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INVESTMENT MANAGEMENT & STOCKBROKING

MARKET COMMENTARY

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ROMO: Risk Of Missing Out

Despite a pullback late in the month, most global equity markets continued to rally in February. The US is now up 11% year to date, making it the best two-month start to a year since 1987. Worries over escalating trade wars, disorderly Brexit and Trump-led government shut-downs subsided as investors were swayed by an upbeat US earnings seasons and increasingly dovish outlook for interest rates. China and the broader Asian markets fared particularly well as prospects for a trade deal with the US seemed to improve. The story was somewhat different for bonds, with most fixed-income indices edging lower following a strong run that began in early November. Sterling continued its resurgence, briefly breaking through $1.33, a level last seen in June. Commodities were a mixed bag with metals firmer, led by palladium up 18% for the month, whist some agricultural grains such as wheat plunged by more than 10%.

Our attention of late has been focused much closer to home and this month we have made several changes to our UK equity allocation. Firstly, we have added the Lindsell Train UK Equity fund which has been on the radar for some considerable time. This is a focused fund of twenty predominantly large-cap UK companies, based on a philosophy very closely aligned to that of Warren Buffett. The strategy can be summed up by the great man's quote back in 1990, "Stocks are simple. All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever." Lead manager Nick Train has been running the fund since mid-2006 and the results speak for themselves – we pick up on this further below.

Lindsell Train accompanies the incumbent SDL CF Buffettology UK fund, run by Keith Ashworth-Lord. As the name suggests this fund is run on very similar principles, however with 30 stocks, there is more of a mid and small-cap bias. We have been huge fans since we first met in the summer of 2016, immediately taken by the business perspective investing philosophy. The fund was less than £40m in size back then, but it didn't put us off and it already features in many client portfolios. Today it has grown to almost £600m and has picked up countless awards along the way, frequently ranked number one in its peer group.

The pushback that we have received so far has been along the lines of 'what if this approach suddenly stops working?' The only reply that we can offer is that Warren Buffett has been investing this way since the early 1940s and it has made him one of the richest individuals on the planet. To suggest that the process will suddenly fail implies that there is some kind of game-changing, cataclysmic moment about to occur. We doubt it and try to think long-term. "Someone's sitting in the shade today because someone planted a tree a long time ago," is the way to look at it. There is a potential issue with overlap, with a few common holdings such as Sage and Diageo. But with turnover so low, if this starts to rise it won't be difficult to spot.

Ultimately, the consistent and significant outperformance cannot be put down to luck – there is clearly something going on here.

Year	FTSE All Share Index Return	LF Lindsell Train UK Equity Fund	Relative	SDL UK Buffetology	Relative
2006*	9.00%	11.00%	+2.00%		
2007	5.30%	2.20%	-3.10%		
2008	-29.90%	-25.80%	+4.10%		
2009	30.10%	34.90%	+4.80%		
2010	14.50%	30.00%	+15.50%		
2011	-3.50%	1.10%	+4.60%		
2012	12.30%	21.40%	+9.10%	34.20%	+21.90%
2013	20.80%	35.30%	+14.50%	36.00%	+15.20%
2014	1.20%	7.30%	+6.10%	1.78%	+0.58%
2015	1.00%	11.50%	+10.50%	27.86%	+26.86%
2016	16.80%	11.30%	-5.50%	11.85%	-4.95%
2017	13.10%	20.70%	+7.60%	26.60%	+13.50%
2018	-9.50%	-1.10%	+8.40%	0.37%	+9.87%
2019	4.20%	2.30%	-1.90%	3.00%	-1.20%
	100%	299%		248% **	

**From July 2006; ** vs FTSE All Share +73%*
Source: Bloomberg®

So given these numbers, why on earth would anyone buy an index-tracking fund? If there was any doubt, the table above surely vindicates one of our central beliefs that (with the right strategy) active management is superior to passive. In other words, the starting point of any regional investment decision should be based on the *best* stocks in an index, not the *biggest* stocks in an index.

In which case it might seem a contradiction, to put it mildly, that the other major tactical change made this month is the introduction of the HSBC FTSE All Share fund. This seemingly paradoxical decision is based upon one simple factor – Brexit.

Over the last few years, the directional flow of funds has been undeniably away from UK equities. After all, Brexit has made the UK uninvestable according to some supposed experts. Uninvestable might be something of an overstatement, but The Bank of America Merrill Lynch Fund Manager Survey (see chart overleaf) shows that there has been a growing underweight consensus position represented by the light blue columns since the referendum in 2016.

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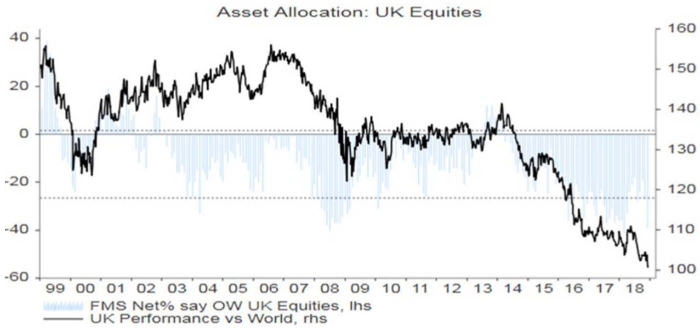
Interestingly, the survey shows that fund managers have been fairly consistently underweight the UK over the last 20 years, but it is today certainly well below the -30% average level. The chart also shows just how badly the UK stock market has fared relative to the rest of the world. £1,000 invested in the UK five years ago would be worth £1,300, but if invested in the world index it would be worth nearer to £1,800 in sterling terms.



Source: Merrill Lynch Bank of America

The problem is however, what if some kind of Brexit deal is achieved? What if a compromise is reached and some kind of visibility returns? We have cautioned over the folly in trying to second guess the outcomes, but one does need to consider the balance of probabilities because there is a scenario in which sentiment rapidly turns and the money that has been going out of the UK, floods back. If those blue lines at very least start to shrink then the case for UK outperformance gains strengthens and in the short–term at least, all of sudden, size matters.

There is a noticeable absence of names such as Shell, HSBC and AstraZeneca in either Ashworth-Lord or Train's funds yet these could be the main beneficiaries for no better reason than they are the most liquid. The direction of sterling is highly relevant too because a favourable (or less bad) outcome would likely see the pound appreciate which tends to be bad news for many UK companies with dollar exposure. However, at the risk of contradiction, we are talking about the short-term, in which case any bounce would be indiscriminate in much the same way it was when nearly everything fell immediately after the referendum result in 2016.

In other words, we think that the risk of being out of the market has rarely been so pronounced, in which case our barbell approach has logic. One one side you have the quality names that are to a large extent Brexit-neutral. On the other side you have the big names that will gain momentum quickly if things work out for the better.

Of course, things may not work out. Another General Election, a People's Vote, an horrendous no-deal trade crunch are outcomes that immeditely jump to mind. However, we happen to think that these outcomes are already - to an extent - already priced in. How much will the market fall in the event of a *no deal*? It seems frivolous to suggest that UK equities are in a win-win situation but the odds do look appealing.

Brexit certainly hasn't put off the Norwegian state investment fund, that manages some £750 billion of assets. In late February it stated that it was set to increase its investment in the UK. "With our time horizon, which is 30 years plus, current political discussions do not change our view of the situation."

All food for thought and we are delighted to be hosting an advisor lunch in Belfast in early March, with Keith Ashworth-Lord presenting. It will be interesting to hear his take on where we are right now. We expect a Buffett quote along the way and maybe the most fitting is his view on short-term worries and long-term reality:

"In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497."

Brexit could prove to be just a small footnote in a history of rising stock markets – in other words, as always, the real risk is being out of the market.

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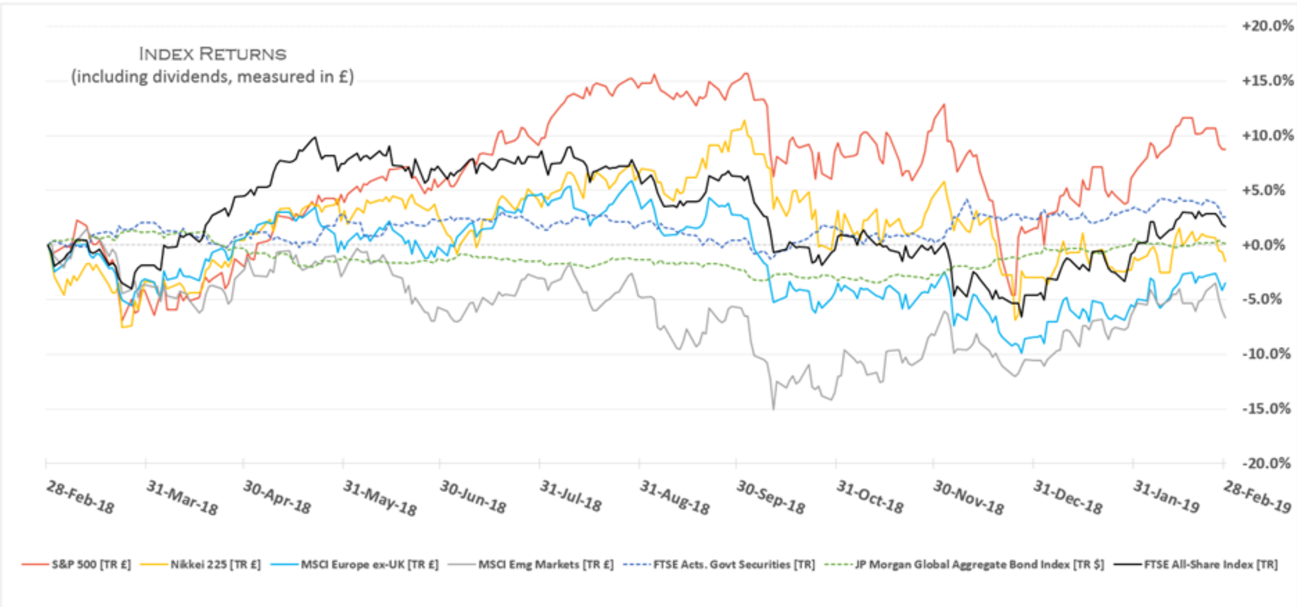
INDEX RETURNS

Index	Region/Asset Class	28 Feb 2019	1 Month Change	1 Year Change	2 Year Change
UK 100	UK	7,074.7	+1.5%	-2.2%	-2.6%
UK Mid Cap	UK	526.1	+2.5%	-3.7%	-1.8%
UK Small Cap	UK	5,422.8	+0.9%	-4.9%	+2.5%
Dow Jones Ind Avg	USA	25,916.0	+3.7%	+3.5%	+24.5%
S&P 500 Index	USA	2,784.5	+3.0%	+2.6%	+17.8%
NASDAQ Comp.	USA	7,532.5	+3.4%	+3.6%	+29.3%
Nikkei 225	Japan	21,385.2	+2.9%	-3.1%	+11.9%
Euro Stoxx 50	Europe	3,298.3	+4.4%	-4.1%	-0.6%
CAC 40 Index	France	5,240.5	+5.0%	-1.5%	+7.9%
DAX Index	Germany	11,515.6	+3.1%	-7.4%	-2.7%
Milan Index	Italy	20,659.5	+4.7%	-8.6%	+9.2%
MSCI Emg Mkts (£)	Emg Mkts	545.4	-0.9%	-6.7%	+10.0%
IBOVESPA Index	Brazil	95,584.4	-1.9%	+12.0%	+43.4%
IMOEX Index	Russia	2,485.3	-1.4%	+8.2%	+22.1%
S&P BSE SENSEX	India	35,867.4	-1.1%	+4.9%	+24.8%
Shanghai SE Comp.	China	2,941.0	+13.8%	-9.8%	-9.3%
Hang Seng	Hong Kong	28,633.2	+2.5%	-7.2%	+20.6%
UK All Property	UK Property	134.5	-0.2%	+2.0%	+9.7%
UK Conv Gilts	UK Gilts	3,615.8	-0.9%	+2.5%	+1.3%
UK Index linked Gilts	UK IL Gilts	4,884.2	-0.8%	+1.8%	+0.6%
JPM Glob Agg. Bond ($)	Global Bonds	569.2	-0.5%	+0.1%	+5.5%
iBoxx Non-Gilt	UK Corp Bonds	340.6	+0.0%	+1.8%	+2.8%
WTI Crude ($/barrel)	Oil	57.2	+6.4%	-7.2%	+5.9%
LMEX	Base Metals	3,058.0	+3.7%	-8.4%	+5.8%
Gold Spot ($/oz)	Commodities	1,313.31	-0.6%	-0.4%	+5.2%
S&P Agri & Livestock	Agriculture	688.94	-3.4%	-11.6%	-16.2%
£1 = US$	Currencies	1.33	+1.2%	-3.6%	+7.1%
£1 = €	Currencies	1.17	+1.8%	+3.4%	-0.4%
£1 = Yen	Currencies	147.73	+3.5%	+0.6%	+5.8%



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