Fund Watch

Q3 2020

Contact us

+44 (0)800 085 0383
sales.support@bmogam.com
bmogam.com/adviser

Telephone calls may be recorded.

Fund Watch uses our team's process to highlight the past quarter's developments in the fund world. It is fact-based and uses performance analysis techniques which form part of our investment process. All data is from Lipper for Investment Association (IA) sectors and is calculated in total return terms in sterling for periods ending 30 September 2020.

This quarter's report includes the following analysis:

- **The BMO MM Consistency Ratio** – highlighting the surprisingly limited number of funds beating their peers on a regular basis.
- **Tops and bottoms** – the ultimate winners and losers over the quarter.
- **Sector skews** – the best and worst of the 39 IA sector averages.
- **Risky business** – a look at the leading funds for combining first class longer-term returns with the lowest levels of volatility.

We analyse thousands of funds each quarter – in Fund Watch we highlight the elusive few that manage to outperform on a consistent basis.

Rob Burdett, co-head of BMO Multi-Manager Solutions

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Past performance is not a guide to future performance. Stock market and currency movements mean the value of investments and the income from them can go down as well as up and you may not get back the original amount invested.

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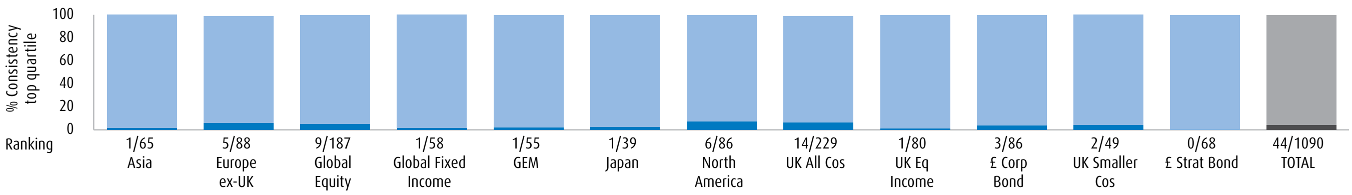
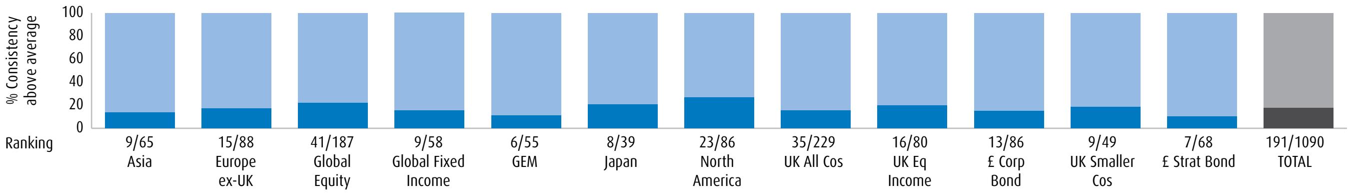
The BMO MM Consistency Ratio

Top quartile performance rolling 3 years: 4.0%



Above average performance rolling 3 years: 17.5%



Source: Lipper, 30-Jun-20 – 30-Sept-20, percentage growth, total return.

Here we conduct a review of the 12 major market sectors, filtering out only those funds that are consistently above average in each of the last three 12-month periods, and those which consistently top quartile. In the 12 main sectors researched, there are currently 1,090 funds with a 3-year track record.

- The BMO MM Consistency Ratio for top quartile returns over three years (to the end of Q3 2020) fell to 4% (5% last time) with 44 of the 1,090 funds assessed achieving this feat. This ratio was within the usual historic range of c.2-4%.
- The IA North American sector was again the most consistent for top quartile returns with 7% of funds making the cut (this number has been high for the last three quarters). It was followed by the IA UK All Companies and IA European ex UK sectors, which had 6.1% and 5.7% of funds making the grade respectively. The IA £ Strategic Bond sector failed to deliver any funds that achieved this level consistency, with five of the IA sectors having just 1 fund achieving the feat.
- Lowering the hurdle rate to simply above median in each of the last three 12-month periods saw 191 of the 1,090 funds delivering above median returns consistently. This means this less demanding ratio fell to 17.5% from 18.8%.
- All 12 main IA sectors contained funds that met the less demanding above median consistency hurdle. The most consistent sector on this measure was the IA North American sector with an impressive 26.7% of funds performing above median for 3 consecutive years. The IA Global Equity and IA Japan sectors were the next best with 21.9% and 20.5% respectively achieving the target, with the IA £ Strategic Bond sector the least consistent with 10.3% of funds achieving above median consistency hurdle.

BMO MM comment

- Compared to the first two quarters of 2020, Q3 was relatively uneventful. The short term V shaped recovery arguably was more of a Nike swoosh or even a K as areas of the economy recovered while others floundered. With so many variables making the long term impossible to predict with any certainty it is hardly surprising that the same cohort won out in performance terms in the end.
- The consistency figures for the 3 years to the end of Q3 came down to more normal levels. While the quarter overall can be characterised as one where it was business as usual for the behemoths of the equity world there were inklings of a change in the wind in the quarter.
- The US has shown the most consistent consistency (!) so far this year. Hardly a surprise given the drivers of markets i.e. big tech, but worthy of note none the less. On the flipside the IA Strategic Bond sector has faltered somewhat in consistency terms. A reflection perhaps of the breath of mandate and opportunity set for most of these managers who are predisposed to own spread, which has ultimately gained them little relative to a long duration strategy this year.

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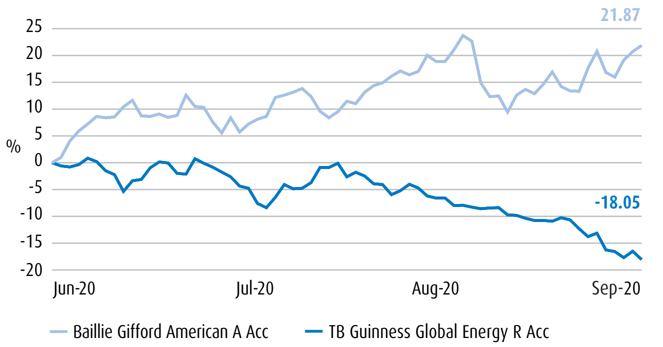
Tops and bottoms

Identifying the best and worst performers of all funds in the quarter across all 39 IA sectors.

- The £5bn Baillie Gifford American Fund run by a quartet of pm's at the Edinbugh based partnership took centre stage in the return table in the quarter. As an unashamedly growth biased house, this fund, investing in the home of technology, shone amongst its peers with a heady exposure to the likes of Tesla, Spotify and Amazon.com. This focused fund of 30-50 stocks was well placed to benefit from the continued outperformance of such stocks in a period where uncertainty in the outlook remains rife, and the stalwarts won out (again).
- The £107m TB Guinness Global Energy Fund continued to suffer from the malaise in energy related areas in the quarter as the worst performer in the IA peer group. Run by the trio of Will Riley, Jonathan Waghorn and Tim Guinness the fund focuses on integrated oil and gas companies as well as exploration and production. This has been more than a little painful in 2020.

Baillie Gifford American A Acc v TB Guinness Global Energy R Acc



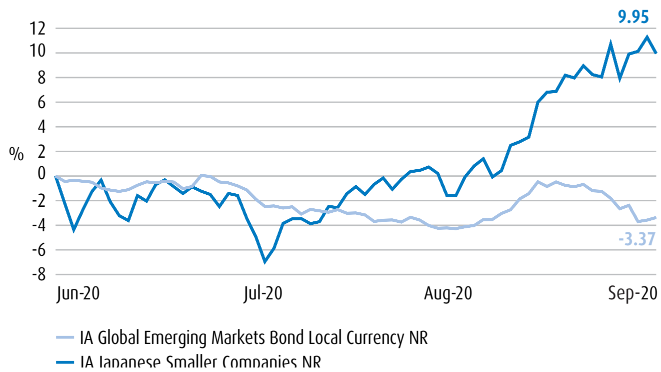
Source: Lipper, 30-Jun-20 – 30-Sept-20, percentage growth, total return.

Sector skews

Identifying the best and worst performers in the quarter across all 39 IA sectors.

- 29 of the 39 IA sectors made positive ground in the third quarter, continuing the generally upbeat mood of the second quarter. Year to date 19 of the 39 have made gains though this is heavily skewed to an interesting combination of risk assets and long dated Government bonds – arguably both driven by the same theme of 'lower for longer' interest rates. One could also read this as a dichotomy with the riskiest and safest assets outperforming. The equity and bond markets seem to be taking very different perspectives on the current economic situations.
- The IA Japanese Smaller Companies sector topped a table of IA sector averages gaining 10%. It was a quarter for the minnows with 4 of the 8 top sectors being small cap equities focused.
- The relatively newly created (1st January 2020) IA Global Emerging Markets Bond Local Currency sector was the worst performer falling 3.4% with the IA UK Equity & Bond Income sector next worst falling 2.7%.
- Of the UK equity sectors the IA UK Smaller Companies sector was the best performer gaining 5.3%. It is worth noting this sector is still down 11.7% in 2020 so far. The IA UK All Companies sector actually fell 1.1% with the IA UK Equity Income sector falling the most at 2.1%. The looming deadline on Brexit surely has to be a factor here.

IA Global Emerging Markets Bond Local Currency NR v IA Japanese Smaller Companies NR



Source: Lipper, 30-Jun-20 – 30-Sept-20, percentage growth, total return.

- In corporate bond related sectors, all averages made positive ground as the backstop of central bank buying and ever illusive income streams from alternative sources provided a steady technical tailwind to the asset class. Unsurprisingly the IA £ High Yield sector led gaining 3.2%, with the IA Strategic Bond fund returning 1.9%. The IA £ Corporate Bond fund gained 1.6% in the quarter.

Sector skews (continued)

- The IA UK Gilt sector gave back 1.1% in Q3 after a stunning run but has still gained 8.9% year to date. The IA Index Linked sector which has an even greater sensitivity to long term interest rates fell 1.7% but is still up 11.9% in the last 9 months. The IA Global Bond sector returned 0.5% and 4.3% respectively in comparison.
- The IA Targeted Absolute Return sector gained 1.3% in the quarter. In the year to date the sector is now down 1.4%.
- Looking at the Mixed Asset IA offerings, the IA Mixed 40-85% Shares sector was the strongest performer rising 1.9%. The IA Mixed Investment 20-60% Shares returned 1.3% ahead of the 0.9% gain from the IA Mixed Investment 0-35% Shares. All three have lost money year to date, however.
- The IA Global Equity sector rose 4.2% against a return of 1.5% for the IA Global Equity Income sector as the ability of companies to pay dividends continued to hamper their ability to progress relative to their growth fund cousins. On a year to date basis the difference is now 5.1% for the IA Global Equity Sector against -4.7% for IA Global Equity Income.

Currencies

- Q3 2020 proved to be a bit of a rollercoaster for Sterling against all but the Euro with the end result being less dramatic than the moves intra period. From here inevitable Brexit shenanigans into the closing months of the year are likely to create a reasonable amount of volatility for the pound.

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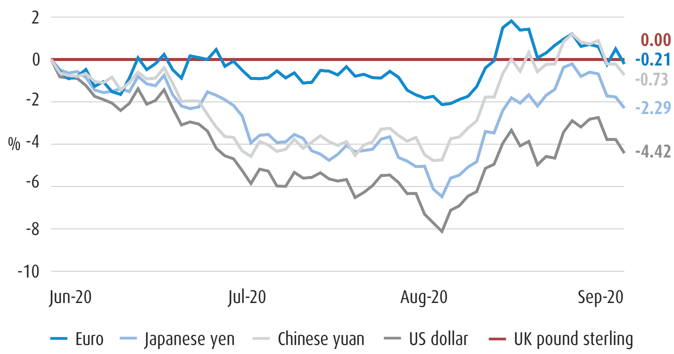
Kelly Prior, Investment Manager

Currencies relative to sterling



Source: Lipper, 30-Jun-20 – 30-Sept-20, percentage growth, total return.

Risky business

Can you have your cake and eat it? Here we search for funds with good risk characteristics and establish which offer the holy grail of low risk and high returns. For this purpose, a longer time period is required, so we look back over three years to the end of the quarter.

- Measured to the end of Q3 2020, yet again no fund achieved the perfect mix of top of the sector 3-year returns with bottom of the sector 3-year volatility. This mix seems to be becoming ever more elusive. The Trojan Income Fund came close after achieving 99th percentile risk and a 4th percentile return. There were no funds with top decile returns and bottom quartile risk over the three years to the end of the quarter. A simplistic observation could be that you have been able to make good returns in these years, but you may have had to weather more volatile performance to achieve it. The middle ground is becoming a crowded place – to achieve long term excellence patience is a necessity.

> The short term V shaped recovery arguably was more of a Nike swoosh or even a K as areas of the economy recovered while others floundered

Kelly Prior, Investment Manager

Looking Ahead – the final push to get 2020 over with!

- The third quarter of the year proved to be something of a mixed blessing. On the one hand economic numbers surprised on the upside, but the re-emergence of COVID-19 cases alongside the headwinds of the impending US election and Brexit conclusion (the last two an impressive sideshow to the first – who would have predicted that a year ago!) raised questions on the sustainability of any trend.
- There are increasing questions regarding the sustainability of that fiscal support that has thus far been the life support of developed economies through the crisis. We take comfort from the narrative that support will come, but the bickering on its form from the likes of the US is unhelpful. Other countries around the world seem better placed to coordinate their response which thus far has been outstanding. Emerging countries have taken a harsher approach but been rewarded with faster recovery in the main. It is however early days.
- It remains difficult to see markets making significant progress from here and the brief moment in the sun for the unloved less-sexy value segments of the market within the quarter was an interesting interruption to what has otherwise been a one way bet for all things 'quality growth'. A vaccine would certainly shake things up from here. 'Cyclicals' for Christmas anyone?

Summary

To sum things up, we believe the performance numbers are – as always – well worth crunching to find trends, provide ideas, layer knowledge on how each fund performs and to generally provoke thought.

Of course, the analysis must be taken in context, and the qualitative work must be done to allow for fully informed judgments. We hope you found this review interesting, and if you have any questions, please contact:

BMO Global Asset Management press office
+44 (0) 20 7269 7226

Rob Burdett
+44 (0) 20 7011 4743

Kelly Prior
+44 (0) 20 7011 4739

If you would like further details or would like to discuss why we think these points are of interest, then please do contact us. We have our own observations and opinions on this analysis and would be happy to discuss them if appropriate.