Fund Watch

Q1 2021

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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 31 March 2021.

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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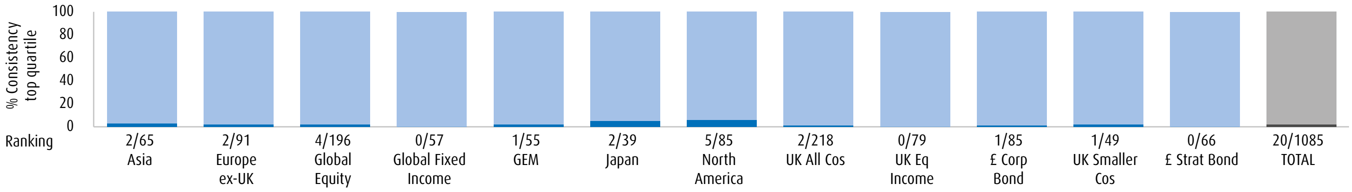
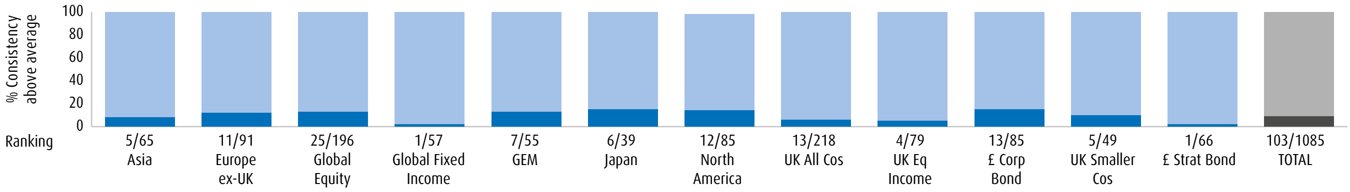
The BMO MM Consistency Ratio

Top quartile performance rolling 3 years: 1.84%



Above average performance rolling 3 years: 9.49%



Source: Lipper, 31-Dec-20 to 31-Mar-21, 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 consistently top quartile. In the 12 main sectors researched, there are currently 1,085 funds with a 3-year track record.

- The BMO MM Consistency Ratio for top quartile returns over three years (to the end of Q1 2021) fell to just 1.8% (3.2% last time) with 20 of the 1,085 funds achieving this feat. This ratio was below the usual historic range of c.2-4%.
- The IA North American sector was again the most consistent for top quartile returns with 5.9% of funds making the cut. It was followed by the IA Japan Equity and IA Asia ex Japan sectors, which had 5.1% and 3.1% of funds making the grade respectively. The IA Global Bond, IA Strategic Bond and IA UK Equity Income sectors failed to deliver any funds that achieved this level consistency, with three 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 103 of the 1,085 funds delivering above median returns consistently. This means this less demanding ratio fell to an astonishing 9.5% from 16.2%. The lowest this figure has gone was exactly 10 years ago in Q1 of 2011 where only 8.6% of funds were consistently above average on a 3 year rolling basis.
- 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 Japan Equity sector with 16.4% of funds performing above median for 3 consecutive years – it should be noted that this was actually just 6 funds from a universe of 39. The IA £ Corporate Bond and IA North American sectors were the next best with 15.3% and 14.1% respectively achieving the target, with the IA Strategic Bond sector the least consistent with 1.5% of funds achieving above median consistency hurdle. This was slightly ahead of the IA Global Bond Sector which had 1.8% of funds consistency above average, but in reality only one fund in each of these two sectors achieved this feat.

BMO MM comment

- Since the global financial crisis the direction of interest rates has been a one way (downhill) street allowing certain styles of investing to freewheel to the front of the leader board of performance charts, while others have had to pedal hard just to stand still. The weight of money thrown at global economies to keep the lights on could change things from here.
- The last 12 months has seen markets grapple with what the future will look like. The first quarter was a taster of what may be to come in terms of volatility between styles of investing being favoured. Consistency of performance over the last 3 12 month periods has unsurprisingly faltered as we have seen managers increasingly specialise in styles of investing in recent years which in turn leads to less consistent performance when compared to the average (which is made up of these extremes).

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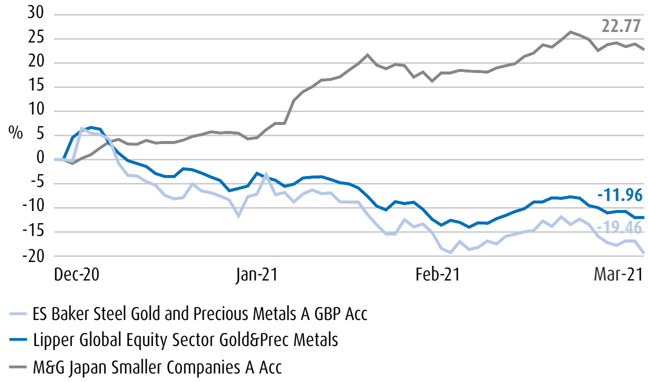
Tops and bottoms

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

- The £87m M&G Japan Smaller Companies fund run by Carl Vine led the UCITS universe in the return table in the quarter with strong performance for the 3 month period with specific stocks driving the strong returns rather than any overriding theme.
- The £4.2m ES Baker Steel Gold and Precious Metals fund lagged the IA universe as gold continued to falter as an asset class with reflation fever gripping the market. A global fund with a focus on equities across mainly gold, but also silver the fund compounded the double digit falls within its market.

ES Baker Steel Gold and Precious Metals A GBP Acc v Lipper Global Equity Sector Gold&Prec Metals v M&G Japan Smaller Companies A Acc



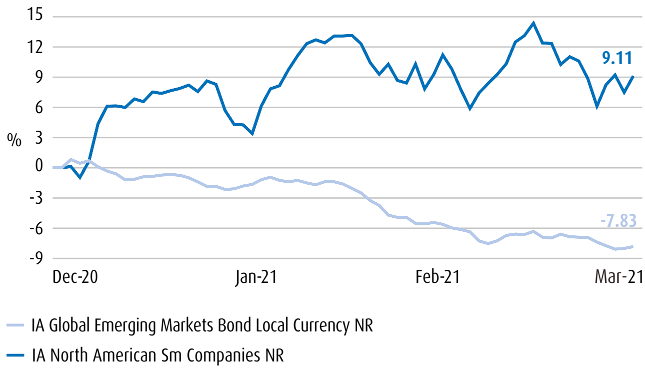
Source: Lipper, 31-Dec-20 to 31-Mar-21, percentage growth, total return.

Sector skews

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

- 22 of the 39 IA sectors made positive ground in the first quarter, with the rotations in markets shaking out some interesting variances in fortunes for certain areas. 10 of the 15 that lost money were either money market or fixed income sectors as markets took a decide turn to risk on with small caps taking up the performance mantle.
- The IA North American Smaller Companies sector topped a table of IA sector averages gaining 9.1% as the American vaccine program, and proposed fiscal spending bill buoyed sentiment in the domestic economy, with the table laggard being the IA Global Emerging Markets Bond Local Currency sector – a reaction to significant moves in the US yield curve alongside reflation fears and specific issues in the likes of Turkey and Brazil.
- It was a strong month for all UK equity sectors – the IA UK Smaller Companies sector was the best performer gaining 9% with the IA UK Equity Income the next best sector in the table returning 6.7%, just ahead of the IA UK All companies sector returning 5.9%.
- The IA £ High Yield was the only fixed Income sector to make positive ground this quarter. More correlated to equity than interest rate sensitivity, the risk on mood music meant spreads in this space ground tighter in the period.

IA Global Emerging Markets Bond Local Currency NR v IA North American Sm Companies NR



Source: Lipper, 31-Dec-20 to 31-Mar-21, Percentage growth, total return.

The IA Corporate and IA Strategic Bond sectors fell back 1.2% and 3.2% respectively – unsurprisingly given their greater sensitivity to interest rates.

- The IA UK Gilt sector fell a massive 7.4% in Q1 as the reflation narrative and lack of compensation for a change to the landscape was repriced. The long duration IA index

Continued

Sector skews (continued)

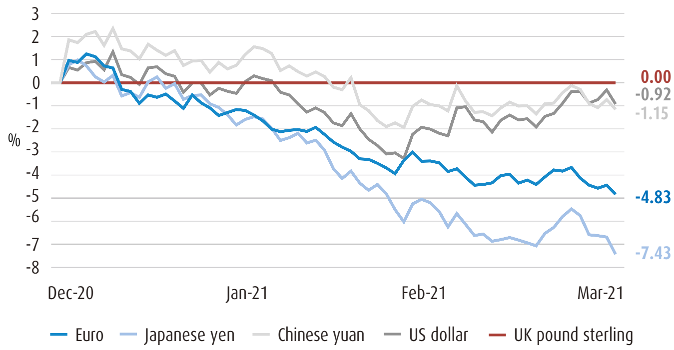
Linked sector was not far behind falling 6.6% in the first quarter of the year. It is worth recalling the staggering 2020 return of 12% for this "risk free" area of the market. The IA Global Bond sector returned -2.6% in comparison.

- The IA Targeted Absolute Return sector gained 1% in the quarter.
- Looking at the Mixed Asset IA offerings, the IA Mixed 40-85% Shares sector was the strongest performer rising 1.7%. The IA Mixed Investment 20-60% Shares returned 1% ahead of the 0.8% loss from the IA Mixed Investment 0-35% Shares.
- The IA Global Equity sector rose 3.3% against a return of 5.1% for the IA Global Equity Income sector. This single statistic alone reflects the change in sentiment for income over growth companies in the period.

Currencies

- Sterling continued to strengthen in the quarter as the roll out of the vaccine progressed ahead while others floundered – the expected strength of the economy buoying the prospects for the pound. The pandemic weighed on Europe as economies fell back into lockdown in the latter stages of the quarter, while the dollar benefited from a reflation narrative as a result of the significant stimulus package pushed through Congress by President Biden. The Yen was the loser in the month – the risk on sentiment meaning its safe haven status was not in demand.

Currencies relative to sterling



Source: Lipper, 31-Dec-20 to 31-Mar-21, Percentage growth, total return.

> The notion of vaccinations not vaccines ending pandemics certainly rang true when analysing how individual countries and economies have fared in the first quarter.

Kelly Prior, Investment Manager

Risky business

Can you have your cake and eat it? Here we search for funds with good risk characteristics and establish which funds 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 Q1 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 VT Gravis Clean Energy Income close achieved a respectable 95th percentile risk, and 4th percentile return however. 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 first quarter was a taster of what may be to come in terms of volatility between styles of investing being favoured.
>
> **Kelly Prior, Investment Manager**

Looking Ahead – Spring is in the air but what about the markets?

- The notion of vaccinations not vaccines ending pandemics certainly rang true when analysing how individual countries and economies have fared in the first quarter. As Boris Johnson announced the further easing of lockdown in the UK, President Macron is tightening up restrictions in France. Q2 GDP figures could well be very telling as to the effectiveness of the vaccination campaigns of the various global administrations.

- At the headline level markets are certainly not a bargain, but from here it feels like active management should have its time to shine. Companies that are well placed to respond to the changing landscape should see superior earnings compared with those that have been propped up artificially. 2021 is shaping up to be an interesting year.

Summary

In summary, 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:

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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.