SALTUS
Investment Managers

November 2018 market background

Another volatile month during which aggressive 'rules based' selling offset some marginal improvements in the risk outlook

November was a continuation of the weak and volatile market trends which have been such a feature of the year so far. Trading patterns and the direction of price movements were very similar to October, albeit on a smaller scale, with most asset classes remaining weak across the board. Oil suffered a very large -23% fall, its biggest move for a decade, but also one which we think tells us more about excess of supply, as opposed to a collapse in demand. Previously high flying growth stocks, particularly in the technology sector, suffered from consistent profit taking and, given their prominence in investor psychology, also managed to sour investment sentiment across the globe. However, for all the aggressiveness of the price falls, we do think that the corrections in these type of assets are from lofty price levels as well as also being long overdue and rational. Not every price fall is a bad thing, especially if one has a reasonably long investment time horizon.

Closer to home as Brexit related deadlines loom, the noise and excitement level has been cranked up without any accompanying increase in clarity of outcomes. The price of sterling and UK equities is beginning to stand out in terms of cheapness compared to international peers which have themselves become cheaper, something we find strategically attractive but also something we don't feel the need to be tactically aggressive about. We think we have the largest risks broadly appropriately sized for each particular risk appetite and in the absence of any obvious 'great trade' don't intend to alter positions into year end.

Perhaps the single most important event of the month was a change in tone from the Chairman of the Federal Reserve. By recanting his previous opinion that interest rates were 'a long way from neutral' (they are now apparently 'just below neutral') Chairman Powell significantly reduced investor fears that the Fed would tip the world into recession by raising interest rates too quickly. If true, this would be a major support for markets in 2019 which, coupled with one other tension reducing event in Europe (where the new Italian government backed away from a damaging fight with the European Commission), contributed to markets ending November in a slightly less panicky state than they entered it.

The outlook is still punctuated by volatility and uncertainty but it also still holds plenty of opportunities

Last year, according to JP Morgan, was one during which returns from 95% of investible asset classes were not only positive but also two to three times higher than normal when adjusted for risk. After such an unusually good year it is perhaps no surprise that some form of payback was coming in 2018. As a combination of high valuations, rising interest rates and geopolitical influences gathered momentum, market performance turned south. In fact, the year so far has been one during which 95% of investable assets have produced negative returns, a very unusual environment which we haven't seen since 1901 and clearly one which is tricky to manage through.

For recent price falls to become something more than a normal correction we would need to see real signs of a recession looming, as well as some indication of headline inflation ballooning. Neither of these things are apparent just now, nor do they look like they will be in the year ahead. In fact the opposite is true, with the economic outlook looking to be one of continual moderate expansion with limited inflationary pressure.

As overconfident, overleveraged investors have now had quite a shakeout, cutting back heavily on their position sizes into thinly traded markets, the scene is set for the more moderate, positive macro realities to reassert their influence. Although geopolitical events retain the very real ability to upset the applecart – particularly in the arena of Sino-US trade negotiations – lower valuations and more realistic investor expectations still offer us the potential to make money in the months and years ahead and we continue to hold to our cautiously optimistic outlook.

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Portfolio performance

Portfolios returned between -0.8% and +0.2% in the context of -1.6% for UK equities and -1.2% for UK gilts. The resilience was driven by a late recovery in overseas equity markets, particularly in Asia/Japan as well as generally solid returns from corporate bonds and index-linked securities. Weakness was concentrated again in all forms of UK equity investments and some of our macro managers who struggled with the whipsawing sentiment.

EQUITIES	Negative	Neutral	Positive
UK Equities			•
European Equities		•	
US Equities			•
Japanese Equities			•
Asian/EM Equities		•	
Equity Market Neutral		•	
Equity Hedged Strategies			•
Private Equity			•
FIXED INCOME	**Negative**	**Neutral**	**Positive**
Gilts		•	
Investment Grade Bonds		•	
High Yield Bonds		•	
Fixed Income Multi Strategy			•
OTHER ALTERNATIVES	**Negative**	**Neutral**	**Positive**
Global Macro Trading			•
Commodities		•	
Real Estate	•		

David Cooke
Saltus Investment Managers, December 2018