COMMUNICATIONS
Omnis Investment Team
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OMNIS MANAGED PORTFOLIO UPDATE

Tactical asset allocation

An Introduction to the Omnis Managed Portfolio Service

The Omnis Managed Portfolio Service ("OMPS") offers a range of five risk-rated portfolios based on the risk profiles offered by the Openwork network. These portfolios are managed by the Omnis Investment Team, which has the flexibility to tilt portfolios towards asset classes they believe offer the most compelling investment opportunities and away from those where the outlook is less favourable. This process – known as 'tactical asset allocation' – is intended to help manage risk and, ultimately, to deliver superior investment returns over the medium to long-term.

The degree of tactical flexibility given to the Omnis Investment team when constructing a portfolio is strictly controlled by the Openwork Investment and Proposition Committee. This is to ensure that portfolios are aligned to clients' attitude to risk, are diversified and largely remain invested.

The way the Omnis Investment Team approach tactical asset allocation is founded on the belief that markets are not efficient in the short term. Investors are liable to excesses of fear and greed, as a result of which they may be willing to buy or sell stocks and bonds at prices far removed from the true value of the underlying asset which presents opportunities to the long-term investor.

The concept of value is key to our approach. As Warren Buffet once explained, "price is what you pay, value is what you get". Our research, covering multiple markets and numerous definitions of 'value', demonstrates a clear link between the valuation at the point an investment is made and the return that is subsequently earned from that investment. At its simplest, the research work of the Omnis Investment Team can be summarised as a search for attractively valued assets.

Unfortunately, finding and investing in attractively valued assets is often easier said than done. Buying assets that appear too cheap and selling those that appear too expensive requires a willingness to go against the consensus. Contrarianism can be difficult to sustain, particularly when short-term market movements are unfavourable. At the same time, we must be willing to acknowledge the possibility that short-term losses are telling us something: maybe we missed an important piece of information or perhaps something fundamental has changed, impacting the appraisal of value? It is therefore important to regularly reappraise decisions and test assumptions against what new information may be available.

The relationship between valuations and future returns is only meaningful when those returns are accumulated over a period spanning months or even years. We therefore try to focus on that horizon and only change our positioning if something meaningful has changed.

Market Update

By a number of measures, the first quarter of 2020 was the worst for equity investors since the aftermath of the Black Monday stock market crash in 1987. As coronavirus spread around the globe, and as the economic implications of efforts to contain its spread became clear, the eleven-year bull market in global equities came to a halt. Stock market indices across Asia, Europe and the US fell in unison, with the UK's FTSE All Share index falling close to 35% from its peak.

Some – including us (see 'Shades of 2008') – have compared recent weeks to the financial crisis of 2008. In early March, these comparisons were justified by signs that the very structure of the global financial system was once more under threat. However, decisive action from central banks, led by the US Federal Reserve, appear to have mitigated this risk, ultimately paving the way for a partial recovery in stock markets towards the end of the quarter.

The current crisis is differentiated from 2008 not just by the reaction it has elicited from policymakers, but also by its cause. Whereas the financial crisis was precipitated by the bursting of a bubble in the market for US real estate, the coronavirus is a truly exogenous shock – one delivered from outside the realm of the global economy or its financial system. As a result, it's arrival was all but impossible to forecast.

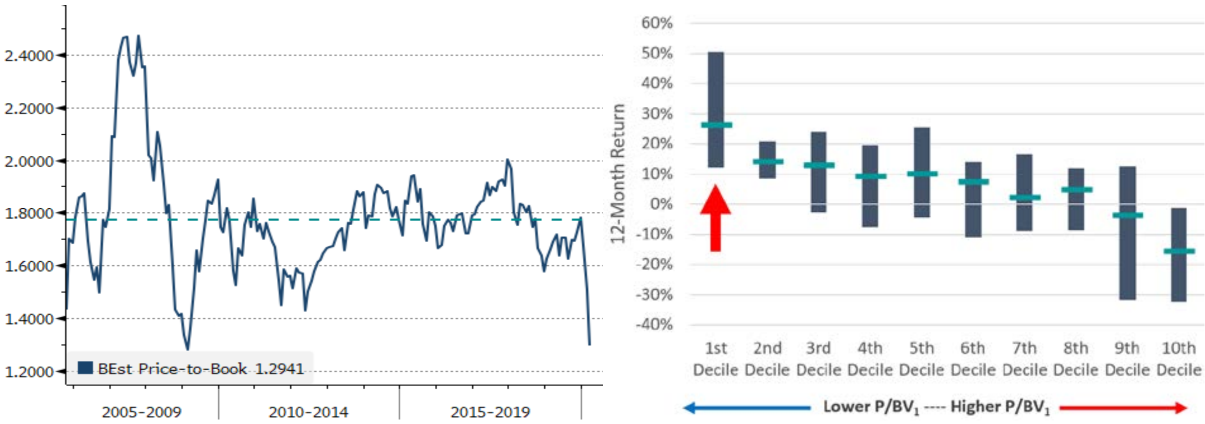
A further difference to 2008 – and to the vast majority of other periods of major market turbulence – is the pace at which recent events have unfolded. We now know that, at the onset of the financial crisis, the US economy entered recession in December 2007. However, this was not confirmed until December 2008, by which time Lehman Brothers had gone bust and the US stock market had fallen some 45% from its peak. Fast forward to 2020 and there can be little doubt that the global economy entered recession in March, an event few were predicting as recently as February.

The reaction in stock markets has been severe, with US equities falling 20% in just 21 days. By way of comparison, it took twice as long for the market to fall 20% at the onset of the Great Depression in 1929, and thirteen times as long in the financial crisis. Given the very real threat posed by the virus and given the vast economic impact of efforts to limit that risk, the market response is perhaps understandable to some extent. However, we believe it has resulted in an opportunity for investors willing and able to retain their focus on the medium-to-long term (see 'Focus on the Horizon')

As traumatic as the coronavirus outbreak remains, there are tentative signs that efforts to contain its spread are working. Coupled with an unprecedented level of support from global monetary and fiscal policymakers (see 'The Outlook is Improving'), there are reasonable grounds to hope that the crisis may prove relatively short-lived, and that the global economy can quickly recover (see 'There is a Way Out of This'). We believe current stock market valuations do not reflect the potential for this scenario to unfold.

By way of example, consider the UK equity market. As measured by the price-to-book value ratio (a measure of value which compares a company's share price to the value of its assets, for example its factories, equipment and inventories) the FTSE 100 index has seldom been more lowly valued. If we rank past price-to-book value ratios for the index from lowest to highest, we can see that the current ratio is among the lowest 10% on record. Historically, the twelve-month returns associated with buying UK equities at this level have been very strong (see Figure 1).

Figure 1: The price-to-book value ratio for the FTSE 100 has seldom been lower (left). Historically, buying at these levels has yielded strong gains over the subsequent twelve months (right).

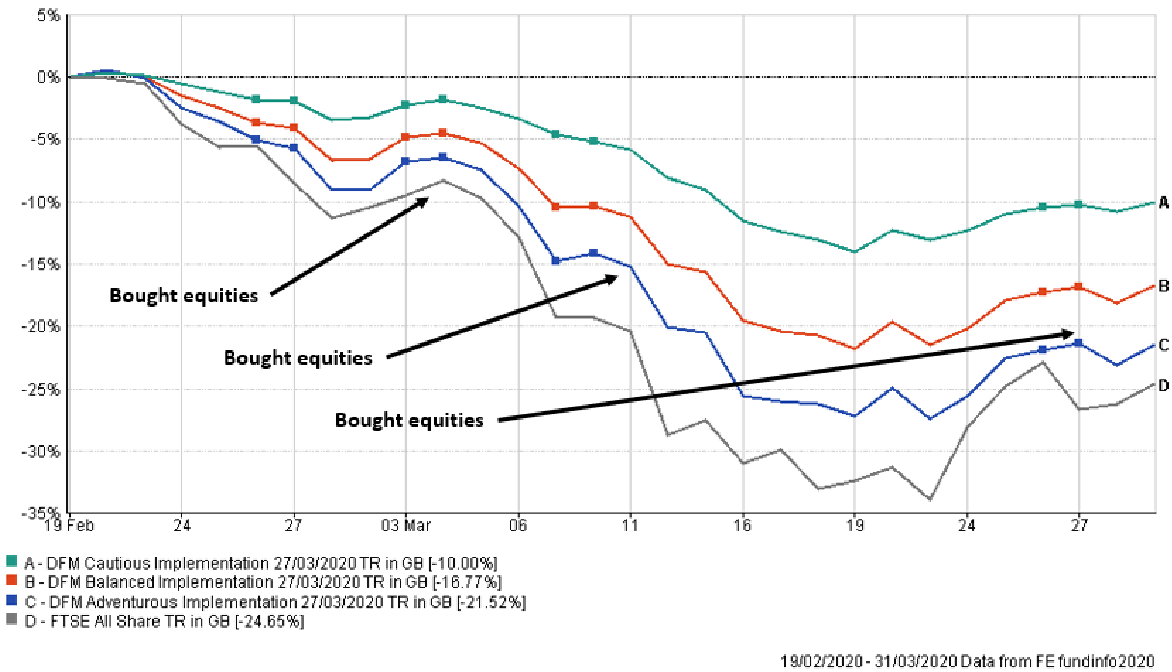


Source: Bloomberg

OMPS Portfolio Positioning Through the Coronavirus Crisis

Our value-driven analysis has led us to add to equity positions and reduce government debt on three occasions in recent weeks (see Figure 2), whilst continuing to tilt the allocations towards the regions where we see better relative value like the UK and Emerging Markets. As markets continued to fall after these trades, the additional exposure to stocks has been detrimental to short-term performance. Though disappointing, we must be clear that these trades were not made with a view to 'calling the bottom' of the market or in the expectation of profiting from daily changes in asset prices. Rather, they reflect our view that, over a timeframe measured in months and years, valuations in some equity regions offer value whilst government debt remains expensive.

Figure 2:



Source: Financial Express Analytics, equity additions calculated using OMPS Balanced model portfolio data.

In Summary

The first quarter of 2020 is likely to be remembered for some time. For investors, it was marked by a rapid reappraisal of the economic outlook, triggering the sharpest stock market declines on record. Though a great deal of uncertainty remains, the Investment Team believes there are reasonable grounds to hope that the crisis may prove relatively short-lived, and that the global economy can quickly recover. Our analysis suggests current stock market valuations do not reflect the potential for this scenario to unfold.

As a result, we have been adding to our equity positions throughout the period of market turmoil. These trades have initially been detrimental to performance. However, they were not made with a view to 'calling the bottom' of the market or in the expectation of profiting from daily changes in share prices. Rather, they reflect our belief that current stock market valuations offer attractive opportunities for those willing and able to invest for a period of months and years.

The job of the Investment Team is to constantly evaluate the investment opportunities with which we are presented. We must accept the potential for our analysis to be wrong, or for unforeseen events to alter its implications. However, where we believe our analysis remains valid, we must be willing to hold firm. For now, that is exactly what we are doing.