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Amity International Fund – Q2 2016 Commentary

Quarter to end June 2016

Performance

	3 Month	1 Year	3 Years	5 Years	10 Years
Fund Performance (B share class)	6.76%	6.24%	16.20%	27.06%	131.97%
FTSE World TR GBP	8.71%	14.62%	38.53%	63.33%	124.89%
IA Global	5.95%	7.35%	26.24%	41.84%	81.66%
Quartile	2	3	4	4	1

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

Review

The main event of the quarter occurred right at the end, as the UK headed to the polls on 23rd June to vote in the referendum on EU membership. The result came as a shock to markets which were virtually pricing in a victory for the Remain camp on the eve of the vote, despite polls suggesting the result was too close to call. As it became clear that the UK had voted to end its 43-year membership of the European Union, markets began to panic; the first victim was the Pound, which fell precipitously against the Dollar to levels not seen in more than three decades. Equity markets also experienced heavy losses, particularly the more domestically-focused FTSE 250 index, whose constituents are a better barometer of the future health of the UK economy than the oil and mining giants of the FTSE 100. The worst-hit sectors were banks and homebuilders, some of whom lost more than a third of their value in just two days. Meanwhile government bonds were the main beneficiary, the yield on 10-year gilts shaking off a downgrading of the UK's credit rating to fall below 1% for the first time on record. After two extremely volatile days, investors finally received some respite in the shape of a relief rally in the final few days of the quarter that helped to calm nerves. Still, the ramifications of the referendum outcome remain very hard to forecast and a period of heightened uncertainty will most likely now engulf both the UK and Europe as negotiations begin over how the UK's future relationship with its European neighbours will look.

The quarter had begun on a more bullish footing as the continuing recovery in the oil price from last year's lows led markets higher; in recent quarters, equity markets have developed a close correlation with oil, so the move of Brent Crude back up towards $50 a barrel supported a rally in equities. Away from the UK, much of the focus of investors during the quarter was on gauging the health of the US economy and likely path of interest rate rises; a more hawkish stance than expected from the Fed in May put a summer rate hike on the agenda, but that quickly receded as June's employment figures showed just 38,000 new jobs had been created, badly missing the 160,000 consensus estimate of economists. The UK referendum outcome and related uncertainty further compounded the view that the Fed may now delay raising rates again until 2017. In the UK, Bank of England governor Mark Carney responded quickly to the referendum outcome by indicating that interest rates may be reduced, possibly all the way to zero and perhaps as early as July, from their current level of 0.5% in an attempt to support economic activity. Labour market data in the UK remained healthy, with unemployment falling to 5.0% and annual wage growth hovering around the 2% mark. In Europe, concerns around Greece's ability to meet upcoming debt repayments were eased by its creditors agreeing to release the latest tranche of bailout funds, with debt relief also now being openly discussed. Finally in Asia, China's FX reserves unexpectedly stabilised during the quarter, alleviating fears of capital flight from the world's second largest economy.

Performance

Geographical asset allocation had a negative impact on performance during the quarter, but this was offset by positive stock selection. Geographical allocation was affected by overweight exposure to UK equities, with the FTSE All Share posting a return of 4.7% for the quarter against a FTSE All-World return (in GBP) of 9.8%, the latter aided by the collapse in Sterling. More positively, overweight allocations to Hong Kong and Singapore added value as both markets recorded strong GBP returns.

The Fund's underweight US allocation acted as a headwind as US equities outperformed the global index, despite some concerns the US economy may be slowing down.

At stock level, the position in automobile-parts manufacturer Minth Group added most value to fund performance as the company's shares rallied following positive results and an improving margin outlook. The Fund also benefitted from its holding in GlaxoSmithKline, whose shares jumped 12% in the days that followed the UK's referendum. A large proportion of GlaxoSmithKline's earnings are generated overseas, making it a beneficiary of the collapse in Sterling. The company's limited sensitivity to the domestic economy, which could come under pressure as a period of uncertainty engulfs the UK, made it a popular purchase amongst investors following the referendum. The Fund's other Healthcare holdings also added value as the sector's defensive growth properties proved attractive in the uncertain economic environment.

Outlook

The coming quarter will likely be dominated by the fallout from the UK's referendum result. The decision to leave the European Union has already triggered heightened market volatility at a time when the global economy is still in a perilously fragile state. Political risk caused by the resignation of the Prime Minister and challenge to the authority of the Leader of the Opposition further raise uncertainty in the UK and could put more pressure on the Pound, which finished the quarter at a thirty-one year low of $1.33. The decline in the value of Sterling is not universally bad news; in fact it provides a strong tailwind to the country's exporters and benefits those companies who generate earnings overseas, although it does increase costs to importers and consumers.

In the US, extremely weak employment data has raised fears that the world's largest economy may be slowing down. Investors will be forensically analysing the next round of economic data from the US to see if the June figure was simply an anomaly or a sign of the start of a downwards phase in the US business cycle. The fund retains its cautious view on the US and instead favours Asia, a view driven by attractive valuations and strong long-term fundamentals found particularly in the Hong Kong and Singapore markets. The stabilisation in Chinese FX reserves during the quarter helped to ease concerns of capital flight, while China's housing market improved and growth in infrastructure investment has picked up.

Further Information

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