SALTUS
Investment Managers

October 2018 market background

A volatile month during which the price of nearly all assets fell

So far this year markets have been struggling to adjust to an environment of more 'normal' interest rates. A heavily indebted financial system has been wobbling as it digests the impact of tighter US monetary policy, a path which the Federal Reserve has made it clear that it will keep following, even if it causes some disruption. Until now the direct impact of this adjustment had been felt mostly in the weakest asset classes, such as emerging markets, but in October the impact spread into other investments across the globe. Equity markets corrected sharply from near record highs, with previous high flying growth sectors finding themselves suddenly friendless. The falls were quick and sizeable as investors simply stepped away until selling pressure had eased and valuations had become more attractive. This feature was as true for US technology stocks as it was for UK micro companies, reminding us just how connected global asset markets are to each other at this point in the cycle.

Geopolitical events continued to add to the poor mood music with the prospect of new US - Iranian sanctions and a Saudi political crisis prompting commodity volatility to rise alongside the more visible stock and bond market volatility. The waxing and waning of the Sino - US trade disputes, together with closer to home Brexit, issues added to the reasons for investors to step away for a bit in October and let prices adjust downwards in order to better reflect the current risks.

None of the above themes are particularly new – the Federal Reserve has already conducted eight interest rate rises before October for example – but they do come after a long period of rising asset prices and we sense that underneath the skittishness is also a recognition that some form of market correction was long overdue.

The underlying outlook remains unchanged

Economically we can find no deep meaning to the October selloff. Growth is definitely slowing but it is also still robust and inflation, although picking up, is still not really considered to be a significant threat. Market liquidity is however, undoubtedly poor, with regulatory changes eroding the depth of credit and equity markets, allowing 'rules based' trading strategies to dominate shorter term price movements. The more fundamental, longer term institutional investors weren't involved in October's moves and we suspect that when the dust settles they may find more reasons to buy into these falls than to start their own selling process.

Although we can observe that tightening policy, trade wars and political populism aren't actually manifesting themselves in higher inflation or recessions, we can also see that they have the potential to morph a skittish investor mindset into a paranoid one. This is perhaps the biggest risk to the future outlook, with fear itself leading investors into a defensive attitude that eventually leaks out into the real economy with negative consequences.

At the same time, we could also have an upcoming period during which we could see a significant reduction in political risk (e.g. a rapprochement between the USA and China at the G20 meeting and the detail of a Brexit deal). Coupling this with better valuations, less extended trading positions and a return of corporate buyback activity, the end result could also easily be a sharp recovery in prices into year end. We don't try to call 'risk on, risk off' market moods, preferring instead to be led by the quality of investment idea in front of us and, on balance, we can still see more reasons to buy than sell currently. We suspect that markets will continue to be noisy and track sideways within wide trading ranges for the foreseeable future. Although this environment probably makes the return outlook lower than it was in the last few years, it is also one which will undoubtedly present a rolling series of long term opportunities and if we are nimble enough, that should allow us to make solid progress towards your portfolio goals.

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Portfolio performance

Portfolios lost between -1.9% and -5.0% depending on mandate, in the context of global stock market falls of -7.6% for the calendar month. The parts of your portfolio that are held to offset falls in more risky assets performed as expected in October, with those managers exposed to gold and index - linked bonds doing particularly well (Troy Trojan and M&G Macro Bond Fund the most prominent here). The worst performers were unsurprisingly in equity managers, who struggled to add anything in an environment where nearly all stock markets fell in tandem. Polar UK Absolute Equity had a particularly difficult month as some smaller company positons in the UK fell more than expected, suffering from the fall in liquidity described earlier. It was a similar story for other regional managers and we took the opportunity to add to some US exposures on weakness at month end.

EQUITIES	Negative	Neutral	Positive
UK Equities			•
European Equities		•	
US Equities			•
Japanese Equities			•
Asian/EM Equities			•
Equity Market Neutral		•	
Equity Hedged Strategies			•
Private Equity			•
FIXED INCOME	**Negative**	**Neutral**	**Positive**
Gilts		•	
Investment Grade Bonds		•	
High Yield Bonds		•	
Fixed Income Multi Strategy			•
OTHER ALTERNATIVES	**Negative**	**Neutral**	**Positive**
Global Macro Trading			•
Commodities		•	
Real Estate		•	

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Saltus Investment Managers, November 2018