AJBell Investcentre

Fundamentals with Russ Mould

July 2016

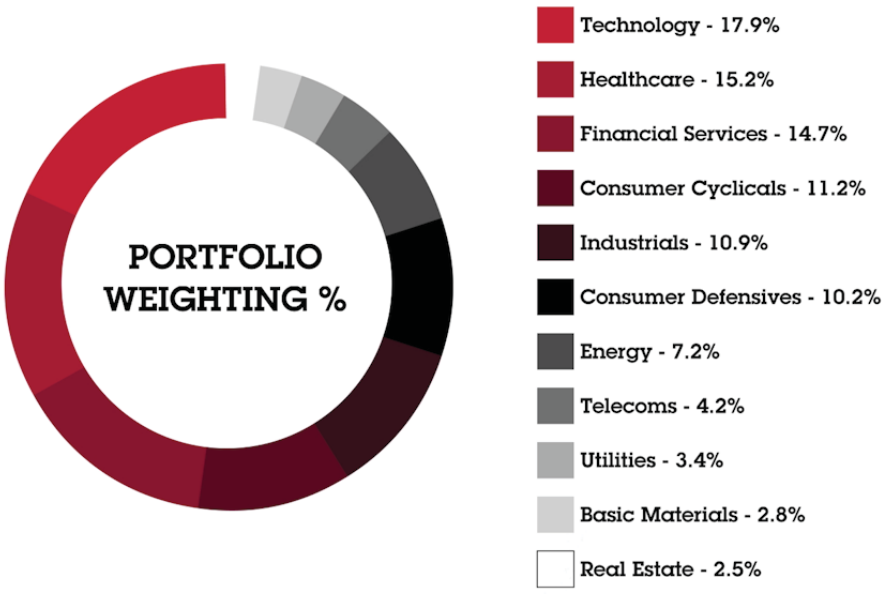
Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to Fundamentals, where I'm going to look at the single most popular Exchange-Traded Fund on the AJ Bell Investcentre platform right now, namely Vanguard S&P 500 ETF.

[CAPTION - Vanguard S&P 500 UCITS ETF (Inc) GBP EPIC code – VUSA SEDOL – B7NLLS3 ISIN - IE00B3XXRP09]

This tracker product is an ETF – Exchange-Traded Fund. It is designed to track, or mirror, the performance of the underlying assets and deliver that performance, minus any running costs. This means this particular tracker is following America's S&P 500 index.

In this case, Vanguard S&P 500 Japan uses physical – or direct – replication to generate performance so it owns the underlying securities. The five biggest stock weightings include tech firms Apple, Alphabet (Google as was) and Microsoft, oil giant Exxon Mobil and health and personal care expert Johnson & Johnson.

This chart here shows the tracker's weightings by sector: technology, healthcare and financial services are the three biggest exposures, while mining, utilities and real estate are relatively under-represented, at least relative to the UK for example.

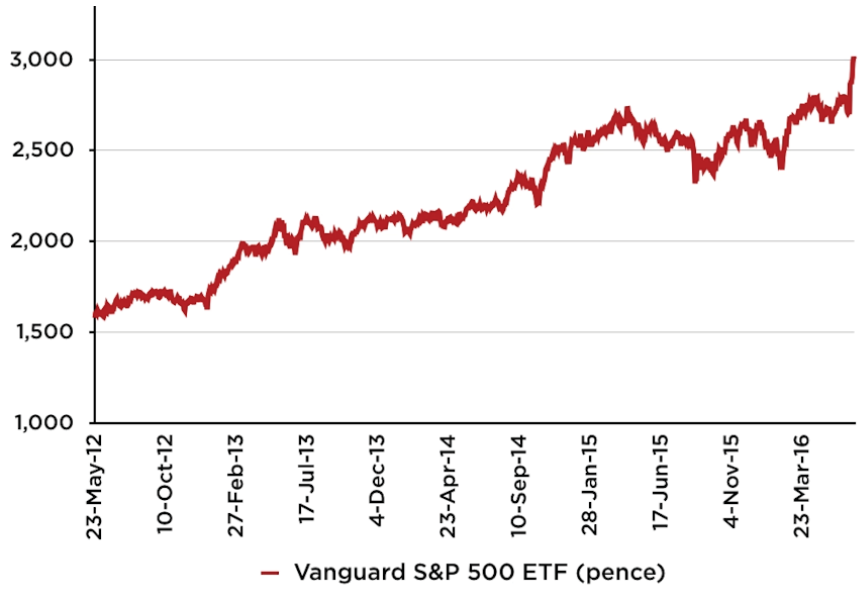


Source: Vanguard fact sheet, Morningstar

The product comes with an ongoing charge figure of just 0.07%, an amount only matched by four trackers in a field of 84 and beaten by none.

The tracker has around $13 billion in assets under management. It's a whopper so you would hope it would be liquid, at least under normal market conditions. It is just over four years old and comes with a five-star ranking from Morningstar, for those who place importance in such things.

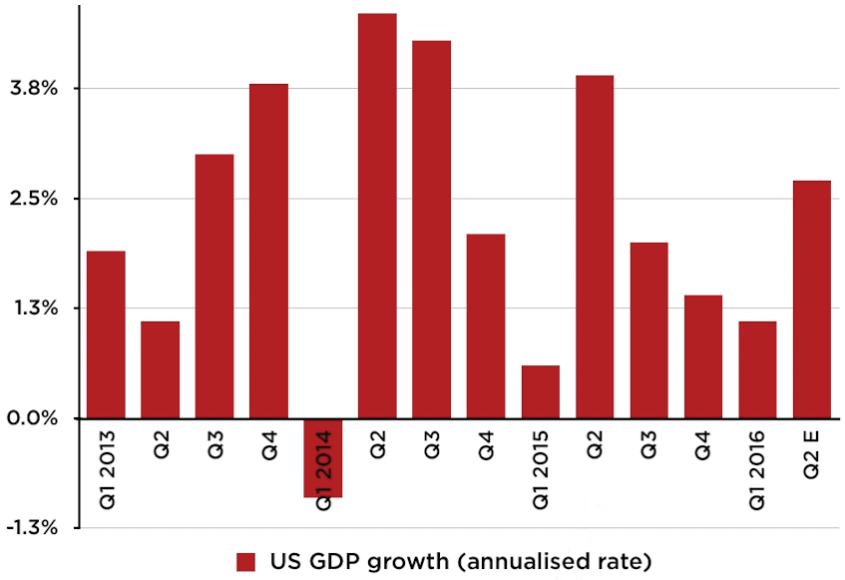
Note that Vanguard S&P 500 comes with dollar or sterling-priced options. This chart shows the performance of the sterling version since its launch



That's the mechanics. So the question is why would advisers and clients potentially be buying now?

I think there are four possible reasons:

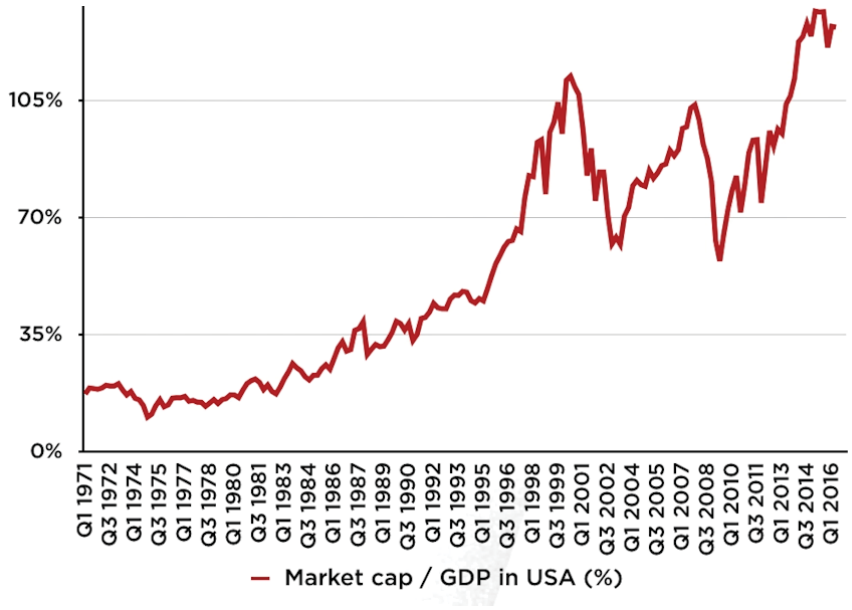
- First, it's a play on an overseas market and as such a bit of a bolt-hole from the confusion caused by the UK's vote to leave the EU. The US economy may not be in pristine condition but in some ways it is the least dirty shirt in the laundry right now. The influential Atlanta Fed GDPNow forecast is expecting 2.7% GDP growth on an annualised basis for the second quarter, a marked improvement on a pretty turgid opening three months of the year.



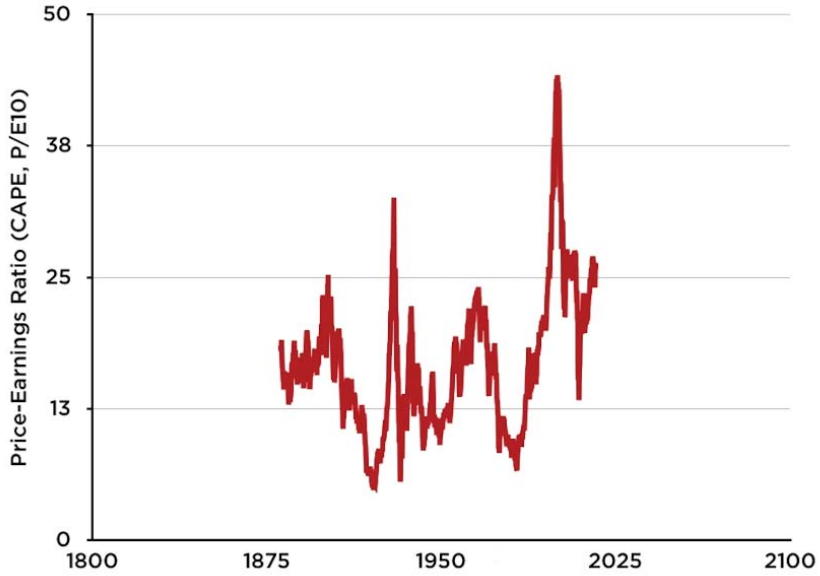
- Second, any advisers and clients buying now get the dollar on their side, and the pound's precipitous plunge since 24 June increases the value of holdings that are priced in the US currency.
- Third, the S&P 500 index offers exposure to sectors where the UK is less well represented, notably technology, an area that may appeal to some given its potential for secular, organic growth, almost whatever the economic weather.
- Finally, the US Federal Reserve has seemingly backed off from its plan to increase its Fed Funds target rate by a quarter-point on four occasions this year. It may move only once – if at all – and some are now even muttering about a rate cut, in response to international events. The prospect of lower rates for longer could provide support for US stocks, given the lowly yields offered by cash and US Treasuries.

This is not to say there are no risks. No-one knows how the US Presidential election will play out in November, as Donald Trump takes on Hillary Clinton. In addition, it is easy to argue that US stocks are expensive relative to their history, using metrics which do not rely on habitually optimistic near-term earnings forecasts from analysts.

The first is market cap to GDP:



The second is the Case Shiller CAPE, or cyclically-adjusted price-earnings ratio, which at just over 26 times trades on a level exceeded only twice before – and the two prior occasions (1929 and 2000) did not end well.



Both suggest some caution is needed, no matter how desirable some advisers and clients feel a haven away from the UK may be, so it may just be worth checking that the US equity market fits with a client's overall strategy, target returns, time horizon and tolerance for risk.

Thank you for watching and I look forward to seeing you next time.