# FUNDWATCH

Investment Managers' commentaries for Clients of Financial Discounts Direct

## JANUARY 2018



**Last year was one of political stalemate and rising interest rates in the US. In Europe there was political uncertainty and animosity over Brexit whilst tensions in Eastern Asia escalated. Despite all this global markets continued to rise, hitting new highs. How can that be and, more importantly, can it carry on?**

The continuing strong growth in corporate earnings is a key contributing factor. However, although markets are at record highs numerically, if you adjust for inflation then they are still well below levels seen in 2000.

In the UK the signs are that a "no deal" Brexit is looking less likely and prospects for an early election seem also to have receded. Europe continues to do well but it would be prudent to expect some sort of correction during the course of this year which could offer a good buying opportunity. US markets are high but are still supported by strong earnings growth. We are seeing synchronisation in economic growth around the world and the latest indicators suggest an acceleration in the global economy.

In this edition we have asked the managers of some of the most popular funds held by our clients to give their views on past performance, current position and future outlooks. We hope this gives you useful insight for future investments. Also enclosed is the latest update for our First Class Funds list.

Wishing you all a very happy and prosperous New Year.

**Paul Penny**
Managing Director

## Exciting Changes in 2018

Later this year, we will be unveiling a major upgrade to the Cofunds platform. In conjunction with Cofund's new parent company, Aegon, we will be introducing a series of improvements and an expansion in the range of products that we offer.

In particular, we will have a SIPP, which will allow you to manage pension arrangements alongside ISA investments. This will allow you greater control over your money, letting you to put it to work more efficiently.

We will be in touch with you again over the coming months with more details.

## ABERDEEN EUROPEAN HIGH YIELD BOND

**FUND FACTS**

| | |
|---|---|
| Fund Managers: | **Ben Pakenham, Steven Logan & Euro High Yield Team** |
| Launched: | **01/10/2012** |
| Fund Size: | **£94m** |
| Annual Fund Charge: | **0.70%** |
| Current Yield: | **5.60%** |
| Distribution Frequency: | **Monthly** |

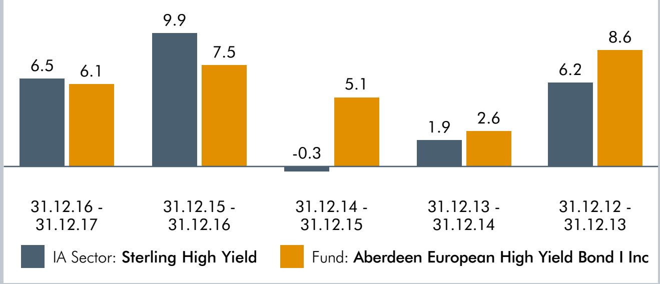
2017 was another strong year for High Yield Bonds and the fund performed well in this environment. The European economy showed signs of life as growth picked up and the profitability and cash flows of companies improved. With the benefit of these tail winds, on an aggregate basis, company leverage declined, credit spreads rallied and defaults fell even further. The fund benefited from the broad rally in credit spreads. In particular, performance was boosted by positions in financials (Phoenix Assurance and Clydesdale Bank), infrastructure businesses (OHL and Aldesa), refiner (Preem) and healthcare (Valeant).

We are mindful of the risk of rising yields and in the near term consider this to be more of a challenge than default risk. We prefer the single B rated area of the market, as in our opinion these provide the optimum combination of a relatively high level of income and a low level of interest rate risk. This positioning ensures that the fund enjoys a significant yield advantage over the market average. The fund is underweight Italian risk, which is predominantly made up of large BB rated companies that we consider unattractive, offering low yields and more interest rate risk. The fund is also underweight cyclicals, where there is currently a lack of risk premia. Balancing these underweights, the fund is overweight healthcare and cable companies.

The easy monetary policies and prevailing growth environment in Europe is very supportive of corporate credit and we continue to see a benign outlook for defaults over the next couple of years. Whilst valuations look a little rich here, they continue to reflect the low level of corporate distress and volatility in the market today.

**6 MONTHS TO 31/12/17: FUND 2.6 SECTOR 2.3**

**DISCRETE ANNUAL % GROWTH**




## ARTEMIS GLOBAL INCOME

**FUND FACTS**

| | |
|---|---|
| Fund Manager: | **Jacob de Tusch-Lec** |
| Launched: | **19/07/2010** |
| Fund Size: | **£3,915m** |
| Annual Fund Charge: | **0.75%** |
| Current Yield: | **3.43%** |
| Distribution Frequency: | **Half yearly** |

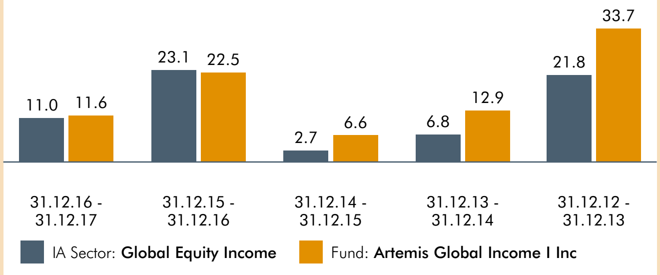
In the early part of last year, we positioned our portfolio with a bias towards the areas of the market we anticipated investors would move into next, favouring cheap(er) cyclical stocks rather than expensive defensives or 'secular' growth. At the same time, having a yield focus means there are parts of the global market in which we can't invest. So we didn't own the (hyper) fast-growing FANGs (mega companies like Facebook, Amazon, Netflix & Google). Yet those stocks, already some of the world's biggest companies by market cap, made huge gains which, for a time, placed us at a disadvantage to the wider market. Towards the end of last year, however, things began to move in our direction. Cyclical stocks began outperforming defensives and returns from our energy and materials stocks improved. And in December the FANGs finally fell out of favour. Even banks began to do a little better, helping the fund to outperform its peer group over the last one, three and six months.

The portfolio remains balanced: we still own a number of companies whose revenues (and dividends) should prove relatively robust if growth in 2018 falls short of expectations. These include AbbVie, a US pharmaceutical, Euskaltel, a Spanish cable operator, and Ocean Yield, a Norwegian maritime-leasing company. But the balance has shifted. In additions to cyclical value stocks, the fund now has as much exposure to US banks as it has at any time since its launch.

It is possible that in 2018 the market starts to accept that deflation is no longer an immediate threat and that interest rates (both short- and long-term) have bottomed out. The expectation of ongoing monetary tightening and the withdrawal of liquidity would not be supportive for markets overall and probably not for most 'traditional' income stocks. And while equity income as a class might come under pressure, we believe there will be ways to generate a 3-4% dividend yield from global equities.

**6 MONTHS TO 31/12/17: FUND 7.2 SECTOR 4.8**

**DISCRETE ANNUAL % GROWTH**






Past performance is not a guide to future returns

## ARTEMIS UK SPECIAL SITUATIONS

| FUND FACTS | |
|---|---|
| Fund Managers: | Derek Stuart, Andy Gray |
| Launched: | 09/03/2000 |
| Fund Size: | £937m |
| Annual Fund Charge: | 0.75% |

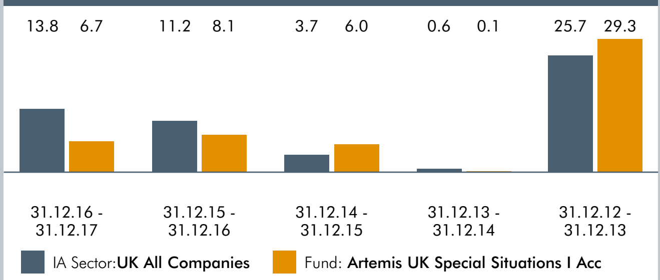
Overall, 2017 was a tough year for the fund. It was a year in which 'momentum' was rewarded and value offered little protection. Momentum in earnings has long been a driver of share prices, but more recently the focus on it appears to have intensified. Partly this is due to the growth of passive investing through ETFs and the growing number of momentum-based strategies. No matter what the valuation is, as long as a company is delivering upgrades to earnings its shares continue to rise. The reverse is also true. No matter how low the valuation, this will not stop a share declining if there is even a modest downgrade. This is somewhat at odds with our strategy: we hope to protect capital by buying lowly valued shares in the expectation that the multiple will expand and drive returns. To compound matters, the spectre of 'disruption' from new technology has cast a shadow over many 'value' equities. In some cases, this shadow is well-deserved – but in other cases it is not. Overall this has meant that value-based investment strategies have not worked over the past year.

Domestic companies are tending to offer the greatest value in the market, but they run the risk of unhelpful politics (both from the current government or any successor). So while we see value here we are selective. The stocks we are attracted to are an eclectic mix and reflect our preferred approach of choosing companies with the ability to 'self-help'.

We are acutely aware of our recent underperformance. We constantly review the fund's holdings to construct a portfolio that we believe is capable of delivering above-average returns. We are taking action in certain stocks where we have already allowed sufficient time for a re-rating to occur but where it has not been delivered. We fundamentally believe that identifying companies that have a high degree of self-help and where the potential for re-rating is significant remains important in a world that will continue to produce macroeconomic surprises.

### 6 MONTHS TO 31/12/17: FUND 4.0 SECTOR 6.1

#### DISCRETE ANNUAL % GROWTH




## FIDELITY GLOBAL SPECIAL SITUATIONS

| FUND FACTS | |
|---|---|
| Fund Manager: | Jeremy Podger |
| Launched: | 15/09/2006 |
| Fund Size: | £2,466m |
| Annual Fund Charge: | 0.75% |

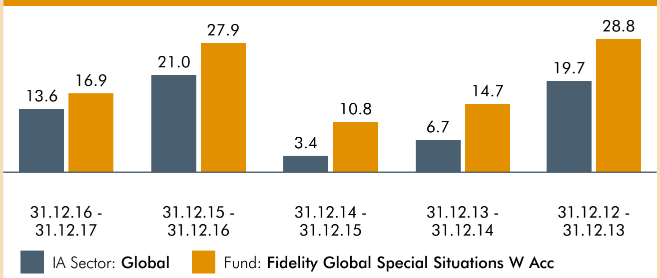
Strong positive returns in 2017 were driven in most part by robust stock selection. Positions in Financials and IT companies benefited from improving fundamentals. IT stocks, specifically semiconductor firms, added value due to increased demand for their strong and growing product offerings. This was driven by the increasing focus on automation across various markets. Financials holdings in Europe and the Emerging Markets also contributed due to increased investor confidence in balance sheet strength and restructuring efforts. On the other hand, holdings in specific Consumer Staples detracted from performance due to challenging business conditions and structural issues. Regionally, the US contributed well whilst holdings in the UK, where the fund is underweight overall, disappointed.

The fund continues to look for opportunities which fall into one of three categories (Corporate Change, Exceptional Value & Unique Businesses). IT companies with growing addressable markets, innovation and strong free cash flows are well represented. The fund is also overweight in the Health Care sector, driven by services and equipment providers that are supported by demographic tailwinds rather than firms which are more exposed to drug pricing concerns. We also remain defensively positioned versus the index in the Consumer Staples sector.

Looking forward, we are now in a new "earning driven" phase of market growth in comparison to the previous years which saw a "revaluation" phase. Whilst the consensus view is that US earnings growth could be up into the teens following the tax reform bill, other regions may prove to be more attractive given that earnings growth has reappeared and valuations are relatively more favourable. One is inclined to be positively disposed toward European, Japanese and other Asian markets more cautious on the US. The fund will continue to focus on finding the best stock opportunities for investors globally.

### 6 MONTHS TO 31/12/17: FUND 9.1 SECTOR 6.2

#### DISCRETE ANNUAL % GROWTH



## JANUS HENDERSON CHINA OPPORTUNITIES

**FUND FACTS**

| | |
|---|---|
| Fund Manager: | **Charlie Awdry**, Co-Manager |
| Launched: | **01/03/1983** |
| Fund Size: | **£1,162m** |
| Annual Fund Charge: | **0.75%** |

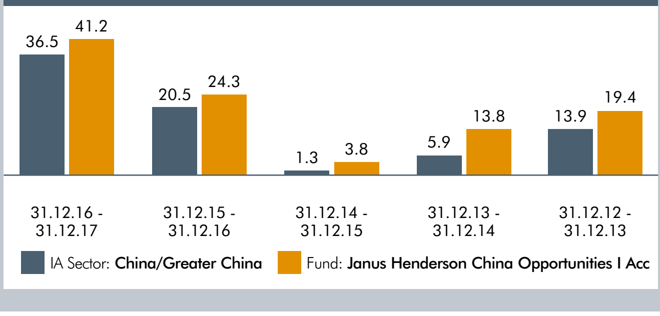
The fund performed strongly over the year. As 2017 began many investors worried about further yuan (CNY) weakness (it fell against the US dollar in 2016) but the CNY actually rallied against the US dollar. We expected President Trump to have an aggressive attitude towards China based on his presidential campaign messages but he's had a much more conciliatory tone. These macroeconomic changes, combined with stronger-than-expected profit growth from a broad range of Chinese shares and sectors, has driven stocks upwards and has improved investor sentiment towards Chinese shares. The fund has long held a preference for consumer-facing Chinese companies and these generally continued to do well in 2017, particularly in the IT sector where internet giants Tencent and Alibaba (the fund's two largest holdings) posted handsome returns over the period.

The foundation of the China investment case remains the consumer and the rise of consumption. We see interesting recovery stories such as Chinese sports brands and other unloved sectors that appear to be more attractively valued at the moment. We reintroduced bank shares in 2017 on the view that the Chinese economy has performed better than many expected; non-performing loans ('bad loans') appear to have peaked and valuations of select bank shares appear attractive. Our focus is on the largest banks with the strongest financial positions.

Chinese shares are typically riskier compared to shares in developed markets. After a strong run there is always the possibility of a pullback or softening in sentiment and some growth shares appear expensive. However, we still see good potential across Chinese shares listed in Hong Kong, Shanghai, Shenzhen, and the US. It's fair to say this period of outperformance continues to mature, but experience suggests this strong run could continue for longer. We feel this could be the case in 2018 as investors have generally been reducing their allocation or ignoring China for a number of years.

**6 MONTHS TO 31/12/17: FUND 18.1 SECTOR 16.5**

**DISCRETE ANNUAL % GROWTH**




## JANUS HENDERSON FIXED INTEREST MONTHLY INCOME

**FUND FACTS**

| | |
|---|---|
| Fund Managers: | **Jenna Barnard, John Pattullo, Nicholas Ware** |
| Launched: | **30/04/1979** |
| Fund Size: | **£895m** |
| Annual Fund Charge: | **0.60%** |
| Current Yield: | **4.60%** |
| Distribution Frequency: | **Monthly** |

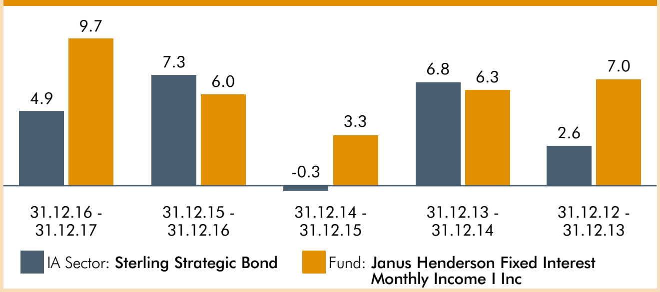
The fund performed strongly in what was overall another good year for corporate bonds. The income focus of the fund meant that it was generally skewed towards the higher yielding and thus more credit sensitive areas of the bond market. Given expected low default rates and our 'lower for longer' view on interest rates and inflation, we kept more interest rate and credit sensitivity in the fund than peers for the most part, which benefited the performance. Interest rate sensitivity (duration) was actively adjusted through purchases of longer maturity investment grade bonds and tactically via interest rate futures in the UK, US and Australia. Discipline was important and we refused to participate in many new bond deals, which we believed were from issuers with poor prospects. The fund's junior banking, insurance and financial bonds performed particularly strongly over the year.

Given our focus on generating a sustainable income, the fund has maintained a relatively high allocation in higher yielding assets. We continue to run a moderately high holding in financials — an area supported by market technicals and potentially rising rates. We have also been adding to positions in 'global titan' and 'new world' companies, which we see thriving in the medium term, having enough scale to be insulated from disruption or being part of the disruption itself.

We continue to view the world through the lens of long-term disinflationary forces and divergent economic cycles in the developed world. The current macroeconomic backdrop still remains favourable for bond investing with modest growth, modest inflation and low company default rates. The range and speed of industry disruptions in 2017 continues to drive our focus on holdings from quality businesses with sustainable cash flows. We believe that the coupon income from bonds will continue to drive returns in 2018.

**6 MONTHS TO 31/12/17: FUND 2.9 SECTOR 1.8**

**DISCRETE ANNUAL % GROWTH**






Past performance is not a guide to future returns

## JUPITER FINANCIAL OPPORTUNITIES

| | |
|---|---|
| Fund Manager: | **Guy de Blonay** |
| Launched: | **02/06/1997** |
| Fund Size: | **£539m** |
| Annual Fund Charge: | **0.75%** |

**FUND FACTS**

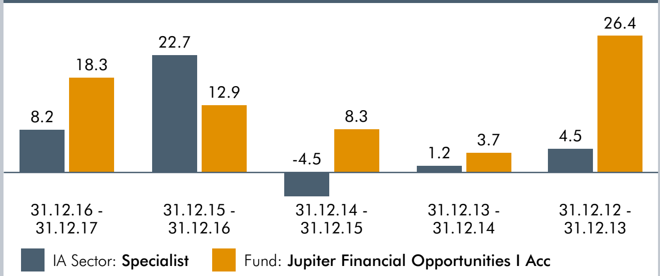
We made several adjustments to our positioning in 2017, as developed market central banks started to move towards normalisation of monetary policy. Firstly, we increased our exposure to US banks on expectations of further macroeconomic improvement. We believe that a number of important catalysts are still underappreciated by the market, including potential deregulation and recently passed tax reforms under the Trump administration, increasing share buybacks, and the power of digitalisation. This latter point should bring down banks' costs, boost customer satisfaction and lift customer retention. We think it's important to also pay attention to the enablers of this disruptive technology, and the fund continues to hold several sizable positions within the financial technology space.

We increased our investments in the European banking sector in 2017. Across Europe, the economic outlook is improving, lenders are benefiting as loan growth continues to pick up and credit quality improves, and earnings are on the rise. In the UK, prospects are more mixed, however, and we continue to favour companies which derive a significant proportion of their revenues internationally. Finally, outside of the US and Europe, the fund holds positions in India, Russia, Brazil and Hong Kong. We are also looking at opportunities in Japan; company management seems increasingly focused on delivering shareholder returns, and, in our view, the market looks attractive.

We believe the ability of a central bank to increase interest rates should be interpreted as a vote of confidence in the resilience of a country's economy. We are seeing a synchronised acceleration in global growth, which is supportive for stocks, and should be good for financials. Concerns remain around the pace of future interest rate hikes, but while a spike in inflation could derail the slow-and-steady approach to raising rates, we think there is limited evidence to suggest this is going to happen.

**6 MONTHS TO 31/12/17: FUND 8.1 SECTOR 4.8**

**DISCRETE ANNUAL % GROWTH**




## L&G GLOBAL TECHNOLOGY INDEX TRUST

| | |
|---|---|
| Index Proposition Manager: | **Dan Attwood** |
| Launched: | **01/11/2000** |
| Fund Size: | **£218m** |
| Annual Fund Charge: | **0.32%** |

**FUND FACTS**

As an index fund, the Legal & General Global Technology Index Trust aims to track the performance of technology companies in the FTSE World Index.

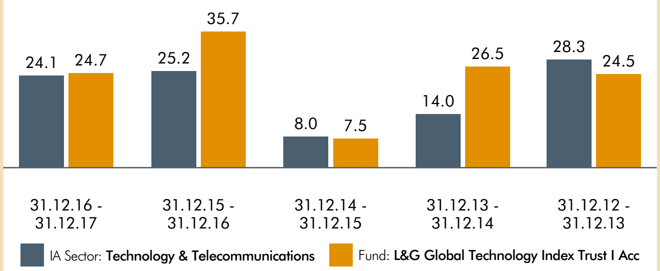
Technology change has been a constant of industry evolution, and disruption. From the spinning jenny and the steam engine, to the wireless and the Ford Model T, there are countless examples of small innovations that have ushered in profound social and economic change. Technology has transformed our lives over the last 200 years and continues to do so at a startling pace. Many of the companies and industries that will shape our future are to be found in the technology sector, presenting strong long-term opportunities.

The trust's ten largest constituents include technology giants Apple, Microsoft, Alphabet (Google), Facebook, IBM, Intel, Cisco Systems, Taiwan Semiconductor Manufacturing, Oracle and SAP. All of these companies are innovators at the forefront of their respective fields, and all except two are based in the United States, a testament the growing influence of Silicon Valley.

Technology remains one of the few sectors still likely to benefit from top-line growth despite the macro slowdown and rising interest rates from the US Federal Reserve. Structural shifts to digital media from traditional media spending channels are set to benefit companies like Google and Facebook, whilst spend on technology-related capital expenditure and migration to the cloud is benefitting names like Microsoft, Intel and Cisco. Positive momentum will continue to be driven by global growth, company earnings and margin guidance.

**6 MONTHS TO 31/12/17: FUND 12.4 SECTOR 9.2**

**DISCRETE ANNUAL % GROWTH**



## LF LINDSELL TRAIN UK EQUITY

| | | |
|---|---|---|
| Fund Manager: | **Nick Train** | **FUND FACTS** |
| Launched: | **10/07/2006** | |
| Fund Size: | **£4,852m** | |
| Annual Fund Charge: | **0.65%** | |

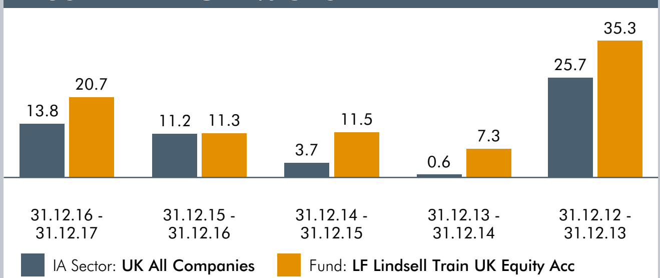
The fund outperformed the FTSE All Share over calendar year 2017, helped in part by further advances for our consumer brands businesses – Diageo, Heineken and Unilever. Early in the year Kraft Heinz announced a surprise short-lived takeover bid for Unilever, and it served as an important reminder to all investors just how valuable the "steady compounding returns" of quality growth companies can be. We remain bullish about the prospects for the great brands owned by these sorts of companies, particularly if you are prepared to invest for the long term.

The Fund is invested in a collection of what we analyse to be exceptional companies, by both UK and global standards. Key ideas include owners of global consumer brands, such as Burberry, Mondelez and Diageo. We also like companies that own or create media content or software to take advantage of the ongoing changes we see in technology and distribution – for example Sage for its business software services, Daily Mail's phenomenal MailOnline or our new purchase in 2017, Manchester United. Finally, we own several outstanding businesses whose prospects depend on the progress of financial markets, such as the London Stock Exchange and Schroders.

We employ a particularly strategic approach in investing client capital, taking positions in a range of companies that we believe are likely to prosper over the long term. We don't invest looking for short term gain but we are optimistic about the long term prospects for the global economy, and it positively benefitting the UK stock market. In particular, Technology and Emerging Markets remain two global themes with the power to create lasting wealth for investors. We are invested in a range of advantaged companies that stand to benefit from growing demand from emerging market consumers for everyday products.

**6 MONTHS TO 31/12/17: FUND 8.5 SECTOR 6.1**

**DISCRETE ANNUAL % GROWTH**




## LF WOODFORD INCOME FOCUS

| | | |
|---|---|---|
| Fund Manager: | **Neil Woodford** | **FUND FACTS** |
| Launched: | **12/04/2017** | |
| Fund Size: | **£738m** | |
| Annual Fund Charge: | **0.75%** | |
| Target Yield: | **5.00%** | |
| Distribution Frequency: | **Quarterly** | |

The fund was launched in April 2017 and so has not yet completed its first year. In its short life thus far, however, it has delivered an attractive total return. The bulk of this has, as the name suggests, come through dividend income. The fund's performance was, however, slightly behind that of the broader UK market.

Nine years into this bull market, the evidence increasingly suggests that it has moved into its late-stages, with momentum replacing fundamentals as the primary driver of shares. Valuations across a wide range of assets have increased and, as a result, there is considerable risk. Such an environment is always likely to prove challenging for our fundamentally-driven investment approach. There are always pockets of value, however, and when a bull market becomes long in the tooth, as this one is now, the stretch between the cheap and expensive stocks can become extreme. We have positioned the portfolio towards areas of the market where valuations look most attractive – in our view, these opportunities are now predominantly in UK-focused stocks which have become profoundly unloved and undervalued – and are actively avoiding the areas of risk. This is an unpopular strategy at the moment because the market excitement has been taking place elsewhere but, when fundamentals reassert themselves, as they inevitably will, the fund is poised to deliver very attractive returns against a backdrop of a more challenging market more broadly.

As well as delivering the level of income that we outlined at the fund's launch, we are confident that capital can grow substantially in the years ahead. As such, we remain confident in the fund's prospects and believe it will deliver attractive long-term total returns to shareholders.

**6 MONTHS TO 31/12/17: FUND 2.8 SECTOR 4.8**

**DISCRETE ANNUAL % GROWTH**

Fund launced April 2017 so annual data not yet available.

## LIONTRUST SPECIAL SITUATIONS

| | | |
|---|---|---|
| Fund Managers: | Anthony Cross, Julian Fosh | FUND FACTS |
| Launched: | 01/11/2010 | |
| Fund Size: | £3,443m | |
| Annual Fund Charge: | 0.75% | |

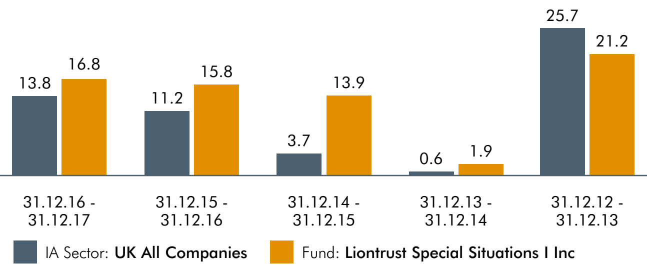
The Fund's return was helped by a backdrop in which small and mid-caps outperformed large-caps. Typically, around two-thirds of the Fund is invested in stocks sitting below the FTSE 100 large-cap index, versus the FTSE All-Share Index which has a weighting of c.20% to these stocks. Good stock selection was a much larger factor than sector trends on Fund performance over the year, helped by some impressive returns for some of its mid-cap and small-cap holdings. The best return came from engineering group Renishaw, which saw its share price rise steadily through the year.

We do not take sector views based on macroeconomic expectations and the sector exposure of the Fund is a result of, rather than an input to, the stock selection process. Higher weightings to certain sector classifications results from the fact that the Economic Advantage characteristics are more commonly found in certain sectors of the stockmarket than others. The Fund is unlikely to invest in companies in regulated industries due to the challenges of generating growth and sustaining high profits in such an environment. By contrast, it has high exposure to IP rich manufacturing and engineering companies, many of which fall into the Industrials sector.

The Economic Advantage process is unashamedly bottom-up. This is not to say that investor sentiment will not have an impact, but over the long term the greatest influence on the type of companies we invest in will be their ability to successfully execute growth plans and compound profits. We expect the economic and corporate landscape to continue to be disrupted by technology, and in this respect we will look to the investment process to both identify investment opportunities and provide barriers against competition. These barriers to competition afford companies the time to respond to technological advances and seize the opportunities of the digital economy for themselves.

### 6 MONTHS TO 31/12/17: FUND 7.6 SECTOR 6.1

### DISCRETE ANNUAL % GROWTH




## SCHRODER US MID CAP

| | | |
|---|---|---|
| Fund Manager: | Jenny Jones | FUND FACTS |
| Launched: | 01/06/2001 | |
| Fund Size: | £2,117m | |
| Annual Fund Charge: | 0.75% | |

The Schroder US Mid Cap strategy modestly outperformed its benchmark, the Russell 2500, before fees in 2017. The excess return was driven by stock selection which was positive in seven out of ten sectors. Technology, financial services and materials & processing were the greatest areas on strength. The strategy also benefitted from underweights in real estate investment trusts and energy, the two worst performing groups in the index during the period. Low returns made from investments in consumer discretionary, energy and health care detracted from overall performance.

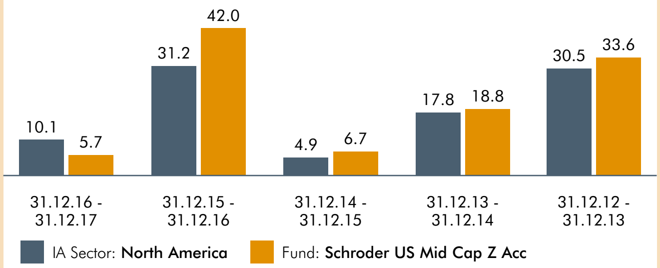
Valuations are still stretched, in large part due to the very low level of interest rates, which does allow for higher price-to-earnings ratios. Relative to large-cap US stocks, smaller cap companies are fairly valued. We are much more comfortable with valuations versus large caps than we were at the beginning of the year and we are finding more investment ideas in the smaller cap space.

On the corporate front, businesses are relatively optimistic. A leading small business association, the NFIB, publishes its Index of Small Business Optimism, which has been elevated since President Trump won the US election. This is a particularly positive indicator given the impact that small businesses have on the US economy: these companies account for 83% of non-farm payrolls jobs.

A lower corporate tax rate is beneficial to all companies, however more so to small-cap companies. Small-cap companies pay a much higher effective tax rate than their large-cap counterparts. However, within the last month the market has priced-in the benefit to many of our companies. We also have concerns about the unintended consequences of the tax bill that was written and passed so quickly.

### 6 MONTHS TO 31/12/17: FUND 4.2 SECTOR 6.9

### DISCRETE ANNUAL % GROWTH



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