Investment review quarter ending 30 September 2020

"Mighty oaks from littel acrons grow" English proverb

On the whole, the third quarter of a tumultuous year turned out rather well for both markets and your investment portfolios. The strong momentum generated by government support programmes, central bank intervention and a gradual loosening of lockdown restrictions lasted well into the summer before a bout of early Autumn nervousness sparked a wave of profit-taking. Overall though, after the shock and confusion of the first half of the year, the last three months have had a much firmer undertone to them, supported by several structural events we think will turn out to be very impactful in the long run.

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In the early Covid period many analysts speculated over the shape of the future recovery, with V-shape or U-shape being two of the more popular guesses. In reality, the shape has turned out more like the letter K, with everything falling and then rising together before markets and society at large began to split into Covid winner and losers. The winners so far have turned out to be larger enterprises, technology stocks and the wealthy. The losers have been the poor, smaller companies and those enterprises in older, more cyclical industries. The analogy stretches to encompass various geographies as well with Asian and US assets storming ahead of the UK, as we struggle to shake off Brexit-related uncertainty.

Eventually we think the gaps between winners and losers are likely to converge with, for example, increased taxation closing the wide gulf between rich and poor, or a market rotation from expensive winning sectors into the cheaper ones currently left behind. The specific timing or speed of such a 'closing the gap' is very difficult to predict, specially given the amount of noise we expect to see in the coming quarter, but over the long run, we think the whole process will offer a number of attractive investment opportunities.

The last quarter also witnessed several strategic events which we think could ultimately turn out to have a profound long run impact. The first was a recognition by the European Union that their €750bn rescue fund needed some form of common debt guarantee to underpin it, an admission that signalled to many the launch of a common tax and spend policy to complement the single currency. If this turns out to be the case then such an action would shore up the investment case for the region, which has often struggled with question marks over the long run viability of the entire project.

Another very important event was the decision by the Federal Reserve in the US to switch to a policy of 'average inflation targeting', an action that would allow the US economy to 'run hot' or above normal growth rates for a period, in order to help pull up the average level of inflation, which has been below target for quite some time. The prospect of a US economy further boosted by the central bank would have widespread positive implications, especially if it is carried out at the same time as a new administration embarks on a stimulus plan.

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Whilst neither of these events passed unnoticed, they did have to fight for attention in an environment where Covid and political news occupies so much bandwidth. We think there is a decent chance that they might just prove to be, over time, the small acorns upon which a solid oak of a recovery could grow.

In the near term however, life is about to become a little more uncertain and noisier, as we have to wrestle with the implications of Brexit, US elections and Covid second waves or vaccines. All these factors are set to dominate immediate market sentiment, given their very direct impact on current and future economic activity. The range of outcomes could also range from universally positive (Brexit deal, smooth transition of power in the USA , positive vaccine news) to universally negative (no Brexit deal, contested US electionsand vaccine delays or failures) as well as all points in between.

Given this complex scenario, we don't think that we can predict the outcome(s) with any degree of confidence at this point and consequently have let cash build a little at the margin, preferring to wait and see how events pan out before doing anything substantially new. A noisy, bumpy period of consolidation is our best guess as to the caracter of the next few months investment environment.

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Beyond this near-term choppy investment climate, the outlook for next year and beyond is also likely to remain complex, volatile and something of a challenge for asset allocation. One of the major complicating factors is that assets which are traditionally protective for portfolios in times of stress are so expensive that one wonders if they will actually do their job when called upon again. For example, government and high-quality corporate bonds currently offer long run returns which are either negative or sub 1.5% per annum, depending on where one looks. This would tend to push allocations inevitably towards higher risk assets such as equities or simply just an acceptance of lower returns. Neither option is particularly appealing.

Fortunately your portfolios are not constrained to invest in only the two main asset classes and there are other areas – convertible bonds, commodities and foreign exchange – to name but three, that we are either already building up exposures to or will be doing so soon. Your portfolios are also not constrained to follow any particular style of investing either (e.g. large cap, small cap. value, growth, high grade, low grade etc etc) a flexibility which offers up another dimension across which we can spread risk and increase diversification.

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We think a little patience at this point will afford us a much better chance of seizing opportunities down the line, especially as all these near-term big issues should have resolved themselves by the end of the year. We will be spending our time over the next few months poring over our spread of current investments to see if there are more ways we can diversify across asset classes and styles, as well as continuing to hunt for new talent to partner with. After the upending of nor al life in a head spinning and turbulent year we can see some real signs of healing in markets and economies. This, coupled with your manager's capability to look far and wide for decent investments, means your Investment Committee still thinks it can view the months ahead with a 'glass half-full' mentality.

With thanks for your continued support,
The Saltus Investment Committee, October 2020

	UK equities	US equities	Europe (ex UK)	Japan	Asia	Other equities	Property	Alternatives	Bonds	Cash
MAP 2	5.8%	7.4%	0.0%	4.3%	2.1%	14.9%	2.9%	24.7%	25.6%	9.9%
MAP 3	8.8%	12.6%	0.0%	7.3%	3.1%	21.0%	1.9%	16.1%	20.0%	8.4%
MAP 4	12.1%	16.5%	0.0%	9.6%	4.6%	28.6%	1.0%	13.6%	5.9%	8.0%

	Quarter	Benchmark quarter	Year to date	Benchmark year to date	Benchmark
MAP 2	3.32%	0.96%	1.73%	2.07%	CPI plus 2.0%
MAP 3	4.89%	1.21%	1.93%	2.84%	CPI plus 3.0%
MAP 4	5.76%	1.47%	1.40%	3.61%	CPI plus 4.0%