momentum

Managed Portfolio Tactical Change - v27

April 2017

The Managed Portfolios are in the process of being rebalanced. Momentum will be making changes to the Equity and Fixed Income portion of the portfolios, as well as marginally increasing cash in the lower risk portfolios and decreasing cash in the higher risk portfolios.

Change & Rationale

Equity Allocation

Sell US Equity – JPM US Equity Income (Managed Portfolio 3 to 8) & Vanguard US Equity Index Fund (Managed Portfolio 6 to 8)

Momentum has taken the tactical decision to sell the two US equity funds currently held in the Managed Portfolios on valuation grounds. The broad US economic outlook remains solid and arguably the region warrants a premium at a time of uncertainty, but the asset class remains one of the most expensive equity regions, with high investor expectations already priced in. With profit margins having peaked, US equities would require meaningful earnings growth to justify today's valuation. The models will continue to have exposure to US equities through our global managers, but selling the JP Morgan and Vanguard holdings will result in a significant move away from a now overly expensive asset class.

Buy Emerging Markets, European, Japan & UK Equity – Veritas Global Focus (Managed Portfolio 4a to 7), Trojan Global Equity (Managed Portfolio 5), Fidelity Emerging Markets Index (Managed Portfolio 8) & Fidelity Index Japan (Managed Portfolio 3 & 4).

Momentum will be adding four new funds to the investment range to help diversify the portfolios. The rationale for increasing exposure to equities in the following regions are:

Emerging Markets

Valuations are attractive in absolute and relative terms. With slowly improving fundamentals and a noticeable repositioning in risk appetite among investors, we like the prospective long term returns offered by the asset class today. Leading indicators continue to support reasonable growth expectations in isolation as well as versus DM economies. Global and localised policy action remains supportive towards riskier assets. However, this remains a volatile section of the equity market and Momentum will take care in position sizing.

European Equities

European equities look reasonably valued at current levels, especially when viewed against corporate and sovereign European bond markets. However, with European political headwinds and a growing recognition that negative rates do more harm than good, we remain cautious in our position sizing.

Japan Equities

Negative rates in Japan should be constructive for equities, despite creating bouts of volatility in the near term. Valuations remain attractive and our return expectations are amongst the highest of the developed market regions. The Bank of Japan also continues to purchase domestic equities through ETF structures, alongside the continuing purchases of Japanese government bonds, and this should also support prices.

UK Equities

Valuations remain a little extended but the continued pressure on sterling will support UK businesses. In particular, exporters and those that earn their revenues overseas will benefit, but the market is discounting a decent rebound in earnings at these levels. Low base rates and the continuing asset purchase program should also keep risk appetite buoyed in the near term.

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Fixed Income Allocation

Sell Corporate Bonds & High Yield – Artemis Strategic Bond (Managed Portfolio 3 to 5), Artemis High Income (Managed Portfolio 3 to 4a), Jupiter Strategic Bond (Managed Portfolio 6 & 7), Kames High Yield Bond (Managed Portfolio 3 to 7).

Momentum has taken the tactical decision to reduce exposure to high yield and corporate bonds by trimming those strategic bond managers which currently have high allocations to these asset classes. We have also decided to significantly reduce and sell out the Kames High Yield Bond fund, depending on the portfolio.

Corporate bonds have continued to rally in recent weeks with spreads tightening significantly, resulting in credit looking increasingly expensive. Therefore, a reduction in position size is, in our opinion, warranted. We believe that the credit cycle is now somewhat extended in the US, and prefer short duration to core high yield today, as scenario analysis suggests a better risk return. Finally, on the basis of expected total returns we prefer the US over Europe.

Buy Inflation Linked Gilts, Government Bonds and Emerging Market Debt – L&G Global Inflation Linked Bond Index (Managed Portfolio 3 & 4), Vanguard US Government Bond Index (Managed Portfolio 3 & 4), L&G Emerging Government Bond Index (Managed Portfolio 3 to 6).

Momentum will be adding both nominal and inflation-linked government bonds in the lower risk portfolios (Managed Portfolio 3 & 4). Real US Treasury yields do not look unreasonable if growth remains muted and inflation is contained, and high quality government paper remains the ultimate safe-haven in times of elevated risk aversion.

Managed Portfolio 3 to 6 will now have exposure to emerging market debt (EMD), as spreads on hard currency denominated emerging market bonds remain attractive when considering duration and reinvestment risks, and (unattractive) opportunities in other asset classes. All in yields are also reasonable, following the recent re-pricing in US rates. In aggregate, the sovereign issuers that comprise the EMD universe today have higher currency reserves and more free floating currencies which should prevent a meltdown comparable to the previous emerging market debt crises, and aggregate ratings quality is better. The worst of EM currency depreciation looks to be behind us and this should provide some support to hard currency spreads, and will benefit from any dollar weakness.