Prospects

November 2015

INSIDE

CANACCORD Genuity
Wealth Management

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Market Commentary

Nigel Cuming
Chief Investment Officer

Whilst we have previously suggested that the setback which occurred in mid to late August constituted a buying opportunity, we must admit that we have not been alone in the fact that the speed of the recovery in equity markets has caught us by surprise.

The FTSE 100, having suffered a rapid near 15% decline, has rallied almost 10%, taking it from oversold to overbought in very quick order.

We are of the view that a US interest rate rise would be welcome sooner rather than later. Market opinion has moved around significantly recently, but at the time of writing, December was deemed the most likely month for a rate rise. We are getting a little concerned that the risk of a policy error by the Federal Reserve is increasing. Whilst the recent slowdown in global economic growth exacerbated by developments in China, prompted a postponement of the interest rate rise, the US economy remains in a reasonable state, it is supported by a robust services sector which continues to grow. US unemployment continues to fall and the decline in oil prices has boosted real incomes, hence growing consumer confidence. All the while inflation has been very subdued, although it is worth noting that this could change very quickly. The oil price is now stabilising - and the positive effects of its near constant decline over the course of the last year will be dropping out of the inflation index. With the recent slowdown in the US payroll numbers being interpreted as an indication that the US is potentially running out of employable labour, it is not unreasonable to expect an upward pressure on wage rates to finally occur. If this happens, the Federal Reserve will be seen to be “behind the curve” to the obvious detriment of all financial markets.

However, that is a future fear. The global economy is still growing but in a manner that has prompted the International Monetary Fund to stress the need for ongoing action from the global authorities - and we feel that further measures from both Japan and Europe remain distinct possibilities. That said, the European recovery appears to be on track - with both loan and consumer demand having picked up significantly and GDP growth accelerating in the third quarter. Whilst China’s third quarter GDP growth figure of 6.9%, the weakest figure for six years, drew some alarmist headlines, it was still better than the market feared and is still expected to prompt further monetary and fiscal easing.

Therefore, against this backdrop of supportive policies, we will continue to look for buying opportunities over the course of the next month. Having rallied so sharply, equities may give up some of their recent gains but despite the fact that there are one or two potential clouds on the horizon the most likely scenario in our view is that equities can resume their advance over the course of this quarter.

> “The European recovery appears to be on track - with both loan and consumer demand having picked up significantly.”

MSI Update

To help you navigate a smoother, more confident path to your client's financial future, we have developed our proprietary Market Stress Indicator (MSI) which has been developed to assist us in seeking to identify periods where markets might be vulnerable to meaningful declines due to increased correlation between the asset classes.

Our MSI has moved further into stress and now reads 4.5 from 4.0 where it had been since the end of June this year. Equity volatility related to China, the series of Asian currency devaluations, and increasing concerns of a policy mistake have driven our indicator into a higher state of stress. While equity volatility continues to drive that reading of market stress, we've also seen continued classic bond market safe haven shifts, with yields falling as investors seek safety – driving out the negative equity correlation with bonds.

We see the Chinese devaluation as having been sparked by domestic concerns on growth, and it seems increasingly likely that the true run rate of GDP growth is now closer to 5% than the 7% target, possibly less, and that will be a concern to many. While most market analysts will have both eyes on China for a while, expecting a policy response to support growth and/or markets, we suspect that the US may hold the key for developed markets. If domestic consumption-led growth can continue, perhaps supported by exported deflation and lower commodity prices, then markets will likely settle as that becomes clear. A delayed start to policy normalisation would clearly help on that front, and has become more likely in our view. Until then, expect markets to remain volatile as they digest news on prospective global growth weakness, with further setbacks in equity markets looking likely.

As ever, we recommend investors remain vigilant.

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Searching for Income in an Uncertain World

Regina Borromeo
Fund Manager, Legg Mason IF Brandywine Global Income Optimiser Fund *

The world can sometimes be a volatile, unpredictable place – especially if you're a bond investor looking for a steady income. But it needn't be that way.

Global financial markets came under huge pressure in August, with a dramatic fall in share prices and credit spreads widening in the bond markets. The immediate cause was growing concern about the strength of the Chinese economy and the timing for the first rate hike, although other factors such as illiquid markets, electronic trading and distressed hedge fund selling probably exacerbated the situation.

However, now the dust has settled a little, let's step back and take a longer term view of fixed income investing and the importance of diversification. Indeed, in an uncertain world, it's more important than ever to adopt a diversified, truly global approach.

When we invest globally we look to deliver a consistently high income while minimising the downside risk. Of course, that's easy enough to say, but far harder to do in practice. However, if you get this right you can generate consistent income and returns over time.

Investment themes

Our approach involves macroeconomic research coupled with a rigorous valuation and fundamental process. We begin the process by deciding on our key investment themes. First, we look at which countries to invest in and which ones we want to avoid. Next, we do the same with currencies, deciding on those we want to buy or sell. We also look at duration – a way of measuring a portfolio's sensitivity to interest rate movements as well as credit risk. And finally we decide which bonds we want to buy and sell.

So how does this work in practice? What themes do we see playing out in the market?

Our current investment theme is to capitalise on the economic recovery taking place in Europe and the US, which is relatively stronger than other parts of the world. At the same time, we're also seeking to protect our portfolios from those in emerging markets that are

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* The Fund changed its name on 29 June 2015. The Fund was previously called the Legg Mason Income Optimiser Fund.

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negatively impacted by the Chinese slowdown and the likelihood of rising interest rates in the US.

Of course, country allocations change over time. Back in 2011, for example, our allocation to the US accounted for over 60% of the Legg Mason IF Brandywine Global Income Optimiser Fund. Today, it's around 44%. The same goes for the bonds we invest in – our sector weighting. Global High Yield bonds accounted for the lion's share of our portfolio, while government bonds, investment grade corporate bonds, asset-backed securities and cash make up the remainder. But like our country weightings, this allocation changes over time, as does our currency exposure and duration positioning. The point is that in the search for income you need to be an active investor and that involves constantly changing and refining your strategy.

I began this piece by talking about the recent volatility in global markets. While things have settled down there is still plenty of risk out there. So what's keeping us up at night?

Our principal concerns right now are declining growth in the emerging world, increased market volatility and the possibility of a central bank policy mistake – in other words, a central bank increasing interest rates too quickly or not acting quickly enough.

At Brandywine Global, however, we believe we have the tools and flexibility to address these macroeconomic issues. For example, during the recent market volatility, we added to our Credit Default Swaps exposure in the Legg Mason IF Brandywine Global Income Optimiser Fund, which act as a protection against default – a type of insurance policy if you like. We also reduced our exposure to the troubled energy sector and several emerging market debt issues and currencies.

Indeed, despite some concerns, we're pretty upbeat about bond markets right now. In particular, we continue to see attractive opportunities opening up in higher yielding credits, European mortgages and some developing market sovereign bonds. In short, our global search for income continues.

Disclaimer >

Ask the Expert

For this instalment, Moira Protani, an expert in charity law, sets out her views on the proposed Charities (Protection and Social Investment) Bill and the power of the Charity Commission to issue warnings to trustees.

Moira Protani
Partner & Head of Charities,
Wilsons Solicitors LLP,

What is the Charities (Protection and Social Investment) Bill?

In light of the Kids Company debacle, the public is naturally concerned about the Charity Commission's ability to effectively regulate charities. The Charity Commission's regulatory work has arguably been hampered by a lack of strong powers and budgetary cuts in recent years. If passed into law, the Charities (Protection and Social Investment) Bill will give the Charity Commission additional powers to act to curb abuses of charitable funds. They include a power to issue an official warning to trustees who the Charity Commission considers to have committed a breach of trust, a breach of duty or other misconduct or mismanagement in that capacity. The Charity Commission's opinion on whether or not there has been a breach of trust or breach of duty will be subjective, it will have the power to publish the warning. Trustees will have no right of appeal to the Charity Tribunal in respect of the warning itself or against a decision to publish it.

Are there any opportunities to appeal Charity Commission decisions?

It will be possible for trustees to apply to the court for judicial review, but this will be unaffordable to most trustees and, in any case, the remedy will not undo the damage done to a trustee's personal reputation if innocent of wrong-doing.

Does the Bill raise any concerns?

Publication of a warning could undermine public confidence in a charity and lead to funders withholding their donations even if an "offence" is minor. By way of an analogy with the criminal law, it is similar to an ASBO in that it has the potential to be a quick way of regulating misdemeanours. It is also not dissimilar in effect to the Charity Commission's current practice of publishing case management reports concerning poor governance practices by charities. Whilst this has proved justifiable in some cases where there have been clear breaches of duty by trustees, in others, the Charity Commission's reasons for publicly denouncing a charity have been very questionable. Trustees, who are volunteers, deeply resent it and it is not hard to see how this can discourage individuals from volunteering for trusteeship.

Has the Charity Commission been successfully challenged in the past?

History has shown that it is never a good idea to give a public body a wide discretion to take executive action without an effective remedy by those who are affected by its decisions. This is especially important where the individuals concerned are volunteers of charities. The whole purpose of the Charity Tribunal, introduced by the Charities Act 2006, was to provide a cost effective and accessible means of challenging excessive use

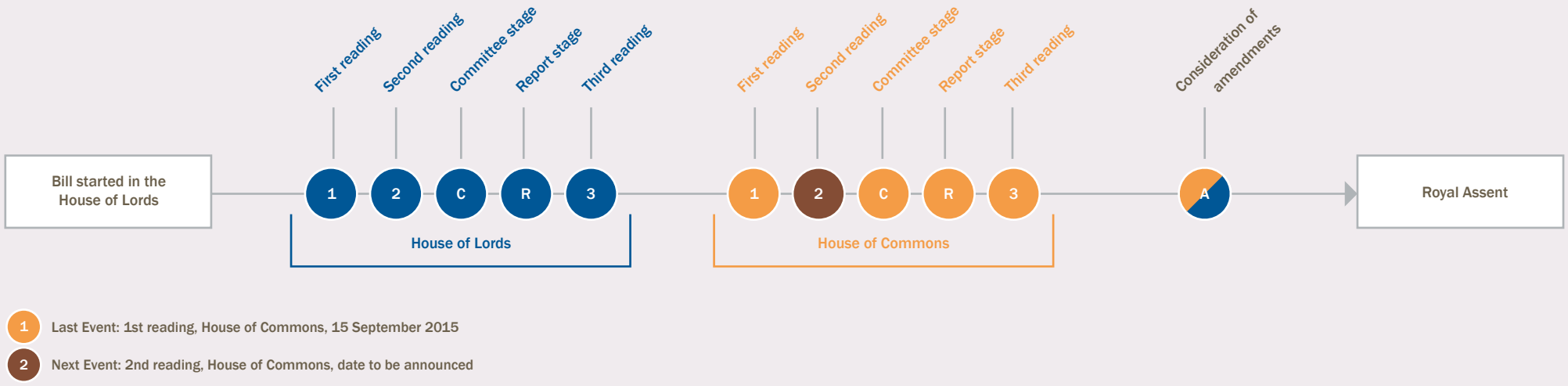
Ask the Expert

of the Charity Commission's powers and of correcting mistakes made by them. For example, the Charity Commission was challenged successfully in the Charity Tribunal over its guidance on public schools, which was found to be flawed.

As the Bill passes through the House of Commons in this Parliamentary session (see Fig.1), it should be borne in mind that if a balance is not struck between the Charity Commission's undoubted need for stronger powers and the need to ensure that its use of those powers is proportionate and does not damage the goodwill of volunteers and their reputations, it will be difficult to persuade individuals to volunteer for trusteeship. This would doubtless be a great loss to the charitable sector and the public. The Bill should be amended to include a right for trustees to make a request to the Charity Tribunal to review a decision to issue a warning and a right to appeal to the Charity Tribunal before the Charity Commission can publish the warning.

It cannot be good law to leave trustees in a positon where they have no realistic and affordable right of recourse against the regulator, either to protect their reputation or that of the charity they represent, especially in circumstances where it is questionable whether they have done anything wrong or where a misdemeanour is minor. It is best to curb the temptation of the regulator to be over-zealous.

Fig 1: Progress of the Bill



Intermediary Desk Update

Sean Taylor
Head of Intermediary Sales

October saw the Rugby World Cup jamboree continue across the UK, despite England's dreams collapsing like a sand castle at "Fortress Twickenham".

Fortunately, after a bruising August and September, the FTSE All-World Index gained 8% in October, its biggest monthly rise in four years, all in all better news for investors than rugby fans. Similarly, European equities had their best month for six years, as optimism mounted that the European Central Bank would bolster its asset-buying programme.

Among countless headlines calling to "change the manager", I also noted quite a large number of publications discussing financial platforms with a specific focus on the "race to the bottom" with regards to pricing and the growing perception of consolidation in the arena. (To clarify, Canaccord Genuity Wealth Management portfolios are available via platforms such as Novia, Nucleus, Transact, AXA Elevate, Ascentric and Fusion).

Platforum 2015, the retail investment conference, recently held its ninth annual event and I thought I would share some of my observations of the event:

New terminology for the intermediary group and pension industry was introduced, including "the Grey Glide", a period between full time work and retirement. Individuals in this transitional period, unlike their predecessors, might still be accumulating wealth, others might be starting to dip into their nest-eggs- however, they remain part of the labour force.

> "Gone are the days of walking into the HR manager's office, agreeing on a day to retire, accepting a gold watch and exiting the building."

The Grey Glide is emerging as an increasingly important phase of adult life. According to data from the Office of National Statistics, 12% of the population worked beyond the state pension age in the final quarter of 2014. This is an increase of 25% since 2001. And the numbers look set to continue to rise.

Indeed, a nationally representative survey conducted by Platforum this summer found that 27% of all working adults plan to work beyond the state retirement age. Our attitudes to life in retirement have increasingly changed. The likelihood that a person will want to work beyond the age of 65 grows with age, income and levels of education. Indeed, more than a third of 55 – 65 year olds plan to stay on the payroll beyond the age of state retirement.

Intermediary Desk Update

Your capital is at risk. The value of investments and the income from them can go down as well as up and you may not get back the amount originally invested.

The reason I am talking about the Grey Glide is because it is crucial to the investment industry. The type of financial service required in this phase of life may be different from that advice needed during full-time work or in the period of retirement. Grey Gliders will continue to earn an income, but will also be drawing on savings and investments. They need to understand how to maximise tax efficiency. They should consider the impact of working a few years longer than expected, downsizing, maximising pension contributions and the like.

This presents a compelling argument in favour of using platforms to offer both our GPS Optimized Portfolio Solutions and the IHT portfolios on financial platforms, as 'Grey Gliders' become increasingly technically astute 'Silver Surfers'.

As a reminder, Canaccord Genuity Wealth Management officially relaunched REMAP as part of the GPS suite of investment solutions under the name GPS Optimized Portfolio Solutions on 5 October.

As you may know, our research indicates that our approach to investment stands out from the crowd; offering a uniquely dynamic and unconstrained approach to risk management. Our portfolio range is structured to help you, the adviser, achieve your clients' objectives. The process underpinning the approach has been recognised as a best-in-class investing discipline.

Our highly successful investment strategy received the Gold Standard Award for Discretionary Portfolio Management in 2012 and 2013, as well as a five-star rating by independent research firm Defaqto in 2014 and 2015.

Towards the end of the year, we will be releasing a new Due Diligence document which was created in light of FCA practice requirements.

As ever, we would love to have your feedback on your investment manager. Are they doing what they should be doing? Finally, we would be interested to know what you classify as "bespoke" - is it just becoming another word for - discretionary - management? We would welcome your views.

We look forward to seeing you at our events in the lead-up to Christmas. As we head into the winter months, we hope that, "the bears stay in hibernation", as some market wags say.

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