AJ Bell

AJ Bell Funds – Q4 2020 report

Introduction

We are delighted to bring you the quarterly report from AJ Bell Investments covering the AJ Bell Funds range over Q4 2020.

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

The final quarter of 2020 turned out to be one of the most tumultuous in history, with COVID-19 vaccines, a Brexit trade deal and a new US President. Each of these would be significant in its own right but to have all three in just three months gave investors plenty of food for thought. All three of these events were received positively by investors and that drove markets higher as the end of the year approached. However, with further lockdowns, rising virus numbers and a very challenging Christmas, it was a reminder of the terrible human cost the virus has brought in 2020. With so many people affected by this virus, the thoughts of everyone at AJ Bell continue to be with all of those impacted by the global pandemic.

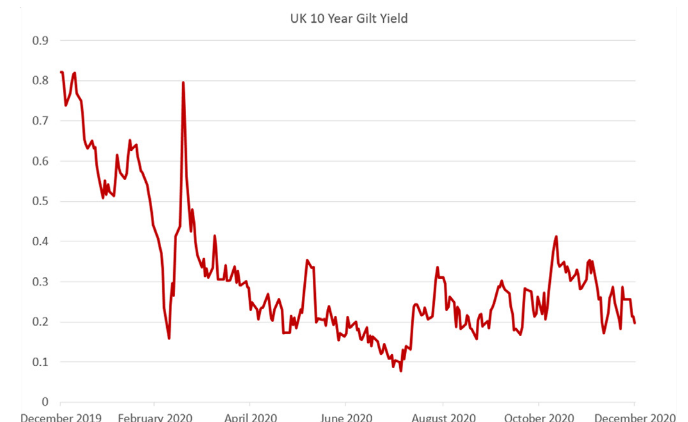
Looking ahead though, it appears things are a little brighter. Vaccines are being delivered and, despite that dark days of winter, the second half of 2021 looks to inspire more hope that we may be able to return to some kind of normality. A Brexit deal has certainly brought some clarity to the UK despite the inevitable bumps in the road, while central banks continue to support economies around the world.

Economic and market review

In 1959, Dinah Washington sang her beautiful song 'What a difference a day makes' and, in the context of this terrible year, Monday 9 November represents that day – when Pfizer announced its breakthrough vaccine in the fight against COVID-19. In the bleakness of winter, with Britain in the grip of the feared second wave, it seems uncomfortable to write positively about the effect it had on stock markets but the reality is that this gave investors a strong boost as it ignited hopes that 2021 could see a return to some normality. With a long-awaited Brexit deal and a new US President, it was a hugely eventful quarter to end a truly historic year. Overall, the MSCI World index finished the quarter up 7.8%, which resulted in a total return for the year of 12.3% – an outcome totally unthinkable just a few short months ago.

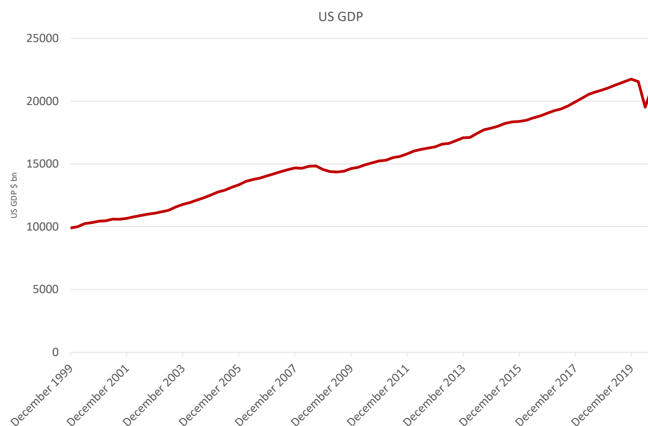
In the UK, a flash news conference on Christmas Eve took the nation away from wrapping their final presents with the announcement that a trade deal with the EU had finally been agreed. While the devil is no doubt in the detail within the 1,000+ page document, investors breathed a sigh of relief that there was finally some clarity on the future trading relationship with the EU. However, the backdrop of further lockdowns across the country highlighted the economic challenge that remains and, in the face of a tough winter, the Chancellor Rishi Sunak had little option but to extend the furlough scheme until April as unemployment ticked up month on month. With the UK locked down during November, retail sales unsurprisingly fell after six straight months of growth, however, manufacturing PMI data hit a three-year high as factory orders picked up, albeit potentially due to stocking up ahead of Brexit. The FTSE All Share index has been a major laggard for a number of years but news of vaccines saw UK shares bounce back strongly and they then received a further boost with the EU deal. As a result, the index increased by 12.6% over the quarter, but over the year, it was by far the worst performing market, falling back 9.8%.

The bond market saw some significant volatility, particularly in the UK where Government gilts fluctuated seemingly on a daily basis as the trade talks between the UK and the EU ebbed and flowed. Having started the period at 0.22%, the 10-year Government bond sold off to 0.42% on news of the vaccines but traded in sharply as the year ended, to finish almost flat at 0.18%, resulting in the FTSE Actuaries UK Conventional Gilts All-Stocks index increasing 0.6% over the quarter. Corporate bonds were more stable, with the iBoxx UK Sterling Corporate All Maturities index increasing by 4.0% over the period, while high-yield bonds were even stronger, with the Bloomberg Barclays Global High Yield Bond GBP Hedged index increasing by 6.0%. This brought 2020 to a close with all three indices delivering a strong total return for the calendar year.



Source: Bloomberg, December 2020

In the US, Joe Biden won the US Presidential race as a variety of legal challenges from Donald Trump petered out. Markets were relatively unaffected by the vote, with many focusing on the race for the Senate which will be determined by two run-off elections in early January. If the Republicans win one of these seats, Congress and Senate will be divided, which will limit how much the President is able to accomplish. This outcome is viewed favourably by investors as it should stop major corporate tax rises and give more certainty to the important healthcare sector. The economy continued its strong bounce back with record GDP growth of 33.4% in Q3, while Congress approved a $892 billion stimulus package, including direct payments to most American citizens to keep the economic recovery moving. In December, Tesla became the largest company ever to be added to the S&P 500 index. Following the announcement, Tesla added over $270 billion of market cap as index funds bought the stock. To put this in context, Tesla added more value in five weeks than the value of every other car maker in the world added together! Overall, the S&P 500 index increased by 5.9% over the period, which made it a return of 14.1% for the year.



Source: Bloomberg, December 2020

Having unlocked their citizens for the summer holiday season, European countries took the opposite view as the second wave of COVID-19 started to bite. Unsurprisingly, this resulted in a hit to the major economies, with weak consumer confidence and unemployment forecast to move above 9% early in the New Year. In response, the European Central Bank announced it was increasing its quantitative easing programme by a further €500 billion and extending the programme to the end of March 2022. This takes the total for the stimulus programme to nearly €2 trillion, however implementation remains delayed due to political arguments between countries which need to approve the spending. Investors received news of a trade deal with the UK positively, helping boost markets into the end of the year, with the DAX index in Germany hitting a record high. As a result, the MSCI Europe ex-UK index increased by 9.0% over the quarter.

In Asia, the recovery continued to take hold, with Chinese GDP expanding 4.9% year on year, helped by retail sales and industrial production hitting their highest levels this year. The big story over the quarter in Asia was the cancellation of the Ant Financial IPO in November, which was on track to be the largest in history at over $300 billion. However, just days before the float, the Chinese Government cancelled it and subsequently launched an investigation into the business and its parent company, Alibaba – which owns 32% of Ant – ordering changes to the business which will in all likelihood slow future growth. Since peaking in late October, Alibaba, China's biggest company, has fallen back around 30%, as investors digest the moves by the Chinese authorities to manage risk in their financial system. Despite this headwind, both Asia and emerging market indices performed well over the quarter with the MSCI AC Asia Pacific ex-Japan index and MSCI Emerging Markets index increasing by 12.7% and 13.2% respectively. As a result, the Asian index ended the year as the best performing region with a total return of 18.7%, outstripping the US. In emerging market fixed interest, bonds provided steady returns over the quarter with the JPMorgan GBI Emerging Market Global Composite Bond index increasing by 3.8% over the period.

Source: Bloomberg, December 2020

In Japan, new Prime Minister Suga announced a further round of stimulus after data showed that the economy suffered its largest quarterly contraction since WWII. The Y73.6 trillion package, equivalent to c.£530 billion, will be spent on direct programmes to boost consumption, including moves to shift to a carbon neutral approach by 2050. In the market, the Nikkei 225 index hit a 30-year high as the end of the year approached, while the more widely used Topix index ended the quarter with a gain of 7.5%.

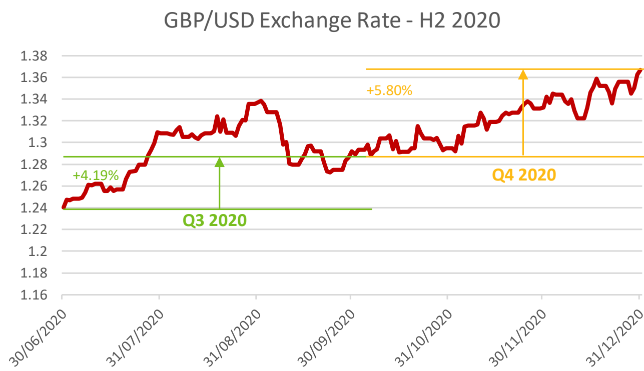
All market performance figures are in GBP.

Asset allocation and positioning

As discussed in our last quarterly update, the team was pleased to have seen a much more constructive investment environment at the end of Q3, with both stocks and bonds managing to shrug off significant headwinds in the quarter itself, to post respectable gains. As we moved into Q4, we felt this robustness boded well for the major events the market would have to contend with in the final period of the year, namely: the ongoing COVID-19 pandemic, the unresolved Brexit trade question and the imminent US Presidential Election. As such, at our last asset allocation committee (AAC) meeting for the year in October, the team felt the portfolios were well positioned and sufficiently diversified from an asset class, geographic and industry basis, such that we didn't need to make any tactical changes to the portfolios.

In Q3, a significant driver of performance in the portfolios was the strength of pound sterling, especially against the US dollar, which fell over 4% against sterling, dampening returns to portfolios from overseas assets, as currency translation acted as a headwind. This continued to be a theme in Q4, again with sterling notably stronger than the US dollar by over 5%, as investors continued to be bearish the US currency as the scale of the US COVID-19 support programmes became headline news. This had an impact on asset classes across the board, with strong international equity returns being reduced in size but remaining positive, whilst fixed-income gains, due to being smaller in scale, were in some instances pushed negative, after translation. However, the double dose of positive news in Q4 – regarding COVID-19 vaccine breakthroughs and a Brexit trade deal being agreed – meant, somewhat counterintuitively, that despite the sterling strength, UK stocks which have for so long been out of favour for investors rallied strongly in the quarter. Our portfolios have an element of home bias, as a consequence of our risk budgeting and, as such, although the sterling strength dampened returns from international assets, our significant UK equity and UK corporate bond positions performed admirably in the quarter.

In previous quarters, we have drawn attention to the performance of some additional equity sectors which were introduced into the funds at the start of 2019, when global consumer staples and global healthcare were added to an existing global technology allocation. In Q3, the nature of and response to the threat, being a global pandemic and mandated lockdowns, meant that all three sectors – technology, consumer staples and healtcare – were additive to performance in the funds, with technology being the largest contributor, as a surge in homeworking required improved technology solutions, leading to a jump in valuations of global technology companies. At one point technology was up over 20% for the quarter, in what could perhaps be described as a bout of irrational exuberance given already heady valuations for the sector, but a sharp fall at the end of August saw returns come out at just under 12% in local currency and just over 7% in sterling for the quarter.



GBPUSD Exchange rate H2 2020. Source: AJ Bell Investments, Bloomberg LP, January 2021

As well as significant UK expsoures, as we move up the risk scale, we also increasingly allocate more weight to higher growth regions and assets, such as the Asian Pacific region and emerging markets. This positioning was rewarded in the quarter, with these regions emerging from the COVID-19 slump strongly and also benefiting from the already-mentioned weakness of the US dollar. This is due to the dollar commonly being a funding currency for a lot of Asian Pacific and emerging market corporates. As a result, periods of dollar strength can weigh on the prospects for businesses and economies in this region, where dollars are scarce and they need them for debt repayments; conversely, when the dollar is weak and supply is plentiful, we generally see improved outlooks for stocks and bonds in these higher-risk, higher-growth areas, which was indeed the case this quarter.

Asset allocation – top contributors

	Portfolio					
Top Contributors	Cautious	Mod. Cautious	Balanced	Mod. Adventurous	Adventurous	Global Growth
1	UK Mid-Cap Equities	Asia Pacific ex-Japan Equities	UK Large-Cap Equities	UK Large-Cap Equities	UK Large-Cap Equities	Asia Pacific ex-Japan Equities
2	UK Large-Cap Equities	UK Large-Cap Equities	Asia Pacific ex-Japan Equities	Asia Pacific ex-Japan Equities	Asia Pacific ex-Japan Equities	Emerging Markets Equities
3	Asia Pacific ex-Japan Equities	Emerging Markets Equities	Emerging Markets Equities	Emerging Markets Equities	Emerging Markets Equities	UK Large-Cap Equities

Source: AJ Bell Investments, Bloomberg LP, January 2021

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Portfolio performance

Equities were the big winners in the portfolios in Q4, with all regions and sectors within the asset allocation showing positive gains for the period. As discussed already, UK stocks had a very strong quarter (although were still negative for the year), despite a stronger sterling, with the FTSE 250 up almost 19% in the quarter and the larger cap FTSE 100 up just over 11%. The improved risk appetite amongst market participants, in the face of continued headwinds, also saw strong gains accrue to our Asia Pacific and emerging market holdings, with the **Vanguard FTSE Developed Asia Pacific ex-Japan ETF** and the **iShares Core MSCI IMI Emerging Markets ETF** up 18.8% and 13.6% respectively. We hold allocations to these regions in all risk profiles, but the riskier portfolios have significantly higher weightings here and therefore benefited more than the lower risk profiles. Last quarter, we advised that, where we have allocations to global equity sector ETFs in the portfolios, rather than the global versions of those ETFs which are more expensive, we hold the US versions as proxy, given the dominance of the US in the global, market cap weighted sector indices. This was a clear positive in Q3 but unfortunately saw a mixed outcome in Q4. The MSCI World Consumer Staples index saw gains of 0.85%, but the **Xtrackers MSCI USA Consumer Staples ETF** posted a small loss of -0.02%. The MSCI World Technology index saw gains of 9.0% whilst the **iShares S&P500 Information Technology ETF** posted a gain of 5.3%; and the MSCI World Healthcare index posted gains of 1.2% whilst the **Xtrackers MSCI USA Healthcare ETF** posted gains of 1.3%. Our implementation decisions on this have been a notable positive to our investors overall, however, we felt it important to highlight that it isn't always the case that the cheaper US lines are always better than the global products. At the highest risk rating in the range, the AJ Bell Global Growth fund, the global technology allocation is further bolstered with an additional holding in the **iShares Automation & Robotics ETF**. This showed a really strong performance, up over 16% for the period.

In the main, gilt and international government bond holdings in the portfolios struggled, especially when one accounted for the sterling translation on international bond holdings, which made weak performances worse. We hold positions in US Treasuries via the **Invesco US Treasury 1–3-year ETF** and **Invesco US Treasury 7–10-year ETF** in the lower-risk Cautious and Moderately Cautious funds and these holdings saw losses of -5.3% and -6.6% respectively, in sterling terms, over the quarter. On a brighter note, our global high-yield allocation for instance – which we express via the **JPMorgan Global High Yield Corporate Bond Multi-Factor GBP Hedged UCITS ETF** and hold in all funds except the highest risk Global Growth fund – saw gains of 5.7% in local terms, which would have been transformed into a negative return, had we not held a hedged position.

In our Q3 report, we advised of a change to our property allocation, with the team choosing the **iShares Developed Real Estate Index Fund (GBP Hedged)** as our vehicle for allocating to property in the portfolios where it is held (Cautious, Moderately Cautious, Balanced, Moderately Adventurous and Adventurous). We are pleased to note that the fund was up over 10% in the final quarter of the year, with our currency hedged position being a significant benefit, since it insulated the position from the negative currency translation effect.

All other areas of the portfolios performed in line with expectations and, across our growth fund range, it was pleasing to see gains in all of the risk profiles. Returns were dispersed quite evenly through the risk scale, with those funds 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 funds, there were no changes to be seen in the quarter in terms of asset allocation, nor were there any changes to the underlying holdings that we use to express our positioning in the portfolios. Furthermore, none of our holdings saw cuts in their ongoing charges. 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 priced or more efficient products become available.

Performance summary (all funds)

	3 months	6 months	1 year	Inception*
VT AJ Bell Cautious	3.33%	3.37%	3.81%	14.20%
VT AJ Bell Moderately Cautious	4.75%	5.78%	5.05%	19.14%
VT AJ Bell Balanced	5.99%	7.03%	5.68%	24.42%
VT AJ Bell Moderately Adventurous	7.95%	9.23%	5.46%	26.16%
VT AJ Bell Adventurous	9.12%	10.72%	6.20%	28.05%
VT AJ Bell Global Growth	11.25%	13.19%	8.46%	17.29%

All the funds launched on 18 April 2017, with the exception of VT AJ Bell Global Growth fund, which has a launch date of 11 June 2018. All performance is net of fees.

Source: Morningstar, AJ Bell Investments, January 2021.

This report provides general information about the AJ Bell Funds. 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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