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Bartholomew Hawkins
ASSET MANAGEMENT

Monthly
Market Insight

Ring the Changes

For a while now, the Investment Committee has been concerned about two key issues; rising interest rates and Sterling appreciation. This month's publication will inform readers of recent changes to our asset allocation in order to mitigate these key issues.

The two key issues our Investment Committee have been discussing for some time are:

1. The potential risk of higher interest rates and subsequent impact on fixed interest exposure within client portfolios.

2. The possibility of significant appreciation in the value of Sterling against a basket of major currencies.

Our previous asset allocation incorporated reasonably high fixed interest exposure, particularly in lower/medium-risk investment mandates. Our Investment Committee had become increasingly concerned about how this exposure could be impacted if there was to be a sudden or progressive rise in interest rates.

Through 2017, we encountered a couple of periods when sovereign debt, in particular UK index-linked sovereign debt, suffered very sharp falls in value. Duration risk, the impact a change in interest rates has on the value of a fixed interest security, was of primary concern.

With inflation gradually rising and positive economic projections, there is the risk that interest rates could increase above consensus levels. Therefore, the decision to decrease fixed interest exposure was deemed appropriate.

Another key risk to client portfolios is a significant appreciation in Sterling against major currency pairs. As Sterling investors, given our diversified and predominantly overseas (non-GBP) asset exposure, falls in the value of Sterling, like that seen post EU Referendum, are favourable to investment performance. Conversely, a rise in the value of Sterling from it's currently depressed levels would be detrimental to portfolio performance.

Therefore, in order to mitigate against this risk, the Investment Committee have decided to increase UK equity exposure, albeit still underweight against benchmark. This enables recent positive currency translation to be effectively 'locked-in' while protecting against a sharp or progressive appreciation in Sterling.

Increasing exposure to UK equities given the Brexit backdrop could be considered somewhat risky. However, the Investment Committee feel that they have considered this risk and employed an appropriate blend of strategies so that UK-centric investment performance can be generated throughout the Brexit negotiation phase.

In summary, the changes mentioned above are significant, but warranted given the Investment Committee's commitment to managing risk and delivering positive returns for clients. We feel client portfolios are now well positioned and on a solid platform from which to generate further positive returns through 2018.

Adam Sketchley

Director of Investment Management