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Amity International Fund – Q1 2018 Commentary

Quarter to end December 2017

Performance

	3 Month	1 Year	3 Years	5 Years	10 Years
Fund Performance (B share class)	-3.52%	4.33%	25.6%	41.0%	123.0%
FTSE World TR GBP	-4.43%	2.55%	36.3%	74.3%	161.9%
IA Global	-4.78%	2.87%	28.4%	58.0%	112.1%
Sector Quartile	2	2	3	4	2

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

Review

The first quarter of 2018 saw global markets give back some of their exceptional gains in 2017. Last year's combination of a synchronised global growth outlook, accommodative monetary policy and an absence of inflationary pressures resulted in high levels of optimism as we entered 2018. The overly benign levels of volatility reverted to more normalised levels, triggered by indications wage growth was rising in US. The rate of the acceleration in wage growth caused financial markets to revaluate the expected pace of monetary policy tightening, fuelling concerns that the Federal Reserve may be behind the curve. The prospect of a more abrupt withdrawal of excess liquidity in the system resulted in higher Treasury yields and hurt risk-assets, particularly highly valued bond-proxies. As expected, the Federal Reserve raised its benchmark interest rate by 0.25% in March focussing on global growth recovery rather than recent market volatility.

In the US, political headlines continue to dominate market sentiment, a trend that can be expected to persist as we approach mid-term elections in November. The US Administration increasingly raised the possibility of a global trade war, as policymakers in both the US and China threaten to impose a number of tariffs which could restrict trade between the world's two wealthiest nations. At this point, the US administration has released a proposed list of roughly 1,300 Chinese products subject to tariffs (and is exploring tariffs on $100 billion in additional products), and China's Ministry of Commerce has responded in kind. However, the direct economic impact of the announced tariffs for both nations and global growth more broadly is expected to be relatively modest. According to Fitch Ratings, the direct impact of tariffs of 25% on trade flows amounting to $150 billion would negatively impact US GDP by 0.2% and China's GDP by 0.3%. That is not to say that risks to the trade outlook do not exist and given the increasingly aggressive rhetoric in recent weeks, we believe that further escalation in trade tensions is possible, however, it is important to contextualise the size and importance of these measures that have been announced.

Performance & Activity

In Sterling terms the Amity International portfolio outperformed in the first quarter falling 3.5% vs 4.4% for the benchmark. The fund outperformed the IA Global peer group average decline of 4.8%, finishing in 2nd quartile for the quarter under review and rolling twelve months.

Despite the prospect of rising rates, there was a continuation of the global style trends with MSCI World Growth total return of 0.7% vs. MSCI World Value total return of -3.0%, meaning growth continuing its outperformance by c.3.7% in Q1. At a regional level, there was less disparity between returns, and as a result overall geographical allocation was relatively flat over the period. Regionally the US, Europe ex UK and Asia ex Japan suffered returns that were close to the global market fall of 4.4%. Japan proved to be more resilient than other developed market economies falling only 2.6% in Sterling terms as the Yen strengthened steadily over the quarter from ¥/$112 to ¥/$106 levels as investors sought safe havens. In local terms, the Topix fell around 5.5% over the quarter as the Yen headwinds hurt Japanese exporters in particular.

In terms of Asia ex Japan contributors, strong stock selection led to 4.6% outperformance versus benchmark, driven by further performance from Hi-P, the Singaporean precision moulding company, and Public Bank, the cautiously-run Malaysian consumer and SME lender. In terms of detractors, in China, Tarena, the education and training provider, and Minth, the lightweight auto parts, suffered as they reported short-term margin pressure as both companies invested heavily to expand operations given the favourable long-term opportunities. In Japan, stock selection was particularly positive with the fund's holdings outperforming by 8.7% due to lower exposure to exporting and Yen headwinds. Recent addition, Horiba (environmental measurement), reported strong earnings resulting in a 20% gain over the quarter, although Amada (machine-tools) fell back on global trade concerns. Within Europe, stock selection was largely flat, with the main highlight being a cash-and stock bid for Irish packaging leader Smurfit Kappa from US-peer International Paper.

In terms of portfolio activity, we sold out of NXP Semiconductors, a top three position, following Qualcomm's willingness to increase the bid price for the company by 16% at the end of February. Some of the proceeds were invested in Aptiv, a key player in the development of electrical architecture within transportation, capturing similar long-term sustainable themes as NXP. As the realisation of our investment thesis has led to excessive valuation, we exited our long-held position in Technopro, the Japanese engineering collective. Further, following a strong rebound and stretched valuations, we took some profits in IPG Photonics (fibre lasers, US), Hi-P and Capita Commercial Trust (property, SG). The proceeds from these transactions were invested into Japanese environmental testing, safety and measurement leader Horiba, which benefits from tighter emissions and environmental legislation.

Outlook

Although concerns on the pace of tightening subsided towards the end of the quarter, market sentiment remains data dependent. The underlying tone of monetary policy remains broadly hawkish and overall economic data continues to the support the case for stimulus removal. While the global economy continues to demonstrate increasing breadth with almost all global PMIs indicating expansionary conditions, there have modest softening of economic data in recent weeks. While earnings estimates for 2018 continue to see upgrades, supporting the case for investing in equities, aggregate valuations still appear to be discounting a reasonable degree of investor optimism. With the upcoming earning season and increasing concerns that trade wars will damage sentiment, these weaker data points need to be carefully monitored for any signs that the rate of growth is ebbing. As ever, the fund continues to seek out companies with strong sustainable fundamentals within a robust value framework.

Further Information

To obtain further information please speak to your normal EdenTree representative, visit www.edentreeim.com or call our support team on 0800 011 3821.