Shares	MSCI AC Asia Pacific ex Japan	12.7%	18.7%
Japanese Shares	Nikkei 225	14.9%	17.5%
Gold	S&P GSCI Gold Spot	-5.8%	17.2%
Emerging Market Shares	MSCI Emerging Markets	13.2%	14.7%
North America Shares	S&P 500	5.9%	14.1%
World Shares	MSCI World	7.8%	12.3%
Corporate Bonds	Bloomberg Barclays Sterling Aggregate Corporate	4.1%	9.1%
UK Gilts	Bloomberg Barclays Sterling Gilts	0.6%	8.9%
European Shares	Euro STOXX 50	9.9%	2.3%
UK Commercial Property	FE UK Property Proxy	1.3%	-2.5%
UK Shares	FTSE All Share	12.6%	-9.8%

Performance Data: FE Analytics in GBP

It really was an interesting Q4 to wrap up an extraordinary 2020, which will be a year referred back to long into the future. As a reminder (if needed), by the end of the third week of March stock markets had reversed positive gains in January and early February moving to losses of more than 30%, with the speed of decline exceeding the 2002 dotcom and 2008 financial crises. Central banks and governments stepped in to prevent a cash crunch, which was sufficient to restore investor confidence and turn the tide, with markets not looking back.

During the final quarter the big news for markets was of course in November when vaccine news was released, later dubbed 'Vaccine Monday'. This led to a broad market rally of economically sensitive companies, rather than just technology and healthcare companies that had previously prospered.

Fixed Interest

UK gilts and sterling corporate bonds have again provided investors with returns far above expectations in 2020. The increase in price and fall in yield of such investments reflects expectations of a low interest rate environment for the foreseeable future. In general, we are not holders of gilts at current levels because of lower expected returns.

The return on the 10-year UK gilt at the year-end was 0.29%, which is an improvement on the low point seen last summer though at the lower end of the 52-week range of 0.06%-0.79%. Performance in Q4 was muted though corporate bonds fared better reflecting a more optimistic corporate environment and an attractive income uplift.

However, one market in which yields have started to climb is the US, where the 10-year return had risen to 0.93% by year-end (currently 1.08%) having been as low as 0.31% last year. This is notable because the expected returns of other assets are anchored to this risk-free rate and it may suggest that the market believes that interest rates will have to rise sooner than expected should the economy enter a broad recovery.

2. Market Performance cont.

UK Shares

After a dismal year for the UK stock market with a near 10% full-year fall, Q4 showed much better performance. The development in vaccine availability is a big tailwind to the UK economy given that over 70% of activity comes from the service sector. The UK-EU deal announced on the 24th December was underwhelming but it did prevent panic crossing into 2021. Our inkling was that an agreement would be announced resulting in making the UK a viable investment region again by removing a major risk event. We believe that the UK will put in a better relative performance this year.

Improving sentiment is not yet clearly reflected in the value of the pound, but there does appear a trend developing in support of a higher exchange rate, which took hold in October. Over 2020 the pound has fallen against the euro (-5.8%) and yen (-2.1%), but risen against the US dollar (+2.8%), which says more about weakness in the dollar, especially as the Federal Reserve suggested it would be more relaxed about inflation.

Global Shares

Positive returns have accrued from mostly all global stock markets during 2020 but with a change of leadership in the final quarter, with Asia and Emerging Market regions overtaking the US, which is slightly surprising given intense public attention towards the US technology sector.

The US election outcome has been positive for the expected easing of global trade tensions stoked by former President Trump, with those exporting countries so reliant on the US consumer seeing investor inflows[1]. At the same time, the policies of new President Biden may well slow down US activity as corporate tax rates rise and certain industries see tighter regulation. We previously suggested in November that relative US market outperformance may well have come to an end and Q4 did see other markets start to outperform. As part of our portfolio rebalancing we have been taking some gains from our global/US positions.

The Asia region including Japan, continues to benefit from China's economic stability, as the OECD forecast suggests China will eventually be the only country to show positive GDP growth during 2020 at 1.8% as against the G20 group -3.8[2] . With the change in US politics out of the way and the perceived easing of trade tension with China we suggest sentiment will continue to improve.

Property

We have seen a number of commercial property funds re-open to investors in recent months, allowing both the sale and purchase of investments. In a challenging time for the asset class there is a divergence between the winners and losers, dependent upon portfolio positioning across commercial, retail, leisure and industrial sectors. It is likely, on average, that commercial property values will struggle to make headway for the next few years until repurposing of buildings in response to the pandemic washes through, but income yields (the primary return from commercial property) remain of interest in some cases.

[1] Financial Times, Jan 2021, "Emerging Markets attract $17bn of inflows in first three weeks of 2021"

[2] OECD 2020, "OECD Economic Outlook, December 2020", OECD Economic Outlook: Statistics and Projections

3. Irrational Exuberance

This phrase from ex US Federal Reserve Chairman Alan Greenspan in 1996 was made at the time to suggest market behaviour had pushed US stock market levels too high. Such comments are made by influential commentators to try and temper investor enthusiasm and to avoid speculative bubbles emerging. However, famously, markets continued to climb for a further 3 years after Greenspan's comment, before finally having a significant retracement, so investor enthusiasm showed itself to be very strong.

The relevance is that there has been recent market commentary suggesting that certain areas of the market may be exhibiting speculative behaviour. This is especially the case in the technology sector as investors try to consider the forward value of companies deemed 'futureproof'. One of the most prominent examples being electric car and clean energy company Tesla Inc, whose share price rose by approximately 700% during 2020 to $705 per share (currently the shares earn $0.52 per share). Fundamentally the company did make progress and by showing consecutive quarters of profit growth met the criteria for inclusion in the S&P500 index but the extent of the rise is startling and leaves much work to do to meet future earnings expectations.

Those investors who have done their homework may, in the long term, be proven correct, but what is apparent is that this company has certainly attracted greater attention from investors simply because of the price rise, which begets further price rises. The point being that price has become the determining factor, rather than value, which hints of some speculative fervour.

The iconic quote below from technology company Sun Microsystems CEO Scott McNealy in 2002 follows a period during the dotcom boom of 1999-2002 when the company shares rose from $5 to $64, before falling back down to $5 per share:

"At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at $64…?"

This is a timely reminder that the relationship between price and value remains extremely important and investors who suffer 'fear of missing out' when headlines speak of large share price gains in certain sectors/investments need to be careful that the value is, or will be, there to justify the price paid. Ultimately earnings are the support for share prices.

4. Looking forward...

There are relatively fewer events to get excited about in 2021 but the themes carried over from 2020 should continue to shape the behavior of markets and investors:

• Emergence from the Coronavirus pandemic and expected large rebound in economic activity, but potentially with inflationary consequences.

• Continued loose monetary support and low interest rates from global central banks.

• Progression of the climate change agenda with the UK hosting the Conference of the Parties (COP26) in November.

We expect that later in 2021, because of the vaccine roll-out and pent up demand from the release of high savings rates, that global economic activity will see rapid growth. Add this to company operational improvement through technological enhancement and we could well see surprisingly strong company earnings supporting present market valuations.

However, as ever we remind clients that there is a cost to being an investor and benefiting from longer-term portfolio growth, which is to accept periods of volatility. One does not come without the other. This volatility can come without warning as was seen in 2020 and its important that the broader financial plan provides the confidence to ride out these periods.

We regularly review our overall asset allocation stance in the context of individual risk profiles and plans, as well as conducting detailed due diligence on individual investment funds, and we are confident that FPC clients are well positioned.

Any feedback or queries welcomed to mike@fpc.co.uk.

Invest With Confidence

At the heart of what we do is a simple goal – to help you achieve and maintain financial independence, provide for those who rely on you and live life well.

We do that by providing the financial planning and investment advice you need to secure your future.

We recognise that investors with similar risk profiles may have very different objectives, tax positions and personal circumstances so we adopt a bespoke approach in each case. There are no 'off the shelf' solutions.

We focus on choosing the right blend of assets, managing risk, and minimising tax and costs. Our strategies consistently deliver. Our investment philosophy is founded on a number of key principles which have served our clients well for more than 30 years:

- Differentiate savings from investment
- Understand and manage risk
- Get the "investment recipe" right
- Avoid market timing
- Fear inflation
- Manage tax and costs
- Process is paramount

We believe you win by not losing and this core principle lies at the heart of our investment approach. To find out more, get in touch.

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