AJ Bell Passive MPS – Q4 2019 report

Introduction

We are delighted to bring you the quarterly report from AJ Bell Investments covering the AJ Bell Passive MPS over Q4.

This report is designed to keep you up to date on what is happening with your AJ Bell managed investments. It covers the major macroeconomic events of the past three months, looks at how these have impacted the portfolios and highlights any changes made in the period.

Summary

With signs of political stabilisation in the UK and elements of a partial trade deal between the US and China, equities finished 2019 in very strong fashion. With a further interest-rate cut from the Federal Reserve and stimulus from the likes of China and the ECB, investors continue to pin their hopes on central bank support and this drove equity markets higher.

In the UK, the deadlock in Parliament was broken with the General Election and now the Brexit process moves on to the trade negotiations. Those hoping that the Withdrawal Agreement would be the end of the process were rapidly reminded it was just the end of the beginning! Nonetheless, with some element of clarity, bond yields moved higher as the immediate risk of a hard Brexit subsided.

Economic and market review

The fourth quarter of 2019 saw equity markets climb higher but most of this pick-up in equities came in the last couple of weeks when the traditional 'Santa rally' seemed to be in full swing following the outcome of the UK General Election. Returns were even stronger in local currency terms but a rise in sterling in the final quarter held back returns in overseas equities. This positive end to the year brought to a close a phenomenally strong year for equities, which started 2019 on the back foot and finished it with the MSCI World Index up 22.7%. It wasn't just equities that had a strong year, with bond markets performing well too as central banks around the world continued to provide positive conditions for all assets.

It was a remarkable quarter in the UK with the political landscape dramatically shifting, with Prime Minister Boris Johnson first managing to renegotiate the Brexit deal with the EU, then seeing his 31 October deadline pushed back to the end of January 2020 and then finally getting the General Election he craved. When the election came, it was the Conservative Party securing a large majority that finally looks to have brought some stability to politics in the UK. Investors welcomed this, with sterling strengthening sharply, hitting 1.35 against the US dollar at one point, up from 1.23 at the start of the quarter. Domestically-focused equities also rallied hard, with the FTSE 250 ex IT Index gaining over 6% in the two days following the election, as investors hoped that the handbrake would be released on the UK economy, which has shown GDP growth of 1.1% for the year. However, investors are well aware that attention will now turn to the trade negotiations with the EU and – with an ambitious timetable of just 11 months for completion – it wouldn't be a surprise if some degree of uncertainty returned to the UK during 2020, as it is remembered that the Brexit process remains in its early stages. Over the quarter, the FTSE All-Share Index gained 4.2%.

Source: Bloomberg LP, AJ Bell Investments, January 2020

As some degree of clarity appeared in the UK over the quarter, the 10yr gilt yield climbed sharply, starting the quarter at just 0.49% but ending the quarter at 0.83%, representing a significant sell-off as fears of an immediate hard Brexit reduced. This saw the FTSE Actuaries UK Conventional Gilts All Stocks Index fall back by -3.9% over the quarter, while UK corporate bonds performed somewhat better with the iBoxx UK Sterling Corporate All Maturities Index, but still delivered a negative return of -0.2%. With investors having confidence, it was a strong quarter for high-yield bonds with the Bloomberg Barclays Global High Yield Bond GBP Hedged Index growing strongly with a return of 2.4%.

In the US, there was significant activity at both an economic and political level of the quarter. With some signs early in the quarter that the US economy was slowing, the Federal Reserve cut interest rates for the third time this year amid concerns of slowing job creation and lower consumer confidence. The trade war continues to be the main focus for investors and there were positive signs in October when President Trump announced a 'phase one' trade deal with China. However, it is recognised that this element of the trade deal is relatively limited and much more serious talks will be needed to find a proper resolution. US corporate performance remained solid over the quarter, with earnings growth surpassing expectations while GDP growth came in at 2.1%. The major political development over the quarter was the impeachment of President Trump over allegations that he sought help from Ukraine to boost his re-election hopes. This will see a trial held by the Senate in January that will decide whether or not Trump is found guilty and potentially removed from office. Investors were relatively unmoved by the initial decision, although this may change in January once the trial gets underway. Over the quarter, equities increased sharply, with the S&P 500 Index increasing by 1.3% and hitting record highs. This performance meant that the index has delivered a remarkable 25.7% during 2019. Despite the interest-rate cut, the US 10-year Treasury yield increased from 1.67% at the start of the quarter to 1.91% at the end of the quarter, as expectations of further cuts in 2020 reduced.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In Europe, data remained mixed as the major economies continued to be held back by the ongoing trade war and slowing growth in Asia. The quarter saw Mario Draghi step down as Chairman of the ECB with Christine Lagarde talking his place; in her first speech she made it clear that the region could no longer rely on exports for growth and had to boost domestic demand with a clear expectation that government spending should increase. These comments seemed particularly directed at Germany, which has been reluctant to unleash some of its huge budget surplus. With manufacturing data showing the largest decline for seven years and new orders declining for the 15th month in a row, it is clear that it will take a concerted effort from both the ECB and domestic governments to help the Eurozone out of its malaise. Despite challenging economic conditions, the MSCI Europe ex UK Index increased by 0.9% over the quarter.

In Asia, the continued unrest in Hong Kong dominated the news agenda as the protests and violence seemed to pick up pace. Chinese GDP growth came in at 6%, which initially sounds very healthy, but is actually the slowest growth since 1992, as the trade war continued to bite. There has long been talk of slowing growth in China, not least because of the pure size of the economy making it inevitable that growth has to moderate as it readjusts from an export-led economy to one more domestically focused. The Chinese central bank continues to support the economy and cut the reserve requirement for banks twice in quick succession. In South Korea, retail sales fell back sharply after signs of improvement over the summer, not helped by a steady pick-up in unemployment, while in India, the central bank cut interest rates, with investors hoping for further tax reforms to help boost the economy. Over the period, the MSCI AC Asia ex Japan Index rallied strongly, increasing by 4.0%, and, although over the year the index was up 13.6%, this actually made it the poorest performing region in the world.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In Japan, consumption tax was increased at the start of October and this combined with a huge typhoon saw retail sales fall sharply in October, however these rebounded in November. Annual GDP growth came in at 1.7%, much higher than had been seen for the previous year, while there were tentative signs that inflation was picking up after falling back in the first half of 2019. However, there were mixed signals from business and consumer confidence, with the former falling back and the latter increasing. Over the quarter, the Topix Index delivered a positive return of 1.2%.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In the emerging markets, equities were helped by a weakening of the US dollar and supportive central banks and commodities. In Russia, central banks cut interest rates by more than expected in October and then again in December on the back of lower inflation expectations, while higher gas prices drove the commodity-sensitive market higher. In Brazil, interest rates were cut to 5%, their lowest ever level, while significant pension reform was passed that sees the pension age rise to 65 for men and 62 for women. Argentina continued to be volatile but saw some signs of stabilisation following the presidential elections in October. Over the period, the MSCI Emerging Markets Index delivered a positive return of 4.0%, while emerging markets fixed interest had a tough time, down sharply for much of the quarter before rallying strongly in December. As a result, the JPMorgan GBI Emerging Market Global Composite Bond Index fell back by -1.9% over the period.

All market performance figures are in GBP.

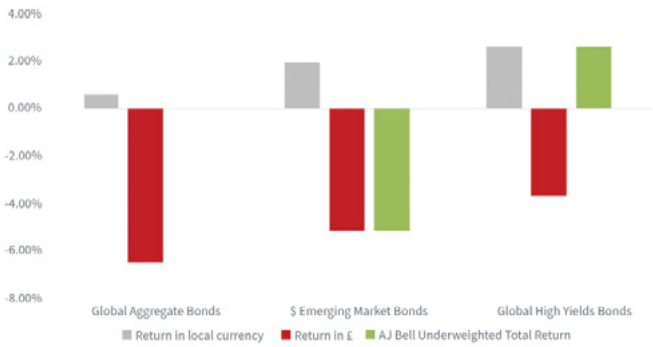
Asset allocation and positioning

Over the first half of 2019, we saw the situation of all major asset classes being up together, an unusual state of affairs and one we were sure would be unlikely to last. This indeed turned out to be the case after Q3, with fixed income and defensive sectors such as consumer staples being the best performers, whilst 'risk-on' assets such as growth equities, whilst still gaining, lagged behind the performance of bonds, as markets weighed up a number of threats to global growth and contended with ongoing political headwinds from a US/China trade war and a Brexit-led political logjam in the UK. It was interesting then, in Q4, to see market participants change tack, with most of Q3's winners becoming the laggards, as risk-taking and optimism returned to markets.

The big news of the quarter for UK-based investors was likely that of the General Election in December, in which Boris Johnson's Conservatives secured a significant majority, bringing an end to a Parliament led by a minority Government and riven with division and entrenchment, thus potentially allowing Johnson to bring some closure to the Brexit stalemate. Our portfolios have an element of

equity home bias inbuilt, as an output of our risk budgeting and, as such, all portfolios benefitted from the pop in UK equities, in particular those higher risk portfolios with not just larger weightings in UK equity, but also larger mid-cap exposures.

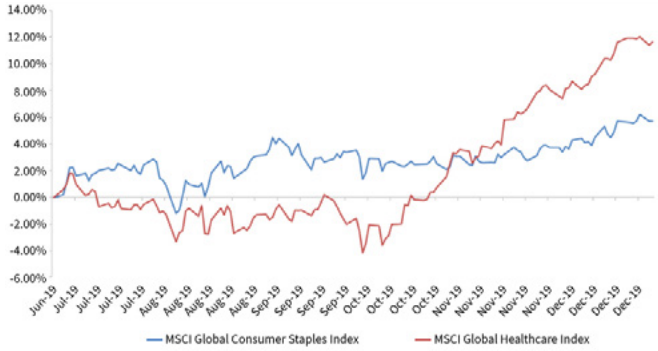
One corollary of the improved political landscape in the UK was a much improved sterling, which climbed sharply on the news, as investors saw the election result as a sign of increased stablilty and confidence. In contrast to last quarter, where a falling pound was a boon to our holdings overseas, this quarter we saw the opposite, as currency translation acted as a headwind to portfolios, weighing on returns originating outside the UK. This had an impact on asset classes across the board, with international equity returns being reduced in scale, whilst some local currency fixed-income gains were also significantly impacted. For instance dollar-denominated emerging market debt, up 1.95% in local currency terms, saw falls of -5.16% in sterling terms; Global High Yield, up 2.62% in local currency was down -3.72% when converted back to sterling; and, finally, Global Aggregate (an extremely broad government and corporate bond index) up 0.58% in local terms but off -6.53% in sterling. The team took the decision to remove Global Aggregate index exposures from our strategic asset allocation at the start of 2019, meaning we had no exposure to this asset class, in what was a tough quarter, whilst we also took the decision to hold sterling-hedged versions of Global High Yield positions in the portfolios, hence we retained the performance seen in the local currency:



Selected asset class returns for Q4 2019.

Source: AJ Bell Investments, Bloomberg LP, January 2020

As part of our process in considering asset allocation, in the main, we are trying to avoid being too heavily exposed to any one theme or asset class and instead utilise the multi-asset nature of our mandate to try and ensure we are sufficiently diversified and always have some elements working for us, even when others aren't. Last quarter, we drew attention to the performance of some equity sectors which were introduced into the portfolios at the start of 2019, when Global Consumer Staples and Global Healthcare were added to Global Technology. Last quarter, Consumer Staples was a big winner in the portfolios, as the defensive nature of the sector saw it outperform as investors were more risk averse, in general. Q4, however, saw Consumer Staples struggle for traction, whilst another ostensibly defensive sector, Healthcare, was a notable outperformer. The drivers behind this improvement in Healthcare were sector specific, as investors saw the sector as cheap, with constructive earnings and an improving environment going into the US Presidential Nominee race:



MSCI Global Consumer Staples Index & MSCI Global Healthcare Index returns; 1 July 2019–31 December 2019. Source: AJ Bell Investments, Bloomberg LP, January 2020.

This barbell approach to sectors, with some benefitting from defensive, risk-off environments (Consumer Staples and Healthcare) and others benefitting from more constructive, risk-on environments (Global Technology), as well as their own unique industry drivers, demonstrates our work to improve the diversification and risk-adjusted performance of the portfolios we run, such that there should always be something receiving the baton, as other areas of the portfolio are struggling. We hold Global Healthcare in all risk profiles in the growth range.

Asset allocation contributors

	Portfolio					
Top Contributors	MPS 1	MPS 2	MPS 3	MPS 4	MPS 5	MPS 6
1	Global Healthcare Equities	Global Healthcare Equities	UK Equities (Large Cap)	UK Equities (Large Cap)	UK Equities (Large Cap)	Emerging Markets Equities
2	UK Equities (Mid Cap)	UK Equities (Mid Cap)	UK Equities (Mid Cap)	UK Equities (Mid Cap)	UK Equities (Mid Cap)	UK Equities (Mid Cap)
3	UK Property (REITs)	UK Property (REITs)	Global Healthcare Equities	Global Healthcare Equities	Emerging Markets Equities	UK Equities (Large Cap)

Source: AJ Bell Investments, Bloomberg LP, January 2020

Passive Managed Portfolio review – Q4 2019

Passive MPS performance

Equities were the big winners in the portfolios in Q4, with most regions and sectors held showing positive gains for the period, despite a stronger sterling. The improved political climate in the UK saw notable gains in UK equities, with the UK mid-cap space posting strong quarterly gains of over 11%. We use the **Vanguard FTSE 250 Index ETF** in all of the portfolios, meaning all risk profiles saw gains from this holding in the quarter. Also posting strong performances were Healthcare holdings, as discussed and, higher up the risk spectrum, emerging market equities, which bounced back from a weak Q3 to post strong gains for the quarter. We use the i**Shares Core EM IMI ETF** in order to gain our emerging markets exposure, with the riskier portfolios having significantly higher weightings here and the fund posted gains of 4.12% in the period, in sterling.

In the main, fixed-income holdings in the portfolios had a more challenging time as investors regained confidence in growth and yields rose across most developed government bond complexes. We hold positions in short duration US Treasuries via the **Invesco US Treasury 1–3 Year ETF** in the lower risk MPS 1 and 2 portfolios and this holding saw falls of -6%, in sterling terms, over the quarter. In addition, as highlighted already, hard currency emerging market debt holdings – which we express via the **Vanguard USD Emerging Market Government Bond ETF** and included in all MPS models up

to and including MPS 4 – saw gains in local terms, but these became negatives when translated back into sterling.

At the higher risk end of the range, global technology continued to play a part in the returns, with the **iShares S&P 500 Information Technology Sector UCITS ETF** we hold in MPS 3 through 6 up over 6% in the quarter, whilst the **iShares Automation & Robotics ETF** which we hold only in MPS 6 as an additional Technology exposure also showed good gains, up almost 5% for the period.

Lastly, those portfolios with UK Property exposure (MPS 1 through 5) saw significant gains in the quarter from their holding of the **iShares MSCI Target UK Real Estate ETF**, an ETF which blends UK REITs with index-linked gilts, to reduce the volatility associated with REITS and which posted gains of over 7% in the quarter.

All other areas of the portfolios performed in line with expectations and, across our passive growth portfolios, it was pleasing to see gains in all of the risk profiles. Returns were dispersed quite evenly through the risk scale, with those portfolios lower down the risk spectrum – and with larger fixed income and defensive positioning – seeing smaller gains, whilst those higher up the risk spectrum and with larger equity exposures and less fixed income, saw larger gains.

Portfolio changes

In the portfolios, there were no changes to be seen in the quarter in terms of asset allocation, nor were there any changes in the makeup to the portfolio that were driven by the team. However, one holding change was enforced on the portfolios, with the unexpected announcement by BMO of their intention to close their successful range of passive ETFs. We held the **BMO Barclays Global High Yield £ Hedged ETF** in MPS 1 through 5 and, as a result, we took the decision to switch this holding into the **iShares Global High Yield £ Hedged ETF**, which follows a similar index and closely matched the characteristics of the BMO product. Whilst the exposures we have via the switch will be very similar, the iShares ETF is, it must be said, a little more expensive than the BMO product we held, at 0.55% versus 0.35% but, at present, the universe of passive, sterling-hedged Global High-Yield products is relatively undeveloped. As a result, we are working with other providers to broaden the options available, as well as continuing to engage iShares on the price point of their product, with the aim being to bring the cost of our holding in this asset class back down to the same or below that of our former holding. We hope to be able to update you on successful outcomes here in due course.

Elsewhere, we maintain a watching brief on developments in the passive ETF and indexing space as costs continue to fall across the providers' various ranges. Vanguard was the latest to cut costs across its range, with an announcement made to the market in Q4. This impacted one of our holdings – held in MPS 2 through 6 – the **Vanguard FTSE Asia Pacific ex Japan ETF**, whose OCF fell from 0.22% to 0.15% as a result of the cuts. Whilst none of our other holdings saw price-cuts in the period, we believe this speaks more to the fact that we are already using some of the most efficient and best value products available in the marketplace, but we remain alert and will act to make changes, should better products become available.

Performance summary (all models)

	3 months	6 months	1 year	Inception*
Passive MPS 1	0.41%	3.05%	10.22%	12.07%
Passive MPS 2	1.04%	3.67%	13.19%	17.04%
Passive MPS 3	1.89%	4.76%	16.60%	22.42%
Passive MPS 4	2.23%	5.17%	17.97%	25.85%
Passive MPS 5	2.65%	5.35%	19.41%	27.50%
Passive MPS 6	3.08%	4.58%	18.76%	13.09%

**All the portfolios launched on 18 August 2016, with the exception of MPS 6, which has a launch date of 19 February 2018. All performance is net of fees.*

Source: Bloomberg LP, AJ Bell Investments, January 2020

This report provides general information about the AJ Bell Managed Portfolio Service. It should not be read or construed as investment advice. It is your responsibility to assess your circumstances and make sure it is suitable for your needs.

The value of investments can go down as well as up and you may not get back your original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

The target yields are not guaranteed and can fluctuate.

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Economic and market review

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It was a remarkable quarter in the UK with the political landscape dramatically shifting, with Prime Minister Boris Johnson first managing to renegotiate the Brexit deal with the EU, then seeing his 31 October deadline pushed back to the end of January 2020 and then finally getting the General Election he craved. When the election came, it was the Conservative Party securing a large majority that finally looks to have brought some stability to politics in the UK. Investors welcomed this, with sterling strengthening sharply, hitting 1.35 against the US dollar at one point, up from 1.23 at the start of the quarter. Domestically-focused equities also rallied hard, with the FTSE 250 ex IT Index gaining over 6% in the two days following the election, as investors hoped that the handbrake would be released on the UK economy, which has shown GDP growth of 1.1% for the year. However, investors are well aware that attention will now turn to the trade negotiations with the EU and – with an ambitious timetable of just 11 months for completion – it wouldn't be a surprise if some degree of uncertainty returned to the UK during 2020, as it is remembered that the Brexit process remains in its early stages. Over the quarter, the FTSE All-Share Index gained 4.2%.

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In Asia, the continued unrest in Hong Kong dominated the news agenda as the protests and violence seemed to pick up pace. Chinese GDP growth came in at 6%, which initially sounds very healthy, but is actually the slowest growth since 1992, as the trade war continued to bite. There has long been talk of slowing growth in China, not least because of the pure size of the economy making it inevitable that growth has to moderate as it readjusts from an export-led economy to one more domestically focused. The Chinese central bank continues to support the economy and cut the reserve requirement for banks twice in quick succession. In South Korea, retail sales fell back sharply after signs of improvement over the summer, not helped by a steady pick-up in unemployment, while in India, the central bank cut interest rates, with investors hoping for further tax reforms to help boost the economy. Over the period, the MSCI AC Asia ex Japan Index rallied strongly, increasing by 4.0%, and, although over the year the index was up 13.6%, this actually made it the poorest performing region in the world.

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Asset allocation and positioning

When designing income products, the main decision to take as part of the asset allocation is what will be the asset class that provides the main income stream to investors. Will it be fixed income, whereby investments in bonds provide fixed coupons to generate a yield, or will it be equity income, wherby earnings from business, paid as dividends, will provide the yield? This decision is an important element in the performance seen in any income product, since in ordinary market circumstances, the inverse releationship of fixed income to equity means that if one of these asset classes is favoured by the market over the other, the experiences of a portfolio with predominantly fixed income yield will perform very differently to that of a portfolio with predominatly equity income yield. In Q3, nervousness around the prospects for the global economy, saw investors prefer fixed income assets, in the midst of geo-political headwinds in the form of a US-China trade war, Brexit and a UK general election, but in Q4 we saw a reversal of this theme, with Q3's losers becoming Q4's winners as easy central bank policy and a sanguine view of the political stories, saw investors regain their confidence and push into 'risk on' assets.

Our passive income MPS portfolios are built around two distinct mandates, one that targets a yield of 3%-5% with a capital protection target and one that targets the same yield but with a capital growth element. Whilst it may not seem that these two mandates are that disimilar, they necessitate very different portfolio allocations in order to achieve their aims, with the lower-risk portfolio, Passive Income 1 including fixed income, equities, property and cash, whilst the higher-risk, Passive Income 2, eschews fixed income for a blend of equities, property, global infrastructure and cash.

In Q4, with major asset classes experiencing very different performance, it was interesting to note the different outcomes for the two portfolios. Equities being the best-peforming asset class meant that Passive Income 2 performed well in the quarter. However, with fixed income, particularly in sterling terms, struggling in the quarter, we saw Passive Income MPS 1 somewhat hampered in the period.

The big news of the quarter for UK-based investors was likely that of the general election in December, in which Boris Johnson's Conservatives secured a significant majority, bringing an end to a Parliament led by a minority government and riven with division and entrenchment, potentially allowing him to bring some closure to the Brexit stalemate. Both passive income mandates have significant UK equity exposure built into the portfolios, with the UK having a good record of providing high and stable dividends, so this asset class was the single biggest contributor on a total return basis to the portfolios.

One corollary of the improved political landscape in the UK was a much improved sterling, which climbed sharply on the news, as investors saw the election result as a sign of increased stablilty and confidence. In contrast to last quarter, where a falling pound was a boon to our holdings overseas, this quarter we saw the opposite, as currency translation acted as a headwind to portfolios, weighing on returns originating outside the UK. This had an impact on asset classes across the board, with international equity returns being reduced in scale, whilst some local currency fixed income gains were also significantly impacted. For instance, dollar denominated Emerging Market government debt, up 2% in local currency terms, saw falls of -5.2% in sterling terms. US corporate bonds and US High Yield were also big casualties of this situation, up 1.2% and 2.6% respectively in local currency terms, but down -4.5% and -5.9% in sterling terms for the period. These falls had an outsized impact on the lower-risk, Passive Income 1, since the bulk of its assets are in fixed income.

In the higher-risk Passive Income 2 portfolio, the strong performance of equities in local currency terms, whilst hampered a little by sterling strength, helped performance, with all regions contributing positive performance in the quarter. With no fixed income held in the portfolio, the rest of the allocation is made up of global listed infrastructure and listed property (Global and UK). Global infrastructure, with its defensive, almost fixed income-like characteristics, saw falls in the period of -2.2%, but its relatively low weight meant it never had an outsized impact on returns. What was interesting to see was the diametrically opposite performances of global and UK property. With matching weightings in the portolio, relatively flat returns in local currency for Global Property translated into falls of -6.7% in sterling terms, versus gains of 7.4% for UK Property, all driven by the asset class itself, since there were no currency impacts. This highlights the outsized impact of the election on the portfolio, in that it not only drove returns directly in some asset classes, via improved investor confidence toward UK property for instance, but also had currency effects in other, otherwise unrelated ones.

Selected asset class returns for Q4 2019, Source: AJ Bell Investments, Bloomberg LP, January 2020

Passive Managed Portfolio review – Q4 2019

Passive Income MPS performance

Within the lower-risk Passive Income 1 portfolio, the best-performing asset class was UK equity, with our exposure here expressed solely via the **iShares FTSE 100 ETF**, which is used due to the favourable dividend yield seen on the index. Whilst mid-cap UK equities appreciated much more sharply than mega-caps post-election, the FTSE 100 still made respectable gains in the quarter, which helped performance. The biggest detractor in the portfolio was the holding of the **Vanguard USD Corporate Bond ETF**, as a challenging quarter for fixed income was further hampered by sterling appreciation, which saw the asset class post a loss of -5.5% in the quarter. In the higher-risk Passive Income 2 portfolio, the best-performing holding was the **iShares MSCI Target UK Real Estate ETF**, which was up 7.2% in the quarter on the back of improved confidence in UK property, post-election. This was offset, however, by relatively weak performance in the global listed property holding, the **L&G Global Real Estate Dividend Index Fund**, which suffered, with falls of -5.7% for the quarter. Elsewhere in Passive Income 2, UK equities were a good contributor, with gains for the **iShares FTSE 100 ETF** and the additional holding of the more mid-cap focused **SPDR UK Dividend Aristocrats ETF** was also a positive, up over 13.0% in the quarter.

Fund changes

In the portfolios there were no changes to be seen in the quarter in terms of asset allocation, nor were there any changes in the makeup to the portfolio that were driven by the team. However, two holding changes were applied to the portfolios, with the unexpected announcement by BMO of their intention to close their successful range of passive ETFs. We held the **BMO Barclays Global High Yield £ Hedged ETF** in Passive Income 1 and, as a result, we took the decision to switch this holding into the **iShares Global High Yield £ Hedged ETF**, which follows a similar index and closely matched the characteristics of the BMO product. Whilst the exposures we have via the switch will be very similar, the iShares ETF is, it must be said, a little more expensive than the BMO product we held, at 0.55% versus 0.35%, but at present the universe of passive, sterling-hedged Global High Yield products is relatively undeveloped. As a result, we are working with other providers to broaden the options available, as well as continuing to engage iShares on the price point of their product, with the aim being to bring the cost of our holding in this asset class back down to the same or below that of our former holding. We hope to be able to update you on successful outcomes

here in due course. In addition we held the **BMO Emerging Markets Income Leaders ETF** in both Passive Income portfolios and, as a result, we took the decision to exit this holding and consolidate the proceeds into the additional emerging market ETF we already held in the portfolio, the **Vanguard FTSE Emerging Market ETF**, since it was a fund we were already comfortable using and it also carried a favourable dividend and a low OCF.

Elsewhere, we maintain a watching brief on developments in the passive ETF and indexing space, as costs continue to fall across the providers' various ranges. Vanguard was the latest to cut costs across their range, with an announcement made to the market in Q4. This impacted some of our holdings; the **Vanguard FTSE Emerging Market ETF**, held in both portfolios, saw its OCF fall from 0.25% to 0.22%, whilst the **Vanguard USD Corporate Bond ETF**, held in Passive Income 1, saw its OCF fall from 0.12% to 0.09%, as a result of the cuts. Whilst none of our other holdings saw price cuts in the period, we believe this speaks more to the fact that we are already using some of the most efficient and best-value products available in the marketplace, but we remain alert and will act to make changes, should better products become available.

Performance summary (all models)

	3 months	6 months	1 year	Inception*
Passive MPS Income 1	-1.02%	1.30%	11.91%	12.85%
Passive MPS Income 2	1.15%	4.07%	15.77%	16.70%

**Both portfolios launched on 19 February 2018. All performance is net of fees.*

Source: Bloomberg LP, AJ Bell Investments, January 2020

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The target yields are not guaranteed and can fluctuate.

AJB/QR/P-INC/MPS/20200115

AJBell

AJ Bell Active MPS – Q4 2019 report

Introduction

We are delighted to bring you the latest quarterly report from AJ Bell Investments. This report is designed to keep you up to date on what is happening with your AJ Bell managed investments. It covers the major macroeconomic events of the past three months, looks at how these have impacted the portfolios and highlights any changes made in the period.

Summary

With signs of political stabilisation in the UK and elements of a partial trade deal between the US and China, equities finished 2019 in very strong fashion. With a further interest-rate cut from the Federal Reserve and stimulus from the likes of China and the ECB, investors continue to pin their hopes on central bank support and this drove equity markets higher.

In the UK, the deadlock in Parliament was broken with the General Election and now the Brexit process moves on to the trade negotiations. Those hoping that the Withdrawal Agreement would be the end of the process were rapidly reminded it was just the end of the beginning! Nonetheless, with some element of clarity, bond yields moved higher as the immediate risk of a hard Brexit subsided.

Economic and market review

The fourth quarter of 2019 saw equity markets climb higher but most of this pick-up in equities came in the last couple of weeks when the traditional 'Santa rally' seemed to be in full swing following the outcome of the UK General Election. Returns were even stronger in local currency terms but a rise in sterling in the final quarter held back returns in overseas equities. This positive end to the year brought to a close a phenomenally strong year for equities, which started 2019 on the back foot and finished it with the MSCI World Index up 22.7%. It wasn't just equities that had a strong year, with bond markets performing well too as central banks around the world continued to provide positive conditions for all assets.

It was a remarkable quarter in the UK with the political landscape dramatically shifting, with Prime Minister Boris Johnson first managing to renegotiate the Brexit deal with the EU, then seeing his 31 October deadline pushed back to the end of January 2020 and then finally getting the General Election he craved. When the election came, it was the Conservative Party securing a large majority that finally looks to have brought some stability to politics in the UK. Investors welcomed this, with sterling strengthening sharply, hitting 1.35 against the US dollar at one point, up from 1.23 at the start of the quarter. Domestically-focused equities also rallied hard, with the FTSE 250 ex IT Index gaining over 6% in the two days following the election, as investors hoped that the handbrake would be released on the UK economy, which has shown GDP growth of 1.1% for the year. However, investors are well aware that attention will now turn to the trade negotiations with the EU and – with an ambitious timetable of just 11 months for completion – it wouldn't be a surprise if some degree of uncertainty returned to the UK during 2020, as it is remembered that the Brexit process remains in its early stages. Over the quarter, the FTSE All-Share Index gained 4.2%.

Source: Bloomberg LP, AJ Bell Investments, January 2020

As some degree of clarity appeared in the UK over the quarter, the 10yr gilt yield climbed sharply, starting the quarter at just 0.49% but ending the quarter at 0.83%, representing a significant sell-off as fears of an immediate hard Brexit reduced. This saw the FTSE Actuaries UK Conventional Gilts All Stocks Index fall back by -3.9% over the quarter, while UK corporate bonds performed somewhat better with the iBoxx UK Sterling Corporate All Maturities Index, but still delivered a negative return of -0.2%. With investors having confidence, it was a strong quarter for high-yield bonds with the Bloomberg Barclays Global High Yield Bond GBP Hedged Index growing strongly with a return of 2.4%.

In the US, there was significant activity at both an economic and political level of the quarter. With some signs early in the quarter that the US economy was slowing, the Federal Reserve cut interest rates for the third time this year amid concerns of slowing job creation and lower consumer confidence. The trade war continues to be the main focus for investors and there were positive signs in October when President Trump announced a 'phase one' trade deal with China. However, it is recognised that this element of the trade deal is relatively limited and much more serious talks will be needed to find a proper resolution. US corporate performance remained solid over the quarter, with earnings growth surpassing expectations while GDP growth came in at 2.1%. The major political development over the quarter was the impeachment of President Trump over allegations that he sought help from Ukraine to boost his re-election hopes. This will see a trial held by the Senate in January that will decide whether or not Trump is found guilty and potentially removed from office. Investors were relatively unmoved by the initial decision, although this may change in January once the trial gets underway. Over the quarter, equities increased sharply, with the S&P 500 Index increasing by 1.3% and hitting record highs. This performance meant that the index has delivered a remarkable 25.7% during 2019. Despite the interest-rate cut, the US 10-year Treasury yield increased from 1.67% at the start of the quarter to 1.91% at the end of the quarter, as expectations of further cuts in 2020 reduced.

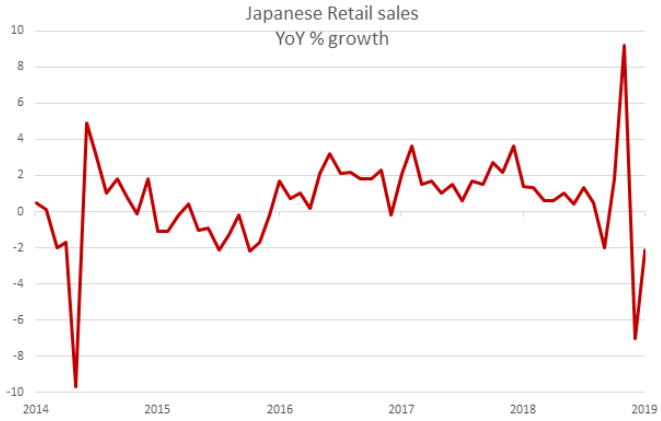
Source: Bloomberg LP, AJ Bell Investments, January 2020

In Europe, data remained mixed as the major economies continued to be held back by the ongoing trade war and slowing growth in Asia. The quarter saw Mario Draghi step down as Chairman of the ECB with Christine Lagarde talking his place; in her first speech she made it clear that the region could no longer rely on exports for growth and had to boost domestic demand with a clear expectation that government spending should increase. These comments seemed particularly directed at Germany, which has been reluctant to unleash some of its huge budget surplus. With manufacturing data showing the largest decline for seven years and new orders declining for the 15th month in a row, it is clear that it will take a concerted effort from both the ECB and domestic governments to help the Eurozone out of its malaise. Despite challenging economic conditions, the MSCI Europe ex UK Index increased by 0.9% over the quarter.

In Asia, the continued unrest in Hong Kong dominated the news agenda as the protests and violence seemed to pick up pace. Chinese GDP growth came in at 6%, which initially sounds very healthy, but is actually the slowest growth since 1992, as the trade war continued to bite. There has long been talk of slowing growth in China, not least because of the pure size of the economy making it inevitable that growth has to moderate as it readjusts from an export-led economy to one more domestically focused. The Chinese central bank continues to support the economy and cut the reserve requirement for banks twice in quick succession. In South Korea, retail sales fell back sharply after signs of improvement over the summer, not helped by a steady pick-up in unemployment, while in India, the central bank cut interest rates, with investors hoping for further tax reforms to help boost the economy. Over the period, the MSCI AC Asia ex Japan Index rallied strongly, increasing by 4.0%, and, although over the year the index was up 13.6%, this actually made it the poorest performing region in the world.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In Japan, consumption tax was increased at the start of October and this combined with a huge typhoon saw retail sales fall sharply in October, however these rebounded in November. Annual GDP growth came in at 1.7%, much higher than had been seen for the previous year, while there were tentative signs that inflation was picking up after falling back in the first half of 2019. However, there were mixed signals from business and consumer confidence, with the former falling back and the latter increasing. Over the quarter, the Topix Index delivered a positive return of 1.2%.



Source: Bloomberg LP, AJ Bell Investments, January 2020

In the emerging markets, equities were helped by a weakening of the US dollar and supportive central banks and commodities. In Russia, central banks cut interest rates by more than expected in October and then again in December on the back of lower inflation expectations, while higher gas prices drove the commodity-sensitive market higher. In Brazil, interest rates were cut to 5%, their lowest ever level, while significant pension reform was passed that sees the pension age rise to 65 for men and 62 for women. Argentina continued to be volatile but saw some signs of stabilisation following the presidential elections in October. Over the period, the MSCI Emerging Markets Index delivered a positive return of 4.0%, while emerging markets fixed interest had a tough time, down sharply for much of the quarter before rallying strongly in December. As a result, the JPMorgan GBI Emerging Market Global Composite Bond Index fell back by -1.9% over the period.

All market performance figures are in GBP.

Active Managed Portfolio review – Q4 2019

Active MPS performance

With equities ending the year strongly, it was another positive quarter for the Active portfolios, with all portfolios ending the period in positive territory and ending the calendar year with strong returns. UK equities were very positive while Asian and emerging market equities also contributed strongly to returns. Fixed interest was mixed over the period, with government bonds falling back while high-yield bonds benefited from the positive environment for risk.

In the UK, the market was positive overall but this doesn't show the wide range of returns within the market. With the Conservatives winning the General Election, domestically-focused equities rallied hard, much to the benefit of the Man GLG Undervalued Assets fund (Portfolio 1–6). The defensively positioned Troy Trojan Income fund (Portfolio 1–6) understandably lagged behind the market, while the core holding of the Investec UK Alpha fund (Portfolio 3–6) was also behind. Smaller companies were big beneficiaries of the 'risk-on' environment and therefore the Tellworth UK Smaller Companies fund (Portfolio 5–6) had a very strong quarter.

In the US, it was a complete reversal of the previous quarter with the lower risk JP Morgan US Equity Income fund (Portfolio 1–2) behind the index. The value style has been out of favour for some time but, during the quarter, the Dodge & Cox US Stock fund (Portfolio

3–6) performed well, outperforming the broader market. The sector positions of Healthcare and Technology were strong both in absolute and relative terms. Healthcare performed very strongly and this was captured via the Xtrackers MSCI USA Healthcare ETF (Portfolio 1–6) while Technology also outperformed the broad market with the US-focused Polar Cap Global Technology fund (Portfolio 3–6) performing well.

In Europe, exposure comes from the Crux European Special Situations fund (Portfolio 2–6), which performed strongly as its tilt towards medium-sized companies paid off over the quarter, with a particularly strong performance in December when equities climbed sharply.

In Asia, our core exposure to the Invesco Asian fund (Portfolio 2–6) reversed its positive performance in the last quarter to marginally lag behind the index while the Schroder Asian Alpha Plus fund (Portfolio 4–6) was ahead of the index. The Stewart Asia Pacific Leaders fund (Portfolio 5–6) naturally lags behind a strong market, performing well when volatility increases, so it was no surprise to see them behind the market as equities rallied. The Fidelity Asian Values IT (Portfolio 6) was weak over the quarter as its focus on smaller companies went unrewarded.

In emerging markets, the Fidelity Emerging Markets fund (Portfolio 4–6) was ahead of the benchmark, making it four consecutive quarters of outperformance, with strong absolute returns. The Lazard Emerging Markets fund (Portfolio 6) has a value tilt and this style was fractionally ahead of the market over the period. The JP Morgan Emerging Markets Income fund (Portfolio 2–6) is focused on high-quality companies and therefore typically lags behind in a rapidly rising market. This proved to be the case during the final quarter of the year.

In Japan, the Man GLG Japan Alpha fund finished the quarter a little behind the Topix Index, as its value focus was relatively neutral. The Evenlode Global Income fund (Portfolio 1–5) is in the portfolio as a method of gaining exposure to consumer staples stocks. This sector significantly underperformed broader equities as their defensive characteristics were shunned in favour of higher risk equities. While Evenlode underperformed broad equities, they significantly outperformed consumer staples stocks.

Fixed-interest markets delivered a mixed performance with differing levels of credit risk performing quite differently. With weak UK Government bonds, the short duration Lyxor UK Gilt 0–5yr ETF (Portfolio 1–3), fell back a little in absolute terms but significantly outperformed traditional gilts, while, in the US, the Invesco US Treasury Bond 1–3yr ETF (Portfolio 1–2) fell back in absolute terms as the unhedged US dollar exposure hurt, given sterling rallied strongly.

In investment grade corporate bonds, the TwentyFour Corporate Bond fund (Portfolio 1–4) performed broadly flat relative to peers while the Fidelity MoneyBuilder Income fund (Portfolio 1–3), which typically has a slightly longer duration stance, was a little behind. The iShares USD Corporate Bond ETF (Portfolio 1–3) performed well with no currency headwind given the hedged nature of the strategy.

Within the high-yield market, performance of the Baillie Gifford High Yield Bond fund (Portfolio 1–5) was positive in absolute terms but behind the index over the quarter. The style of the fund is typically exposed to the higher quality end of the high-yield market and therefore lagging behind a strongly rising market is in line with expectations. The Royal London Short Duration Global High Yield Bond fund (Portfolio 1–4) was also up in absolute terms. Away from UK fixed interest, the M&G Emerging Markets Bond fund (Portfolio 1–5) had a very strong December but this wasn't enough to offset a weaker performance earlier in the quarter in line with broader emerging market bonds.

The final area of the portfolio is the commercial property allocation, which continues to be zero-weighted due to expectations of weak performance, liquidity risks and Brexit concerns. Having mentioned in the previous report that we saw these risks increasing, this stance was vindicated during the quarter with the news that the M&G Property fund had suspended due to liquidity problems. The Janus Henderson UK Absolute Return fund (Portfolio 1–5) delivered positive returns over the quarter while the average physical property fund fell back.

Portfolio changes

There were no major changes made during the quarter, however, towards the end of the period, we were able to negotiate access to a cheaper share class for the Fidelity MoneyBuilder Income fund (Portfolio 1–3) exclusively for users of our MPS. The shares class is 0.20% cheaper than the incumbent share class at 0.36% OCF, representing excellent value for actively-managed UK investment grade fixed interest. This change is live for all new clients and existing investors are in the process of being converted into the cheaper share class.

Performance summary (all models)

	3 months	6 months	1 year	Inception*
Active MPS 1	0.25%	2.46%	8.88%	8.57%
Active MPS 2	1.02%	3.23%	11.87%	9.56%
Active MPS 3	2.12%	4.18%	14.89%	11.28%
Active MPS 4	2.77%	4.73%	16.60%	11.95%
Active MPS 5	3.45%	5.16%	18.68%	11.99%
Active MPS 6	3.60%	4.47%	18.73%	10.38%

**Active MPS launched on 19 February 2018.*

Source: Bloomberg, AJ Bell Investments; January 2020

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It was a remarkable quarter in the UK with the political landscape dramatically shifting, with Prime Minister Boris Johnson first managing to renegotiate the Brexit deal with the EU, then seeing his 31 October deadline pushed back to the end of January 2020 and then finally getting the General Election he craved. When the election came, it was the Conservative Party securing a large majority that finally looks to have brought some stability to politics in the UK. Investors welcomed this, with sterling strengthening sharply, hitting 1.35 against the US dollar at one point, up from 1.23 at the start of the quarter. Domestically-focused equities also rallied hard, with the FTSE 250 ex IT Index gaining over 6% in the two days following the election, as investors hoped that the handbrake would be released on the UK economy, which has shown GDP growth of 1.1% for the year. However, investors are well aware that attention will now turn to the trade negotiations with the EU and – with an ambitious timetable of just 11 months for completion – it wouldn't be a surprise if some degree of uncertainty returned to the UK during 2020, as it is remembered that the Brexit process remains in its early stages. Over the quarter, the FTSE All-Share Index gained 4.2%.

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In the US, there was significant activity at both an economic and political level of the quarter. With some signs early in the quarter that the US economy was slowing, the Federal Reserve cut interest rates for the third time this year amid concerns of slowing job creation and lower consumer confidence. The trade war continues to be the main focus for investors and there were positive signs in October when President Trump announced a 'phase one' trade deal with China. However, it is recognised that this element of the trade deal is relatively limited and much more serious talks will be needed to find a proper resolution. US corporate performance remained solid over the quarter, with earnings growth surpassing expectations while GDP growth came in at 2.1%. The major political development over the quarter was the impeachment of President Trump over allegations that he sought help from Ukraine to boost his re-election hopes. This will see a trial held by the Senate in January that will decide whether or not Trump is found guilty and potentially removed from office. Investors were relatively unmoved by the initial decision, although this may change in January once the trial gets underway. Over the quarter, equities increased sharply, with the S&P 500 Index increasing by 1.3% and hitting record highs. This performance meant that the index has delivered a remarkable 25.7% during 2019. Despite the interest-rate cut, the US 10-year Treasury yield increased from 1.67% at the start of the quarter to 1.91% at the end of the quarter, as expectations of further cuts in 2020 reduced.

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In Europe, data remained mixed as the major economies continued to be held back by the ongoing trade war and slowing growth in Asia. The quarter saw Mario Draghi step down as Chairman of the ECB with Christine Lagarde talking his place; in her first speech she made it clear that the region could no longer rely on exports for growth and had to boost domestic demand with a clear expectation that government spending should increase. These comments seemed particularly directed at Germany, which has been reluctant to unleash some of its huge budget surplus. With manufacturing data showing the largest decline for seven years and new orders declining for the 15th month in a row, it is clear that it will take a concerted effort from both the ECB and domestic governments to help the Eurozone out of its malaise. Despite challenging economic conditions, the MSCI Europe ex UK Index increased by 0.9% over the quarter.

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In the emerging markets, equities were helped by a weakening of the US dollar and supportive central banks and commodities. In Russia, central banks cut interest rates by more than expected in October and then again in December on the back of lower inflation expectations, while higher gas prices drove the commodity-sensitive market higher. In Brazil, interest rates were cut to 5%, their lowest ever level, while significant pension reform was passed that sees the pension age rise to 65 for men and 62 for women. Argentina continued to be volatile but saw some signs of stabilisation following the presidential elections in October. Over the period, the MSCI Emerging Markets Index delivered a positive return of 4.0%, while emerging markets fixed interest had a tough time, down sharply for much of the quarter before rallying strongly in December. As a result, the JPMorgan GBI Emerging Market Global Composite Bond Index fell back by -1.9% over the period.

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Active Managed Portfolio review – Q4 2019

Active Income MPS performance

With equities ending the year strongly, it was another positive quarter for the Active Income portfolios, with all portfolios ending the period in positive territory and ending the calendar year with strong returns. UK equities were very positive while Asian and emerging market equities also contributed strongly to returns. Fixed interest was mixed over the period, with government bonds falling back while high-yield bonds benefited from the positive environment for risk.

In the UK, the market was positive overall but this doesn't show the wide range of returns within the market. With the Conservatives winning the General Election, domestically-focused equities rallied hard, much to the benefit of the Man GLG UK Income fund. The defensively positioned Troy Trojan Income fund understandably lagged behind the market while smaller companies were big beneficiaries of the 'risk-on' environment and therefore the Montanaro UK Income fund (Income 2) had a very strong quarter.

Within global equities, the value-tilted Artemis Global Income fund (Income 2) performed well as its style returned to favour, strongly outperforming global equities. The core position of BNY Global Income (Income 2) fell back over the quarter as its defensive style lagged behind the market.

Looking at the regional allocations, it was a consistent picture with the income style performing well in absolute terms but lagging

behind broader markets as the risk-on environment favoured growth investing. As a result, the BlackRock Continental European Income fund performed well but was marginally behind the broader European equity market, while the higher quality approach of the JP Morgan US Equity Income fund (Income 2) lagged behind the S&P 500 Index. Asia and the emerging markets saw very strong absolute returns over the quarter and this was reflected in the performance of the Jupiter Asian Income fund, JP Morgan Emerging Markets Income fund and the Schroder Oriental Income investment trust (Income 2).

In the alternatives exposure, UK property was a very strong performer, helped by the post-election rally in December. The iShares MSCI UK Target Real Estate ETF (Income 2) was up sharply over the quarter, however, the internationally-focused L&G Global Real Estate Dividend Index fund went from being the best performer in the third quarter to the worst in the fourth quarter as the strength of sterling significantly hit returns. In infrastructure, the relatively defensive Legg Mason RARE Global Infrastructure Income fund was marginally negative over the quarter.

Fixed-interest (Income 1) performance was mixed over the period, with bonds focused away from sterling performing poorly given the strength of the currency over the quarter. The Lyxor UK Gilt 0–5yr ETF fell back slightly in absolute terms but significantly outperformed traditional gilts while the Invesco US Treasury Bonds 3–7yrs ETF fell sharply given its exposure to the US dollar.

In investment grade corporate bonds, the TwentyFour Corporate Bond fund performed broadly flat relative to peers while the Royal London Corporate Bond fund was helped by exposure to financial bonds. Exposure to investment grade bonds in the US through the Vanguard USD Corporate Bond ETF was negative, again driven by currency rather than the underlying bonds.

Within the high-yield market, performance of the Baillie Gifford High Yield Bond fund was positive in absolute terms but behind the index over the quarter. The style of the fund is typically exposed to the higher quality end of the high yield market and therefore lagging behind a strongly rising market is in line with expectations. The SPDR Bloomberg Barclays 0–5yr US High Yield Bond ETF was negative due to the weakness of the US dollar.

In emerging market bonds, the M&G Emerging Markets Bond fund had a very strong December but this wasn't enough to offset a weaker performance earlier in the quarter in line with broader emerging market bonds, which meant that the passively-managed L&G Emerging Markets Government Bond Local Currency Index fund also fell back over the period.

Portfolio changes

No changes were made to the portfolios over the quarter.

Performance summary (all models)

Funds	3 months	6 months	1 year	Inception*
Active MPS Income 1	-0.35%	2.26%	14.02%	11.24%
Active MPS Income 2	3.06%	6.05%	20.02%	16.00%

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Summary

With signs of political stabilisation in the UK and elements of a partial trade deal between the US and China, equities finished 2019 in very strong fashion. With a further interest-rate cut from the Federal Reserve and stimulus from the likes of China and the ECB, investors continue to pin their hopes on central bank support and this drove equity markets higher.

In the UK, the deadlock in Parliament was broken with the General Election and now the Brexit process moves on to the trade negotiations. Those hoping that the Withdrawal Agreement would be the end of the process were rapidly reminded it was just the end of the beginning! Nonetheless, with some element of clarity, bond yields moved higher as the immediate risk of a hard Brexit subsided.

Economic and market review

The fourth quarter of 2019 saw equity markets climb higher but most of this pick-up in equities came in the last couple of weeks when the traditional 'Santa rally' seemed to be in full swing following the outcome of the UK General Election. Returns were even stronger in local currency terms but a rise in sterling in the final quarter held back returns in overseas equities. This positive end to the year brought to a close a phenomenally strong year for equities, which started 2019 on the back foot and finished it with the MSCI World Index up 22.7%. It wasn't just equities that had a strong year, with bond markets performing well too as central banks around the world continued to provide positive conditions for all assets.

It was a remarkable quarter in the UK with the political landscape dramatically shifting, with Prime Minister Boris Johnson first managing to renegotiate the Brexit deal with the EU, then seeing his 31 October deadline pushed back to the end of January 2020 and then finally getting the General Election he craved. When the election came, it was the Conservative Party securing a large majority that finally looks to have brought some stability to politics in the UK. Investors welcomed this, with sterling strengthening sharply, hitting 1.35 against the US dollar at one point, up from 1.23 at the start of the quarter. Domestically-focused equities also rallied hard, with the FTSE 250 ex IT Index gaining over 6% in the two days following the election, as investors hoped that the handbrake would be released on the UK economy, which has shown GDP growth of 1.1% for the year. However, investors are well aware that attention will now turn to the trade negotiations with the EU and – with an ambitious timetable of just 11 months for completion – it wouldn't be a surprise if some degree of uncertainty returned to the UK during 2020, as it is remembered that the Brexit process remains in its early stages. Over the quarter, the FTSE All-Share Index gained 4.2%.

Source: Bloomberg LP, AJ Bell Investments, January 2020

As some degree of clarity appeared in the UK over the quarter, the 10yr gilt yield climbed sharply, starting the quarter at just 0.49% but ending the quarter at 0.83%, representing a significant sell-off as fears of an immediate hard Brexit reduced. This saw the FTSE Actuaries UK Conventional Gilts All Stocks Index fall back by -3.9% over the quarter, while UK corporate bonds performed somewhat better with the iBoxx UK Sterling Corporate All Maturities Index, but still delivered a negative return of -0.2%. With investors having confidence, it was a strong quarter for high-yield bonds with the Bloomberg Barclays Global High Yield Bond GBP Hedged Index growing strongly with a return of 2.4%.

In the US, there was significant activity at both an economic and political level for the quarter. With some signs early in the quarter that the US economy was slowing, the Federal Reserve cut interest rates for the third time this year amid concerns of slowing job creation and lower consumer confidence. The trade war continues to be the main focus for investors and there were positive signs in October when President Trump announced a 'phase one' trade deal with China. However, it is recognised that this element of the trade deal is relatively limited and much more serious talks will be needed to find a proper resolution. US corporate performance remained solid over the quarter, with earnings growth surpassing expectations while GDP growth came in at 2.1%. The major political development over the quarter was the impeachment of President Trump over allegations that he sought help from Ukraine to boost his re-election hopes. This will see a trial held by the Senate in January that will decide whether or not Trump is found guilty and potentially removed from office. Investors were relatively unmoved by the initial decision, although this may change in January once the trial gets underway. Over the quarter, equities increased sharply, with the S&P 500 Index increasing by 1.3% and hitting record highs. This performance meant that the index has delivered a remarkable 25.7% during 2019. Despite the interest-rate cut, the US 10-year Treasury yield increased from 1.67% at the start of the quarter to 1.91% at the end of the quarter, as expectations of further cuts in 2020 reduced.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In Europe, data remained mixed as the major economies continued to be held back by the ongoing trade war and slowing growth in Asia. The quarter saw Mario Draghi step down as Chairman of the ECB with Christine Lagarde talking his place; in her first speech she made it clear that the region could no longer rely on exports for growth and had to boost domestic demand with a clear expectation that government spending should increase. These comments seemed particularly directed at Germany, which has been reluctant to unleash some of its huge budget surplus. With manufacturing data showing the largest decline for seven years and new orders declining for the 15th month in a row, it is clear that it will take a concerted effort from both the ECB and domestic governments to help the Eurozone out of its malaise. Despite challenging economic conditions, the MSCI Europe ex UK Index increased by 0.9% over the quarter.

In Asia, the continued unrest in Hong Kong dominated the news agenda as the protests and violence seemed to pick up pace. Chinese GDP growth came in at 6%, which initially sounds very healthy, but is actually the slowest growth since 1992, as the trade war continued to bite. There has long been talk of slowing growth in China, not least because of the pure size of the economy making it inevitable that growth has to moderate as it readjusts from an export-led economy to one more domestically focused. The Chinese central bank continues to support the economy and cut the reserve requirement for banks twice in quick succession. In South Korea, retail sales fell back sharply after signs of improvement over the summer, not helped by a steady pick-up in unemployment, while in India, the central bank cut interest rates, with investors hoping for further tax reforms to help boost the economy. Over the period, the MSCI AC Asia ex Japan Index rallied strongly, increasing by 4.0%, and, although over the year the index was up 13.6%, this actually made it the poorest performing region in the world.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In Japan, consumption tax was increased at the start of October and this combined with a huge typhoon saw retail sales fall sharply in October, however these rebounded in November. Annual GDP growth came in at 1.7%, much higher than had been seen for the previous year, while there were tentative signs that inflation was picking up after falling back in the first half of 2019. However, there were mixed signals from business and consumer confidence, with the former falling back and the latter increasing. Over the quarter, the Topix Index delivered a positive return of 1.2%.

Source: Bloomberg LP, AJ Bell Investments, January 2020

In the emerging markets, equities were helped by a weakening of the US dollar and supportive central banks and commodities. In Russia, central banks cut interest rates by more than expected in October and then again in December on the back of lower inflation expectations, while higher gas prices drove the commodity-sensitive market higher. In Brazil, interest rates were cut to 5%, their lowest ever level, while significant pension reform was passed that sees the pension age rise to 65 for men and 62 for women. Argentina continued to be volatile but saw some signs of stabilisation following the presidential elections in October. Over the period, the MSCI Emerging Markets Index delivered a positive return of 4.0%, while emerging markets fixed interest had a tough time, down sharply for much of the quarter before rallying strongly in December. As a result, the JPMorgan GBI Emerging Market Global Composite Bond Index fell back by -1.9% over the period.

All market performance figures are in GBP.

Pactive Managed Portfolio review – Q4 2019

Pactive MPS performance

With equities ending the year strongly, it was another positive quarter for the Pactive portfolios, which all ended the period in positive territory, and ended the year with strong returns following their launch in February. UK equities were very positive while Asian and emerging market equities also contributed strongly to returns. Fixed interest was mixed over the period, with government bonds falling back while high-yield bonds benefited from the positive environment for risk.

In the UK, the market was positive overall but this doesn't show the wide range of returns within the market. With the Conservatives winning the general election, domestically-focused equities rallied hard, much to the benefit of the Man GLG Undervalued Assets fund (Portfolios 1–6). The defensively positioned Troy Trojan Income fund (Portfolios 1–6) understandably lagged behind the market, while the core holding of the Investec UK Alpha fund (Portfolios 3–6) was also behind. Smaller companies were big beneficiaries of the 'risk-on' environment and therefore the Tellworth UK Smaller Companies fund (Portfolios 5–6) had a very strong quarter.

In the US, it was a complete reversal of the previous quarter, with the lower risk JP Morgan US Equity Income fund (Portfolios 1–2) behind the index. The value style has been out of favour for some time but, during the quarter, the Dodge & Cox US Stock fund (Portfolios 3–6) performed well, outperforming the broader market.

The sector positions of Healthcare and Technology were strong both in absolute and relative terms. Healthcare performed very strongly and this was captured via the Xtrackers MSCI USA Healthcare ETF (Portfolios 1–6) while Technology also outperformed the broad market with the US-focused Polar Cap Global Technology fund (Portfolios 3–6) performing well.

In Europe, exposure comes from the Crux European Special Situations fund (Portfolios 2–6), which performed strongly as its tilt towards medium-sized companies paid off over the quarter, with a particularly strong performance in December when equities climbed sharply.

In Asia, our core exposure to the Invesco Asian fund (Portfolios 2–6) reversed its positive performance in the last quarter to marginally lag behind the index, while the Schroder Asian Alpha Plus fund (Portfolios 4–6) was ahead of the index. The Stewart Asia Pacific Leaders fund (Portfolios 5–6) naturally lags behind a strong market, performing well when volatility increases, so it was no surprise to see them behind the market as equities rallied.

In emerging markets, the Fidelity Emerging Markets fund (Portfolios 4–6) was ahead of the benchmark, making it four consecutive quarters of outperformance, with strong absolute returns. The Lazard Emerging Markets fund (Portfolio 6) has a value tilt and this style was fractionally ahead of the market over the period. The JP Morgan Emerging Markets Income fund (Portfolios 2–6) is focused on high-quality companies and therefore typically lags behind in a rapidly rising market. This proved to be the case during the final quarter of the year.

In Japan, the Man GLG Japan Alpha fund (Portfolios 1-6) finished the quarter a little behind the Topix Index, as its value focus was relatively neutral. The Evenlode Global Income fund (Portfolios 1–5) is in the portfolio as a method of gaining exposure to consumer staples stocks. This sector significantly underperformed broader equities as their defensive characteristics were shunned in favour of higher-risk equities. While Evenlode underperformed broad equities, they significantly outperformed consumer staples stocks.

Fixed-interest markets delivered a mixed performance, with differing levels of credit risk performing quite differently. With weak UK Government bonds, the short duration Lyxor UK Gilt 0–5yr ETF (Portfolios 1–2), fell back a little in absolute terms but significantly outperformed traditional gilts.

In investment grade corporate bonds, the TwentyFour Corporate Bond fund (Portfolios 1–4) performed broadly flat relative to peers, while the Fidelity MoneyBuilder Income fund (Portfolios 1–3), which typically has a slightly longer duration stance, was a little behind. The iShares USD Corporate Bond ETF (Portfolios 1–3) performed well with no currency headwind given the hedged nature of the strategy.

Within the high-yield market, performance of the Baillie Gifford High Yield Bond fund (Portfolios 1–5) was positive in absolute terms but behind the index over the quarter. The style of the fund is typically exposed to the higher quality end of the high-yield market and therefore lagging behind a strongly rising market is in line with expectations. The Royal London Short Duration Global High Yield Bond fund (Portfolios 1–4) was also up in absolute terms. Away from UK fixed interest, the M&G Emerging Markets Bond fund (Portfolios 1–4) had a very strong December but this wasn't enough to offset a weaker performance earlier in the quarter, in line with broader emerging market bonds.

The final area of the portfolio is the commercial property allocation, which continues to be zero-weighted due to expectations of weak performance, liquidity risks and Brexit concerns. Having mentioned in the previous report that we saw these risks increasing, this stance was vindicated during the quarter with the news that the M&G Property fund had suspended due to liquidity problems. The Janus Henderson UK Absolute Return fund (Portfolios 1–5) delivered positive returns over the quarter while the average physical property fund fell back.

Portfolio changes

There were no major changes made during the quarter, however, towards the end of the period, we were able to negotiate access to a cheaper share class for the Fidelity MoneyBuilder Income fund (Portfolios 1–3) exclusively for users of our MPS. The share class is 0.20% cheaper than the incumbent share class at 0.36% OCF, representing excellent value for actively-managed UK investment grade fixed interest. This change is live for all new clients and existing investors are in the process of being converted into the cheaper share class.

Performance summary (all models)

	3 months	6 months	1 year	Inception*
Pactive MPS 1	0.59%	2.76%	-	6.55%
Pactive MPS 2	1.14%	3.37%	-	8.00%
Pactive MPS 3	2.06%	4.39%	-	9.75%
Pactive MPS 4	2.56%	4.81%	-	10.23%
Pactive MPS 5	3.17%	5.08%	-	10.89%
Pactive MPS 6	3.43%	4.43%	-	10.41%

**Pactive MPS launched on 18 February 2019.*

Source: Bloomberg, AJ Bell Investments; January 2020.

This report provides general information about the AJ Bell Managed Portfolio Service. It should not be read or construed as investment advice. It is your responsibility to assess your circumstances and make sure it is suitable for your needs.

The value of investments can go down as well as up and you may not get back your original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

The target yields are not guaranteed and can fluctuate.

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