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Amity International Fund – Q3 2018 Commentary

Quarter to end September 2017

Performance

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B share class)	1.74%	5.64%	6.68%	57.08%	51.97%	162.63%
FTSE World TR GBP	6.19%	13.80%	14.16%	72.85%	95.08%	221.91%
IA Global	3.82%	11.95%	11.70%	62.56%	72.83%	169.87%
Sector Quartile	4	4	4	3	4	3

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

Review

In the third quarter of 2018, global equities continued to climb despite headwinds from trade, monetary policy tightening and intensifying geopolitical concerns. The threat to global trade escalated significantly over the quarter, with the US enforcing 10% tariffs on $200bn of Chinese goods and threated tariffs on a further $267bn. China responded to the US in kind with a list of tariffs on US products with an estimated value of $110bn. The wide spread tariffs come in addition to the already levied duties on core materials steel and aluminium from allies such as Canada, Mexico and EU. The protectionist policies of the US are placing friction on global supply chains and risk dampening global economic growth.

The standout trend from the quarter was the further strengthening of the US economy, decoupling from other key regions such as Europe and Asia which lagged. The primary driver of desynchronization rests with policies differentials - the late cycle fiscal stimulus in the US has stoked an already strong economy meanwhile stimulatory fiscal policy in Italy has unsettled Europe. In China, continued deleveraging, such as the clamp down on peer-to-peer lending, has moderated the pace of expansion, while sentiment has deteriorated due to negative trade rhetoric with the US. In response to the robust US economy, the Fed raised rates by a further 0.25% in September marking the third hike this year and signalling one more in December. Steady monetary tightening and reversal of quantitative easing in the US is expected to continue, potentially overshooting 3%, seen as broadly neutral level, in light of the prevailing economic strength. Political headwinds in Europe increased over the period as Brexit failed to make meaningful progress, while the newly formed Italian government proposed a budget in keeping with the anti-establishment, anti- austerity position, juxtaposed to the EU's existing budget guidelines. The strong US Dollar has been a negative force for some emerging market economies, with tensions rising around the weakening Chinese Renminbi. The managed deleveraging within the Chinese shadow financing system has created tighter than expected conditions and with trade tariffs posing a real threat to exports, China is increasing system liquidity to ease domestic conditions.

Performance & Activity

The global equity index had its strongest quarter this year, posting a gain of 5.7% (in Sterling terms) but the regional performance disparity continued in similar fashion to the prior quarter. US markets rose an exceptional 8.8% over the period, outpacing Europe ex UK gains of 3.2% and Asia Pacific ex Japan gains of 0.2% with the latter being most affected by threat of a trade war. In Sterling terms, the Amity International portfolio returned 2.3%, with the lower return attributable to regional performance disparity. The fund's underweight allocation to the US equity market has been the overarching performance detractor, given the return variance between the fund's regional overweight allocation to Europe and Asia.

Growth investing globally continued its outperformance of value style investing, with the MSCI World Growth Index, up 10.6% year to date versus the MSCI World Value Index up only 1.1% year to date (USD, TR). Narrow leadership continues to be a key factor with just seven stocks accounting for 50% of the contribution to the S&P 500's gains year to date. Specifically, three of the stocks collectively known as FAANGs (Facebook, Apple, Amazon, Netflix, and Google) are present in these seven. Furthermore, the fund's structural underweight position in Energy became an increasing headwind towards the end of the period as Brent crude prices reached a four-year high driven by US sanctions in Iran.

In terms of stock selection, Asia Pacific ex Japan was the strongest region with the fund's position rising 2.5% in contrast to the markets gain of 0.2%. Contributors included Bingo Industries, the Australian circular economy leader, which rose 26% following the announcement of an accretive acquisition. The fund's largest holding, Sony**,** rose 21.5% as it continued to execute well on long-term strategy. The main declines in the region were related to trade and supply chains which included Singaporean precision moulding company, Hi-P which had been significantly scaled back following its outperformance last year. Other holdings that have been impacted by the trade skirmish include Horiba, the Japanese maker of emissions, semi-conductor and water quality measuring and testing instruments, NXP Semiconductors (micro-controllers for mass-transit and auto industry) and IPG Photonics (US-listed high power laser manufacturer).

In terms of portfolio activity, the fund entered a new position in Italian company Prysmian, a global leader in cabling that enables the infrastructure around renewable energy and decentralised generation. Prysmian was impacted by the domestic political uncertainty highlighted earlier and transient issues around its Western Link project, which led to an attractive entry point from a valuation perspective. In the US, the fund invested in Trimble and Deere, as both companies had fallen sharply due to trade concerns targeting agriculture and soft commodities. Both companies are key players in precision and efficient agriculture machinery and address a number of challenges raised in our Amity Insight: Hungry Planet Revisited. The fund also scaled back the holding in Smurfit Kappa following significant outperformance post the International Paper bid, and reinvested into a Swedish niche packaging peer BillerudKorsnäs**.** The company has been experiencing a few transient operational difficulties, however it aligns to the funds value bias and sustainable focus through the provision of innovative renewable packaging solutions.

Outlook

Global economic growth forecasts for the remainder of 2018 have become more uncertain as trade, rising interest rates and political risks have mounted as the year has progressed. The growth of the US economy has undeniably decoupled from the rest of the world but several negative forces are becoming apparent. The tax cuts that fuelled the US economy have now been fully priced into Earnings per Share growth and in tandem with the wages, interest rates and energy costs rising, profit growth into 2019 should be expected to slow. The latest round of trade tariffs enacted included a large amount of consumer goods including clothing and appliances, which will directly raise prices for US consumers. With the Fed continuing to raise rates beyond the expected neutral level of 3%, success would imply a decelerating growth delta for the US economy. The lack of multiple expansion in US equities suggest the market is beginning to reflect this dynamic. On the receiving end of the majority of the trade tariffs, China is ramping up fiscal stimulus which may act as a catalyst for a polarity reversal of the two economies. With monetary policy starting to tighten globally, growth as a style may be approaching the end of its long outperformance of value (90% since the end of the 2008), which would position the fund well given its consistent value orientation. As ever, the fund continue to seek out long-term investment opportunities in both responsible and sustainable companies that meet our over-arching value bias.

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.