# Quarterly Review

Winter 2019/20

Issue No. 79

## Investment Risk

Investing in ordinary shares and other assets that will be included in your investment portfolio entails risks to your capital and the income that it might generate. The paragraph below is an important reminder, please always remember that:

> *The value of investments and the income you get from them may fall as well as rise and there is no certainty that you will get back the amount of your original investment. You should also be aware that past performance may not be a reliable guide to future performance.*

The second half of this Review, from page 16 onwards, gives information on the Church House fund portfolios that we manage for our clients. Some, or all, of these funds feature in most portfolios and the risk warning above is pertinent to each of them as well as to investment portfolios generally.

It is crucial to our approach to the management of risk to utilise these Church House funds to construct portfolios; each has a specific 'building block' role. This approach ensures a proper diversification and that we know in detail the risks that we are undertaking on your behalf - not something that we are happy to delegate to others.

These fund portfolios are authorised by the Financial Conduct Authority under the Collective Investment Schemes regulations with which we must comply at all times. We are also required to point out that the main risks faced by them arise from market price and interest rate risk; they have no borrowings, or unlisted securities of a material nature (so there is little exposure to liquidity or cash-flow risk) and that we review the policies for managing these risks on a regular basis.

As ever, do please get in touch with any questions about your portfolio, this report or any change in your circumstances that you feel we should know about.

**Church House Investment Management**

www.ch-investments.co.uk

*Church House Investment Management is the trading name of Church House Investments Limited which is authorised and regulated by the Financial Conduct Authority (No. 190548)*
*Registered office: York House, Sherborne, Dorset DT9 4JW*

Church House Investments Limited is authorised and regulated by:

**The Financial Conduct Authority**

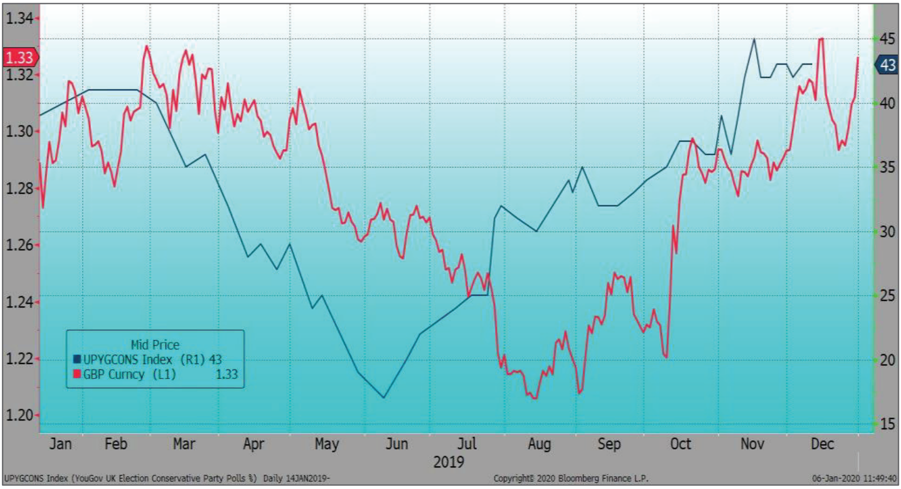
# Quarterly Review

Issue no. 79 - Winter 2019/20

## Contents

The sterling/dollar exchange rate tracked the Conservative Party's fortunes all year and acted as quite a useful indicator. Here is the rate (red) against YouGov polling for the Tories:

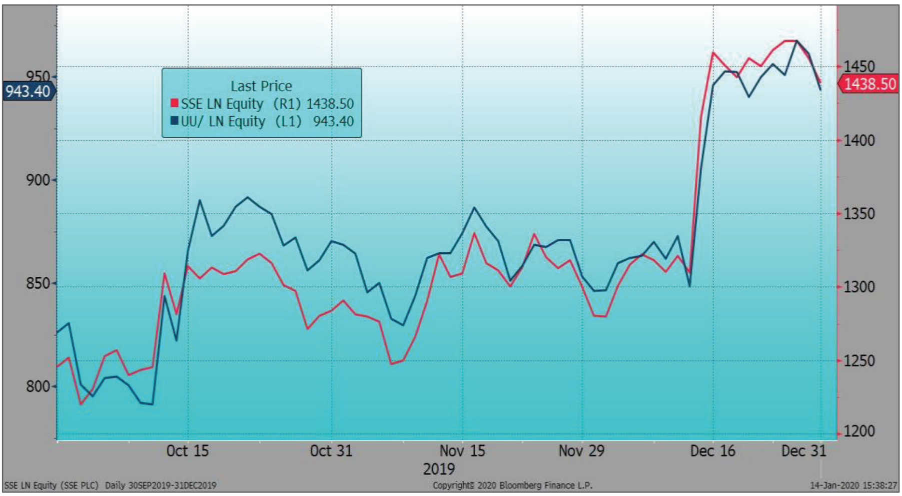
**Sterling and the Opinion Polls, 2019**




*Source: Bloomberg*

Whereas shares in the utility companies leapt as the threat of nationalisation (at highly questionable values) was removed. This shows **SSE** (the old Scottish and Southern Electricty) and **United Utilities**:

**SSE and United Utilities – Final Quarter 2019**




*Source: Bloomberg*

## THE ECONOMIC & MARKET BACKGROUND

2019 was indeed a bumpy year, though it ended on a much brighter note after the Election. The evening of December 12th was, by coincidence, the date for our London office Christmas party; it certainly took on a more relaxed tone after the 10:01 exit poll. We were right to suggest in the autumn that we might be reaching 'peak uncertainty', I hope we can get through the 2020 negotiations with the EU without too many fresh hiccups.

For me, the most satisfactory part of the Election was not the clear result (though this was most welcome), but the comprehensive rejection of the Labour Party's move to the extreme left. Their programme would have been disastrous for the economy, I hope that they can now return more to the centre ground of UK politics; time for a 'Kinnock moment'?

UK stock markets responded with glee, particularly those companies with a UK focus, and pleased to be able, finally, to follow a rampant American stock market. The Americans were rather more focused on apparent improvements in talks with China and the prospects for an improvement in the trade war. Looking at their stock market after such a strong run, it really is getting hard to find value, the relationship with underlying corporate earnings is right at the top of the range (outside recessions). Unless there is a marked improvement in earnings coming, which looks unlikely at the moment, a 'pause to refresh' is in order.

This all gets rather distorted by the actions of central banks. The US Federal Reserve cut interest rates again during the quarter and Mario Draghi's parting gesture from the European Central Bank was a further easing and commitment to 'easy money' policies for as long as necessary. We have a new Governor starting at the Bank of England in March but the retiring Governor, Mark Carney, is discussing a further drop in base rates. I was pleased to see some 'push back' against negative interest rates emerging in Europe, notably Sweden, but, for the meantime, all this cheap money continues to propel (and distort) asset prices.

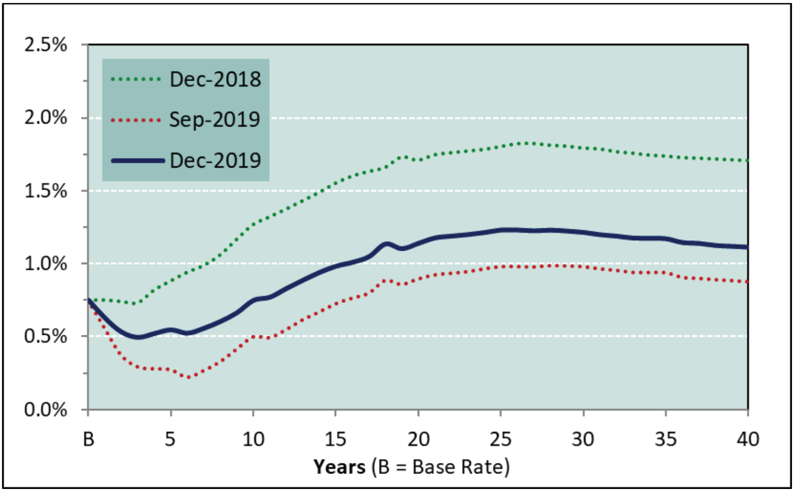
Meanwhile, I am concerned that it now appears to be assumed that inflation is yesterday's problem. There used to be a clear relationship between unemployment and inflation (the Phillips Curve), which, simply, stated that rising unemployment lead to falling inflation and vice versa. This relationship has broken down over the past ten years with steady falls in unemployment and no return of inflation. The reasons for this are complex and not my point. With so much money sloshing around, a burst of inflation would not come as a surprise. If this were to happen, central banks could look quite foolish and asset prices, particularly in the fixed income markets, would be vulnerable.

***James Mahon*** *January 2020*

## The UK Economy and Interest Rates

Base rates remain at three quarters of one per cent.  The Bank of England (the Bank) has maintained the rate at this level since August 2018.  Rates for longer periods moved back up from September's levels:

**UK Interest Rates** (the income yield from Gilts) **– The Yield Curve**




*Source: Church House, Bloomberg*

| **Short-term:** | Base Rate 0.75% | 3-mnth LIBOR 0.8% | SONIA* 0.7%. | | | |
|---|---|---|---|---|---|---|
| **Longer-term:** | | | | | | |
| Gilt maturing in: | 2 years | 5 yrs | 10 yrs | 20 yrs | 30 yrs | 50 yrs |
| Yield** | 0.53% | 0.6% | 0.8% | 1.1% | 1.2% | 1.1% |

***Source: Bloomberg*** **Sterling overnight index average.  **The yield to maturity, taking into account interest received and price paid.*

At their December meeting, held just after the Election, the Bank's Monetary Policy Committee (MPC) noted the move in sterling and UK-focused equity prices and indications for "a reduction in market participants' uncertainty about the future path of the exchange rate".  Otherwise, the Bank spent time discussing the slowdown in economic activity over the final quarter (hardly a surprise) and prospects for inflation. The vote remained at seven in favour of holding rates with two voting for a cut.

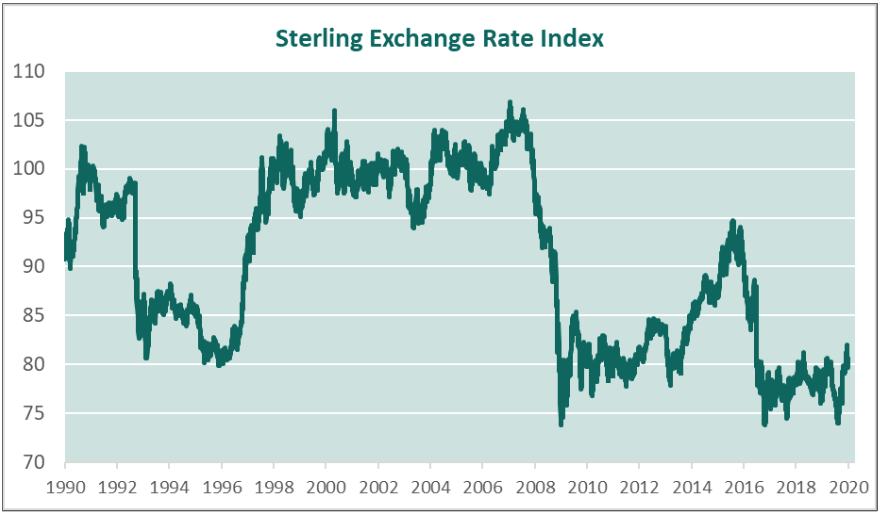
Oddly, in my view, a number of members of the MPC, including the out-going Governor, Mark Carney, now appear to be openly talking about a rate cut.  Surely it is far too soon to judge how the economy will react to Boris Johnson's election and a new administration, not to mention a truce in the trade war.  A decision based on the pre-Election period would seem to be nonsensical.

Following the Election, the Chancellor, Sajid Javid, announced the appointment of a new Governor of the Bank, Andrew Bailey, who starts his term in mid-March. He transfers from the Financial Conduct Authority, where he has been Chief Executive since 2016, prior to which he was a Deputy Governor of the Bank. Hopefully, he might be less of a star turn…

## Sterling

Sterling rallied over the course of the year, notably over the second half, as the political impasse moved towards an end-game. With the prospect of less, unpredictable, political manoeuvring ahead (though we do have a trade deal to negotiate now), it is interesting to put this into a historical context.

The Bank calculates a Sterling Effective Exchange Rate Index each day. This reflects movements in sterling against the currencies of our international trading partners, weighted by the volume of trade in goods and services with each country. Our chart shows movements in this index since January 1990:




***Source: Bank of England.*** *January 2005 = 100*

The trend has been down over this period but it is interesting to see the effects of the various crises and events over the period. First, the steep drop in 1992, following the early 1990's recession and our (rather ignominious at the time) exit from the European Exchange Rate Mechanism in September 1992. Latterly, this proved to have been exactly the medicine that the economy required, and set the scene for a much better period until the Financial Crisis in 2008. Again, the floating exchange rate provided the cushion the economy required and prospects improved until the next drop in 2016 as we voted to leave the EU. We all know about the dreary period that ensued, now sterling has picked-up. Long may it be left to float free from political interference.

## Credit Market Commentary – Jeremy Wharton

As the year drew to a close, there was a mighty sense of relief on many fronts for markets. We begin our year of negotiation with the EU with Governor Carney saying the UK should avoid aligning our financial rules with the EU. His replacement elect, Andrew Bailey, comes from an institution that has arguably followed EU rules slavishly. We have the great relief that our country came to its senses and completely rejected the unpleasant and irresponsible policies of student union fanatics who have never grown up, but we remain in a long haul process. Still, the wet blanket of uncertainty has largely been removed (before the Election, the UK had its outlook cut to negative by Moody's due to policy paralysis).

Optimism abounds that much can be achieved within the time available and that the UK economy can finally begin to return to its potential, especially in the face of a significant fiscal boost from government manifesto spending plans. The Debt Management Office has its work cut out issuing into the gilt market to fund these plans without destabilising the system, but we can take confidence from the fact that it is a well-run and respected institution. The MPC would be wise to refer to post election Economic data rather than data from a period when the country was collectively staring into a political and economic abyss.

We were wondering what the next catalyst might be to unsettle markets and then it was duly supplied by President Trump. The attack on General Qassem Suleimani, head of the Quds Force, the elite arm of the Islamic Revolutionary Guard, who seemed to have decided he was invulnerable, has, once again, destabilised the Middle East. The killing may have been justified but, as usual, the unilateral method of its execution left a lot to be desired (remember, though, that we are at the start of an election, and impeachment, year). Initial sharp, but contained, movements in crude oil prices, equity indices and credit spreads proved to be short-lived, although the situation is still developing and tanker rates have maintained their jump. We look in awe at US equity indices shrugging off any worries and again reaching new high levels, and feel a little queasy about it.

President Xi was upbeat and willing to negotiate an end/pause to the trade war, on the 'basis of mutual respect and equality', not Trump's strongpoints. But, the US has its precious 'Phase One' trade deal now (a 'big, beautiful monster' according to Trump), although there is a long way to go. Most tariffs stay in place under this deal; its most direct effect is the cancellation of December 15's scheduled tariffs on Chinese electronics and a halving of tariffs on $120bn of other imports. We still have 25% tariffs on $250bn of Chinese imports so 'Phase Two' is an important next step. There is a commitment from China to buy $200bn of US exports over the next two years.

As the year turned, liquidity measures from the Federal Reserve ensured we saw none of September's spike in overnight money market rates.

The Federal Reserve remains on hold following three rate cuts, while signalling no change this year, and are becoming more optimistic about the US economy, especially after blow-out employment numbers. However, they remain in the firing line. President Trump appeared to reinstate tariffs on steel and aluminum from Argentina and Brazil out of spite for the Fed not furnishing him with negative rates. Like a jealous child, he remains envious of the eurozone's negative rates, but seems to be completely oblivious to the mess that they have produced.

New European Central Bank (ECB) President, Christine Lagarde, appears to be carrying on where her predecessor Mario Draghi left off. The ECB is 'to continue bond purchases for as long as needed'. However, some in the ECB have been emboldened to express some division and to criticise some of Draghi's parting (and previous) measures; in particular, the Netherlands pointed out that they have produced distortion of pricing in financial markets. He, and former Fed Chairman Yellen, took to the stage at the American Economic Association's annual meeting to warn of policy mistakes in a low rate environment and stated that Central Banks don't necessarily have the right tools at their disposal. With the German Government Bund curve still at negative yields out to ten years ('distortion of pricing in financial markets'), the result of policies directly authorised and overseen by Draghi himself, this seems to turn the spotlight onto his strategy of wiring in the eurozone financial system to an endless cycle of critical support. Weaning economies off dependence on Central Bank action in favour of individual government fiscal measures is surely wise.

Separately, the BoE stress tests showed our financial system could cope with a global crisis or a disorderly exit from the EU. All our biggest banks passed the 2019 test but the counter-cyclical buffer was raised to 2%. The report shows that under the worst case scenario, triggers of Lloyds and HSBC 'bail in bonds' would have been hit. They repeated that banks need to be ready for LIBOR ceasing to exist from 2021.

A dramatically busy burst of early-year bond issuance across all currencies into the primary market has given us one of the busiest starts ever, with €33bn, £5.5bn and $62bn in new issues in the first full week of the New Year. In sterling, we initially saw mainly financial (and floating rate) issues, many times oversubscribed. After issuance records tumbled in 2019, the supply of new sterling credit is likely to be lower this year as we have only £4.4bn of sterling bonds maturing in 2020 as opposed to the £13bn in 2019. The first to redeem is Heathrow Funding, where we would hope to see a rollover replacement. Credit spreads did nothing but rally over the fourth quarter and remain anchored at mid-2007 levels, reaching new five-year lows. This remains a cause of unease because we can all remember where they went from there. We won't try and draw too many parallels with that period, but ultimately investors are not always being correctly compensated for the credit risk that they are embracing.

***Jeremy Wharton*** *January 2020*

## Foreign Exchange

| | Cross Rate: | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|---|
| £ | $/£ | 1.319 | 1.230 | +7.2% | +3.6% |
| | euro/£ | 1.175 | 1.127 | +4.3% | +6.1% |
| | £ Exchange Rate Index | 80.7 | 76.9 | +4.9% | +4.7% |
| $ | US$/euro | 1.123 | 1.091 | -2.8% | +2.0% |
| | Yen / US$ | 108.5 | 108.1 | +0.4% | -1.1% |
| | Renminbi / US$ | 6.96 | 7.15 | -2.7% | +1.2% |
| | $ Exchange Rate Index | 96.4 | 99.4 | -3.0% | +0.3% |

*Source: Bloomberg*

We have already mentioned the move in sterling, which was the obvious feature of the quarter, as it rose against all the major currencies, notably v. the US dollar. With the prospect of a Corbyn administration removed and the chances of a 'hard Brexit' diminished (for now), we would expect sterling to hold most of these gains. Progress, or lack of it, in trade talks with the eurozone are likely to lead to renewed volatility in the second half.

Meanwhile, the US dollar has been fading somewhat against most currencies, particularly over this final quarter of the year (see opposite), while the euro is showing early signs of a recovery after slipping for the past two years (lower chart opposite).

## Commodities

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| Oil – Brent (barrel) | $66.0 | $60.9 | +8.4% | +22.7% |
| Gold (troy ounce) | $1518 | $1470 | +3.3% | +18.8% |
| Copper (25 metric tons) | $6174 | $5725 | +7.8% | +3.5% |
| Wheat (5000 bushels) | $559 | $503 | +11.1% | +1.2% |
| Commodity Price Index | 185.8 | 174.6 | +6.4% | +9.4% |

*Source: Bloomberg*

Commodity prices generally showed strong gains over the final quarter, encouraged by an apparent truce in the trade war, taking them all into positive territory for the year as a whole.

Oil prices are also being pushed around by worries over a renewed flare-up in the Middle East, as events of the past couple of weeks have demonstrated once again. This does have the potential to threaten the nascent pick-up in global economic activity; let's hope that sense will prevail and it can be contained.

This chart shows the value of the US dollar against all major world currencies. As can readily be seen, it is not far off being a mirror image of the chart below:

**The US Dollar Index**


*Source: Bloomberg*

With some signs of an improving economic outlook for the eurozone, the euro has recently began to pick up. This shows the exchange rate to the US dollar (how many US dollars are required to purchase €1):

**Euro / US Dollar Exchange Rate**


*Source: Bloomberg*

## UK Equity Markets

| Index: | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| FTSE All-Share | 4196.5 | 4069.0 | +3.1% | +14.3% |
| FTSE 100 | 7542.4 | 7408.2 | +1.8% | +12.1% |
| FTSE Mid 250 | 21883.4 | 19937 | +9.8% | +25.0% |
| FTSE Small Cap | 5950.5 | 5474 | +8.7% | +15.2% |
| FTSE AIM All-Share | 958.3 | 872.2 | +9.9% | +11.8% |

The last quarter got off to a poor start for London stocks as fears mounted for a hard Brexit. This coincided with some weak economic figures from America, and the first few days of October saw a rapid fall of around 6% in share prices. But that was the worst of it and, despite some early December nervousness, the clear Election result produced a bright finish to the year.

**FTSE 100 (dark blue) and Mid 250 Indices –2017/19**


*Source: Bloomberg, FTSE International*

As the chart and table shows, the major beneficiaries were companies in the mid 250 area, which have much more of a UK domestic focus, while the major international companies with foreign currency earnings did not fare as well. Despite the cheerful annual returns shown, we have (a shade churlishly) shown the chart over two years to illustrate that all that has really happened is that prices have (almost) got back to where they were at the end of 2017. The final quarter did provide some stark contrasts. The oil production companies have been out of favour all year and this continued into the last three months with further falls for both **BP** and **Royal Dutch Shell**. The explorers fared better, with **Tullow** the exception after a poor drilling and production report.

Also weak against the strong market were a number of the 'staple goods' companies, **Diageo**, **Britvic** and **Fevertree** among the drinks companies, along with **Unilever**. **Smith & Nephew** weakened while the less well known **NMC Health** (they are a member of the FTSE 100 Index), suffered a 35% collapse in its share price after the American firm Muddy Waters called their accounts into question.

Leading the market up were a number of sectors that had been out of favour or were particularly worried by the possibility of a Labour government. The utility companies jumped, **United Utilities**, **Severn Trent** and **SSE** were all up around 15% over the quarter, while the beleaguered **Centrica** (British Gas) rose 21%. Construction companies such as **Balfour Beatty** and **CRH**, rose strongly, along with the housebuilders, **Persimmon**, **Barratt Developments** and **Taylor Wimpey**.

The retail sector also celebrated, with **Next** and **Marks & Spencer** both up around 15% and **WH Smith** by 30%. The story in this sector, though was the on-going battle to take over **Just Eat**, which rose 25%. The Dutch company **Takeaway.com** first bid for Just Eat back in July, prior to the appearance of a rival bid from **Prosus** (a subsidiary of the South African company **Naspers**). Post the year end, this has been settled in favour of Takeaway.com. Just Eat was founded in Denmark in 2000, transferred to the UK in 2005, and came to the London stock market in April 2014. This takeover values the business at around £6bn.

The financial sectors largely benefitted. The domestic banks, **Barclays**, **Lloyds** and **RBS**, all rose 15%/20% but the sector was weighed down by the on-going dull performance of **HSBC**, which fell a further 5%. The life assurers, **Prudential**, **Legal & General** and **Aviva** all rose, but the general insurers were rather more mixed as the two Lloyds underwriters **Hiscox** and **Beazley** fell after a disappointing update from Hiscox. Earnings estimates for the year ahead have come down, leaving the market vulnerable to any disappointments in the full-year reporting season:

**Fundamental Valuation Indicators**

| FTSE All-Share Estimates* | 31 Dec 2019 | 30 Sep 2019 | 31 Dec 2018 |
|---|---|---|---|
| Earnings (per Share) | 329.2 | 333.2 | 328.6 |
| Price / Earnings Ratio | 12.7 | 12.2 | 11.2 |
| Earnings Yield | 7.8% | 8.2% | 8.9% |
| Dividends (per Share) | 189.6 | 186.9 | 182.6 |
| Dividend Yield | 4.5% | 4.6% | 5.0% |
| Dividend Cover | 1.7X | 1.8X | 1.8X |

**Bloomberg aggregate earnings estimates for the year ahead*

## INTERNATIONAL EQUITY MARKETS

| Index: | 31 Dec 2019 | 30 Sep 2019 | Quarter* | 2019* |
|---|---|---|---|---|
| US - S&P 500 | 3230.8 | 2976.7 | +8.5% | +28.9% |
| US - NASDAQ | 8972.6 | 7999.3 | +12.2% | +35.2% |
| UK – FTSE All-Share | 4196.5 | 4069.0 | +3.1% | +14.3% |
| Germany - DAX | 13249 | 12428 | +6.6% | +25.5% |
| France - CAC 40 | 5978 | 5678 | +5.3% | +26.4% |
| Switzerland - SMI | 10617 | 10078 | +5.3% | +26.0% |
| Japan - TOPIX | 1721.4 | 1587.8 | +8.4% | +15.2% |
| Brazil - Bovespa | 115645 | 104745 | +10.4% | +31.6% |
| China – Shanghai Comp. | 3050.1 | 2905.2 | +5.0% | +22.3% |
| Hong Kong – Hang Seng | 28190 | 26092 | +8.0% | +9.1% |
| Australia – ASX 200 | 6684.1 | 6688.3 | -0.1% | +18.4% |

*Change in local currency*

A bright end to the year, with (almost) all the indices up, provided the icing for a strong year for international stock markets. As with the UK, this needs to be put in the context of 2018, which was the complete opposite. Over two years, the Far Eastern markets of China, Hong Kong and Japan are still negative, in Europe, Germany is about level while France is up modestly. Once again, the real strength has come from America, which made-up the losses of 2018 and then moved ahead again:

**S&P 500 Index - 2017/19**


*Source: Bloomberg*

The American market was led up by the technology sectors and, specifically, by **Apple** and **Microsoft** the two largest (quoted) companies in the world. Saudi Arabia might wish to argue that statement having spent the best part of two years preparing **Saudi Aramco** (Saudi Arabian Oil Co.) for an initial public offering (IPO) of shares, which finally went ahead in early December. The IPO was delayed, talk of a listing in London or elsewhere eventually came to nothing amid scepticism from non-Saudi investors, so the shares are just listed on Saudi Arabia's stock exchange, the Tadawul. Nominally, Aramco is the biggest company in the world; it is almost certainly the most profitable. But, with around only 1.5% of the Company in public hands, it is hard to say that there is any real price 'discovery' yet, so it doesn't qualify.

We should also mention the Swiss market, which was the only other of the major world markets to show such a strong performance over the two-year period. The Swiss market is dominated by three large companies: **Nestlé** and the two pharmaceutical majors, **Roche Holding** and **Novartis**; a year which saw all three up 25%/30% is almost bound to go well.

American stocks dominated in most of the international sectors. Among the financials, **JP Morgan** and **Bank of America** were both up by more than 40% over the year, while **Mastercard** and **Visa** (both classified as Information Technology companies these days), were even stronger. European banks provided a contrast, in Switzerland **UBS** was up 5%, **Credit Suisse** fared better, up by 23%, but in Germany, both **Commerzbank** and **Deutsche Bank** fell again. The French banks had a better final quarter with improving economic indicators for France, both **BNP Paribas** and **Société Générale** closing positive for the year.

US technology companies led the markets. Beside the major names mentioned above, the semiconductor stocks really stood out, notably **Advanced Micro Devices**. This did spill over into some of the European names (sadly, there aren't many); the Dutch company **ASML Holdings** was up 16% in the final quarter. Industrial stocks mostly put in a good performance though **Boeing**, for obvious reasons, made no headway, and **Fedex** continued to struggle in difficult markets. **Atlas Copco**, the Swedish industrial engineer shone with a 77% gain for the year. The US 'security' contractors **Northrop Grumman** and **Lockheed Martin** also had a notably strong year.

Many of the laggards over the final quarter came from the staple goods area of the markets: **Kraft Heinz** closed a dreadful year with a flat quarter, **Mondelēz** was also flat while **Keurig Dr Pepper** was volatile but closed just ahead. **McDonalds** and **Starbucks** both fell but **Tiffany** was a bright spot, jumping after receiving a bid from **LVMH**. Quite nice to see a bid from this side of the Atlantic for a change.

## CHURCH HOUSE INVESTMENT GRADE FIXED INTEREST

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| CH Investment Grade* - Inc. | 116.3 | 115.7 | +0.5% | +3.3% |
| iBoxx AA Corporate 5-15 year | 99.8 | 102.2 | -2.3% | +5.2% |
| CH Investment Grade - Accum. | 174.3 | 172.4 | +1.1% | +5.6% |
| iBoxx £ ABS 5-10 year TR** | 340.1 | 342.8 | -0.8% | +6.9% |

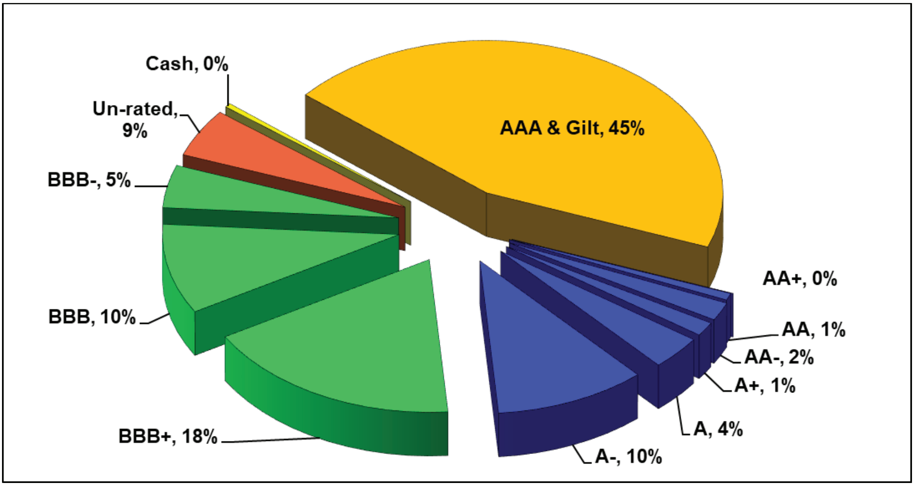
**bid price to bid price, excluding income. **Total Return Index.*

In an increasingly difficult fixed interest market over the final quarter of the year, the Investment Grade Fixed Interest portfolio demonstrated its defensive qualities with a modest increase. As can be seen below, its positioning is still cautious:

| CH Investment Grade Fixed Interest | Dec 2019 | Sep 2019 |
|---|---|---|
| Short-dated Securities (less than 7 years)* | 74.6% | 75.9% |
| Medium-dated Securities (7 to 15 years) | 21.7% | 20.3% |
| Long-dated Securities (over 15 years) | 3.8% | 3.7% |
| Duration of Portfolio | 2.9 | 3.1 |
| Volatility (past year) | 1.0% | 1.4% |
| Number of Holdings | 106 | 104 |
| Yield | 2.1% | 2.1% |
| Portfolio Value | £373m | £358m |

*Volatility is annual standard deviation expressed as a percentage*

**CH Investment Grade Fixed Interest – by Credit Rating – 31 December 2019**




*Source: Church House*

| Top 15 - 31 December 2019 | |
|---|---|
| Treasury 2% 2020 | 3.5% |
| Coventry B/S Covered (SONIA) 2023 | 2.9% |
| Treasury 4.75% 2020 | 2.7% |
| Royal Bank of Canada (SONIA) 2024 | 2.4% |
| Santander Covered (SONIA) 2021 | 2.4% |
| Bank of America 7% 2028 | 2.4% |
| Goldman Sachs Group Inc 7.25% 2028 | 2.2% |
| Lloyds Covered (SONIA) 2021 | 2.2% |
| Nationwide B/S Covered (SONIA) 2022 | 2.0% |
| ANZ Covered 2022 | 1.9% |
| AP Moller-Maersk 2025 | 1.7% |
| Yorkshire B/S Covered (SONIA) 2023 | 1.6% |
| Yorkshire Covered (SONIA) 2024 | 1.6% |
| Lloyds Covered (SONIA) 2024 | 1.6% |
| Orange SA Hybrid 2022 | 1.5% |

The top fifteen holdings in the portfolio are almost unchanged from the end of September. The **Yorkshire Building Society** covered floating rate note 2024 is a new holding, which came to market in mid-November. Otherwise the only movements were in the two short-dated Treasury stocks (gilts), which we use as cash deposit instruments, and a slight shuffling in values. All of the issues marked (SONIA) are floating rate notes linked to the Sterling Overnight Interest Average, which is calculated by the Bank of England each day.

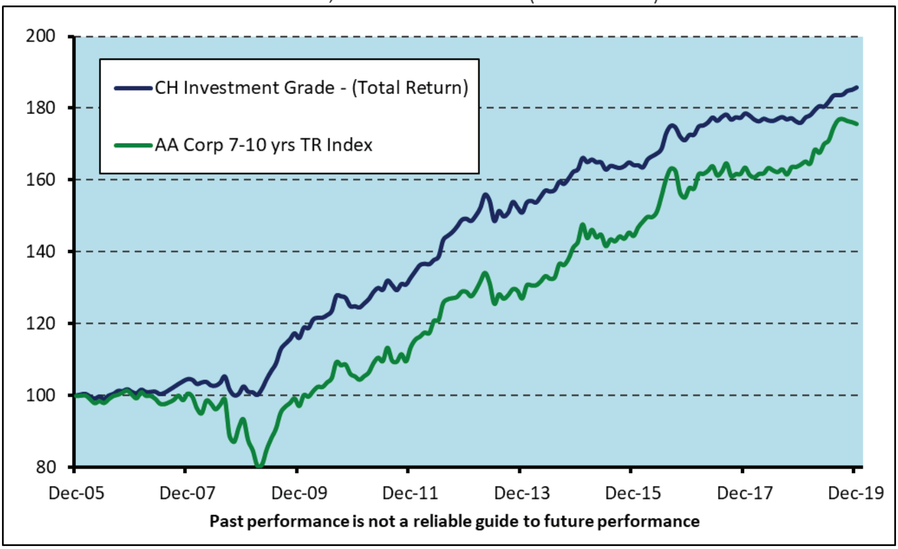
**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 5.6% | -1.5% | 3.3% | 4.6% | 0.1% | 7.2% |

*Source: Church House, bid price to bid price, accumulation units.*

**CH Investment Grade Fixed Interest vs AA rated Corporate Securities**

Bid Prices, Income re-invested (Total Return)




*Source: Bloomberg, Church House*

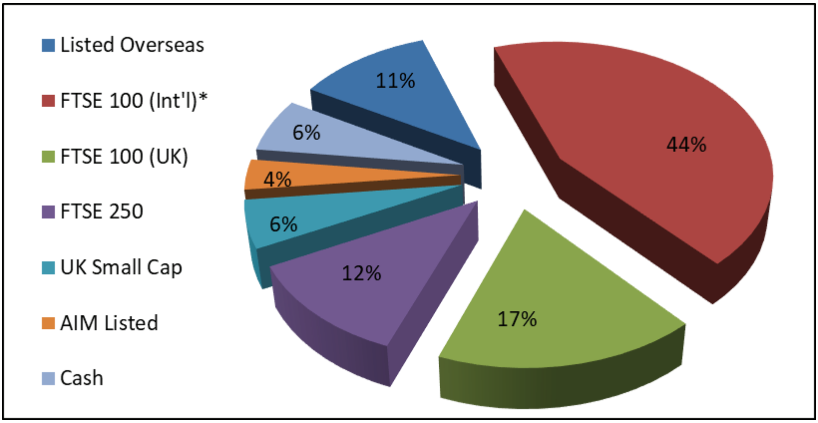
## Church House UK Equity Growth

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| CH UK Equity Growth* | 184.9 | 181.3 | +2.0% | +14.1% |
| FTSE 100 Index | 7542.4 | 7408.2 | +1.8% | +12.1% |
| FTSE All-Share Index | 4196.5 | 4069.0 | +3.1% | +14.3% |

** Bid price to bid price, excluding distributions of income (capital performance)*
*Management fees are charged to income.*

As with the previous quarter, the pie chart reflects the continued shift towards UK assets. Over the period, we also changed its name to Church House UK Equity Growth to better reflect its purpose and ambition:

**CH UK Equity Growth – Disposition – 31 December 2019**




*Source: Church House *FTSE 100 (International) is our definition – FTSE 100 companies with more than 75% of sales arising overseas.*

We exited the position in cruise line operator **Carnival**, after worrying about the long-term quality of the business. A study in the *Financial Times* reported that the cruise brands run by the company emit ten-times more polluting emissions than the total output of Europe’s passenger vehicles combined. In its place, we initiated in **InterContinental Hotels Group** which owns the master franchise for global hotel brands ranging from Holiday Inn to ultra-luxury resort operator Six Senses. In the oil sector, we sold our position in **Premier Oil** after it reached our target price. Unfortunately, we retained our smaller position in **Tullow Oil**, which reported a terrible exploration update, hitting their shares hard; we have sold the position.

We decided to sell our long-standing position in **Eco Animal Health** after an unsatisfactory meeting with their management, which raised a number of warning signs for us. Thankfully, we had fully exited this position before they issued a profit warning in early November, after which their shares halved.

| Top 15 - 31 December 2019 | |
|---|---|
| Diploma | 3.5% |
| Diageo | 3.3% |
| Unilever | 3.3% |
| RELX | 3.3% |
| Smith & Nephew | 3.3% |
| Royal Dutch Shell B | 3.3% |
| Roche | 3.2% |
| Halma | 2.9% |
| Schroders | 2.9% |
| Rio Tinto | 2.9% |
| BHP Group | 2.8% |
| Spirax-Sarco Engineering | 2.8% |
| Melrose Industries | 2.3% |
| Barclays | 2.2% |
| Standard Chartered | 2.2% |

We trimmed our position in cybersecurity provider **Avast** after their peer **Sophos** were bid for by US Private Equity. Avast shares had climbed 50% over the second half so it was an opportune moment to reduce. In the lead up to the Election, and as volatility picked up, we took the opportunity to add to a number of our core positions, such as **Diageo, RELX** and **Unilever**. These high quality businesses were out of favour due to a combination of sterling strength and a wider market sentiment shift away from 'defensive' names. We like these companies' high revenue visibility and long-term record of steady growth through thick and thin (many have been in the portfolio for almost twenty years now).

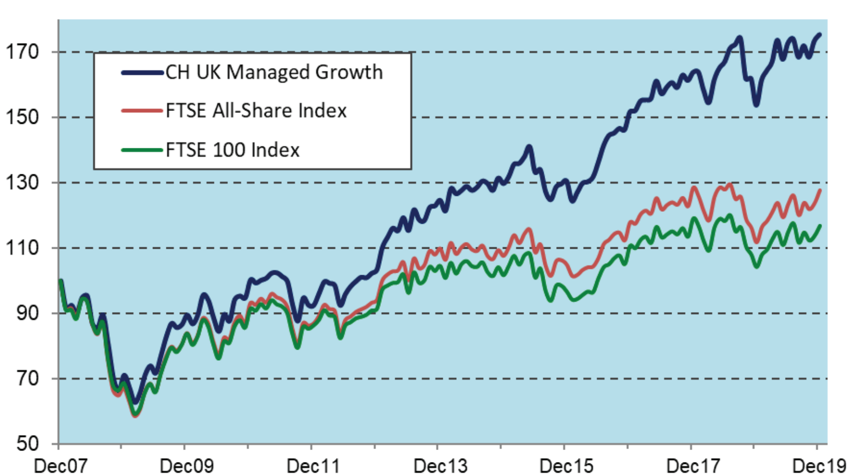
**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 15.7% | -5.1% | 9.0% | 17.6% | 1.7% | 5.2% |

*Source: Church House - bid price to bid price, accumulation units.*

**CH UK Equity Growth vs FTSE Equity Indices**

Bid Prices, excluding income – Capital Performance




**Past performance is not a reliable guide to future performance**

*Source: Church House, Bloomberg*

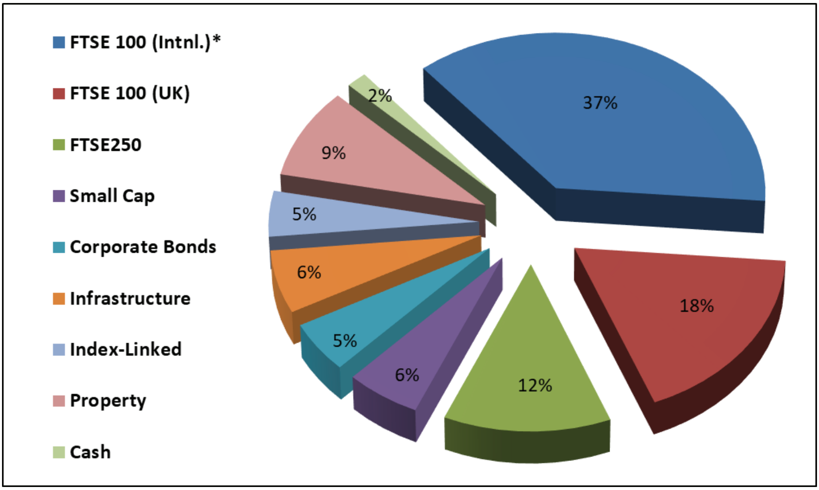
## Church House Balanced Equity Income

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| CH Balanced Equity Income* | 192.1 | 190.7 | +0.7% | +10.7% |
| FTSE Higher Yield Index | 3653.2 | 3538.5 | +3.2% | +7.7% |
| FTSE All-Share | 4196.5 | 4069.0 | +3.1% | +14.3% |
| FTSE Index-Linked All Stocks | 679.8 | 743.8 | -8.6% | +5.8% |
| Composite Benchmark** | 118.7 | 117.5 | +1.0% | +10.1% |

**Bid price to bid price, excluding income payments (capital performance)*
***42% FTSE Higher Yield, 42% FTSE All-Share, 16% FTSE Index-Linked All-Stocks Indices.*
*The management fee in CHBE is split 50/50 between capital and income.*

The Balanced Equity Income portfolio was marked ex-dividend at the end of the period, a modest increase in the dividend paid at this time last year. The portfolio's disposition at the end of the quarter/year was little changed from September:

**CH Balanced Equity Income – Disposition – 31 December 2019**




*Source: Church House *as previously*

In October, we added to the holding in **SDCL Energy Efficiency Income Trust**, which came to the market to raise further funds during the month. There were many reports from portfolio companies, including **HSBC**, **Barclays** and **Lloyds**, which had all suffered a final burst of PPI insurance claims as the deadline arrived (finally). The major pharmaceuticals, **AstraZeneca** and **GlaxoSmithkline**, responded well to their progress reports. We met the management of **Greggs**, who continue the development of new ranges (notably vegan), shop refurbishments and new 'drive-throughs'. Shares in **Compass Group** dipped at the end of November after their trading statement stated that European sales growth was slowing with some accompanying margin pressure; we added to our holding.

| Top 15 - 31 December 2019 | |
|---|---|
| GlaxoSmithkline | 3.7% |
| Royal Dutch Shell 'B' | 3.4% |
| RELX | 3.2% |
| HSBC | 2.8% |
| AstraZeneca | 2.6% |
| Diageo | 2.5% |
| Lloyds FRN 2021 | 2.5% |
| Halma | 2.5% |
| Unilever | 2.4% |
| Smith & Nephew | 2.3% |
| BHP Group | 2.3% |
| Sage | 2.1% |
| Rio Tinto | 2.1% |
| BP | 2.1% |
| Greggs | 1.9% |

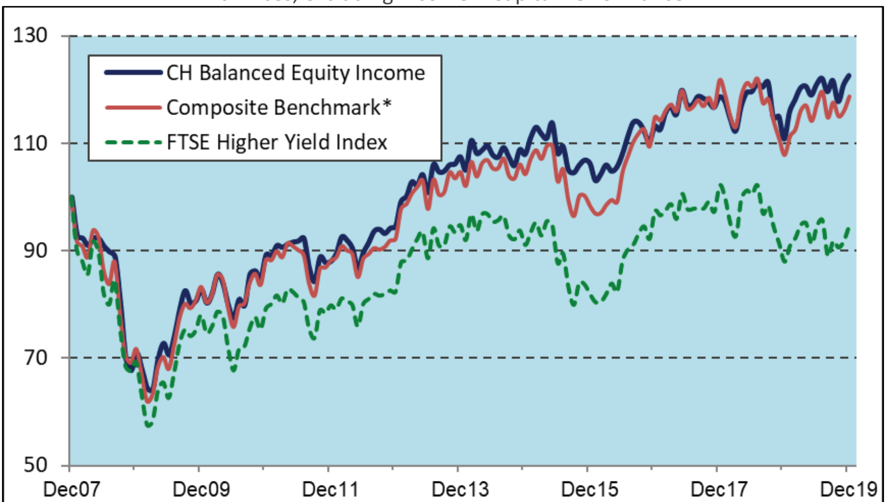
**Micro Focus International** has been weak since their poor statement at the end of August, but their share price appears to have 'found a level' and we added to this holding. December was a good month after the Election, the portfolio benefitted particularly from the strength of domestic equity issues, notably in the financial and utility sectors. We reduced the holding in **Berkeley Group** whose stock leapt after the result, on top of what had already been a good year for house-builders. We note that their Chairman, Tony Pidgley, also reported the sale of just over one million shares from his holding a few days later. A sharp recovery in the shares of the infrastructure and property companies also helped.

**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 14.2% | -3.6% | 8.3% | 10.3% | 2.0% | 3.9% |

*Source: Church House, bid price to bid price, accumulation units*

**CH Balanced Equity Income vs Composite Index* & Higher Yield**
Bid Prices, excluding Income – Capital Performance




**Past performance is not a reliable guide to future performance**

*Source: Church House *40% FTSE Higher Yield, 43% All-Share, 17% Index-Linked All-Stocks*

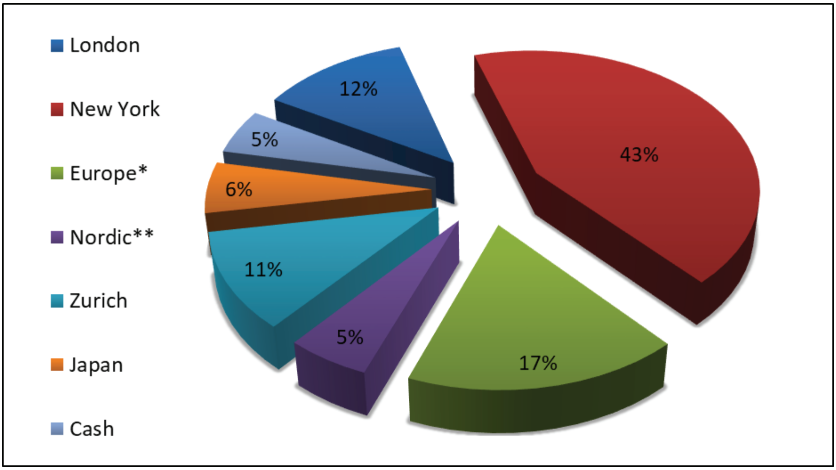
## CH Esk Global Equity

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| CH Esk Global Equity* | 301.7 | 301.4 | +0.1% | +19.1% |
| CH Global Index in £ | 1026.8 | 1017.5 | +0.9% | +19.7% |
| FTSE 100 Index | 7542.4 | 7408.2 | +1.8% | +12.1% |

** Bid price to bid price, excluding distributions of income (capital performance)*

Being priced in sterling, the Esk Global Equity portfolio is held back by the rise in the pound (its assets are principally overseas) but, overall, it has been a satisfactory year. The pie chart shows the geographical split at the year end:

**Esk Global Equity Constituents by Country of Listing - 31 December 2019**




*Source: Church House *Amsterdam, Paris, Frankfurt **Copenhagen, Stockholm*

October was an active month as we reviewed several different areas. Japanese stocks have performed better since the August lows; we added to our holdings in **Nidec Corp** and **Sony** but closed the position in **Bridgestone**. In the Oil Production & Services area, we sold out of **Exxon Mobil** to establish a new position in **Phillips 66,** a 'downstream' energy company, and (re)establish a holding in the oil services company, **TechnicFMC**. We initiated a new position in **The Walt Disney Company**, whose stock price had drifted lower despite the opportunities in online streaming (Disney Plus). Otherwise, we saw opportunities to add to existing holdings in **Monster Beverage Corp** and **McDonald's**, whose share prices had weakened during the month and to **Henkel AG**, whose stock appears to be recovering after a dismal year. But it wasn't only these less cyclical areas; we also added to **Morgan Stanley**. In November, we continued to build the position in **Walt Disney**, now up to our target weighting; it was encouraging to see the strong start to Disney+ reported later in the month. We closed the remaining small position in **Royal Caribbean** while adding further to the holding in **RELX**.

| Top 15 - 31 December 2019 | |
|---|---|
| Microsoft | 3.2% |
| Stryker | 3.1% |
| Alphabet | 2.8% |
| LVMH | 2.6% |
| Nestlé | 2.6% |
| Roche | 2.6% |
| SAP | 2.4% |
| Apple | 2.4% |
| Unilever | 2.3% |
| Mondelez International | 2.3% |
| McDonald's | 2.2% |
| Lonza Group | 2.2% |
| Heineken | 2.2% |
| RELX | 2.1% |
| Illumina | 2.1% |

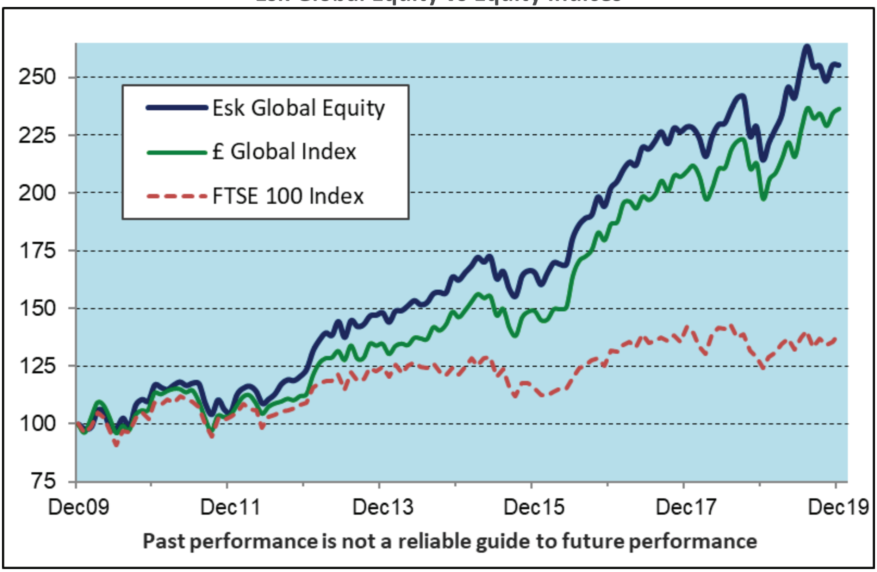
In technology, we sold **Palo Alto Networks** but have commenced a new position in **Intuit**, which provides software and accounting packages, principally for smaller businesses (their QuickBooks accounting system was heavily advertised over the Christmas period). An uncertain start to December for markets presented some opportunities: we topped-up **L'Oréal** and the Amsterdam-listed line of **RELX**. We did establish a new initial position in **Euronext**, the pan-European stock exchange incorporating the bourses of Amsterdam, Brussels, Lisbon and Paris, while closing the position in **Prudential**. Latterly we topped-up the holding in **Unilever** as they weakened late in the month.

**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 20.2% | -5.6% | 13.9% | 23.1% | 3.0% | 10.3% |

*Source: Church House - bid price to bid price, accumulation units*

**Esk Global Equity vs Equity Indices**




*Source: Church House Bid prices of income units (i.e. capital return, excluding income)*

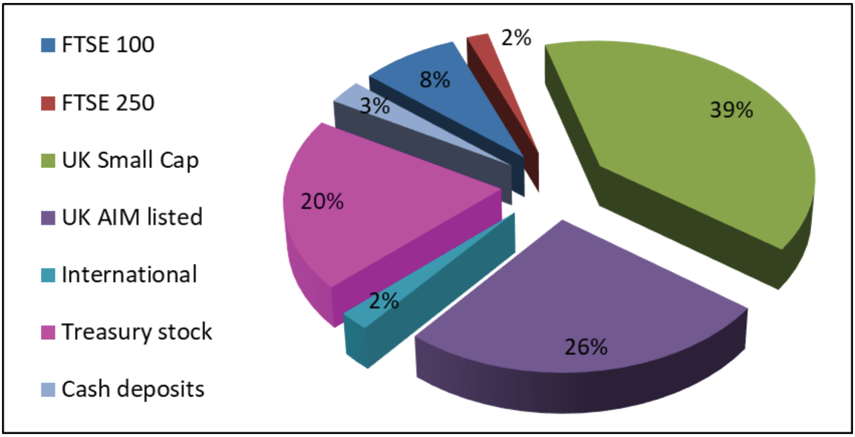
## CH Deep Value Investment

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| Deep Value Investment* | 141.2 | 140.3 | +0.6% | +3.7% |
| FTSE All-Share TR Index | 7838.0 | 7525.1 | +4.2% | +19.2% |
| FTSE Small Cap (ex ITs) TR | 7977.2 | 7109.8 | +12.2% | +17.7% |
| FTSE AIM All-Share Index | 958.3 | 872.2 | +9.9% | +11.8% |

** Bid price to bid price, accumulation shares* Portfolio value: £12.1m

The Deep Value Investment portfolio closed a difficult year for 'value' funds with a modest recovery. The broad disposition of the portfolio is shown below, still with a significant amount in cash assets (23% at the year-end) looking for more interesting opportunities in 2020:

**CH Deep Value Investment – Disposition 31 December 2019**




*Source: Church House*

October was quiet for company updates with only **BP Marsh** and **Record** reporting. Both updates were positively received, particularly **Record's**, which reported further client wins and mandate inflows. **Gattaca**'s share price softened on worries over the outlook for the UK recruitment industry in general. The continued uncertainty around Brexit created a negative backdrop for news in this sector. This spilled over into our other recruitment holding, **Hydrogen Group**, in November, which also suffered from the temporary closure of their Hong Kong office due to the continuing political unrest. The other stock to suffer in November was **Plexus Holdings**. Although this company has recently released a string of positive updates, waiting for a major contract award has caused frustration. However, Plexus currently has a number of tenders outstanding, each of which is capable of being 'game changers'. We opened a small position in **Hunting**, a long-established oil services company, trading on multi-year lows. We did also add to the positions in **Gattaca** and **Plexus** during November.

| Top 15 - 31 December 2019 | |
|---|---|
| Treasury 2% 2020 | 20.2% |
| Cenkos Securities | 9.3% |
| Record Plc | 6.6% |
| Land Securities | 5.8% |
| Plexus Holdings | 5.3% |
| B P Marsh | 5.0% |
| Enteq Upstream Plc | 4.9% |
| Hydrogen Group | 4.2% |
| Indigovision Group | 4.0% |
| Gattaca | 4.0% |
| Xaar Plc | 3.8% |
| Thalassa Holdings | 3.6% |
| Hargreaves Services Plc | 3.5% |
| H&T Group | 3.0% |
| MTI Wireless Edge | 2.5% |

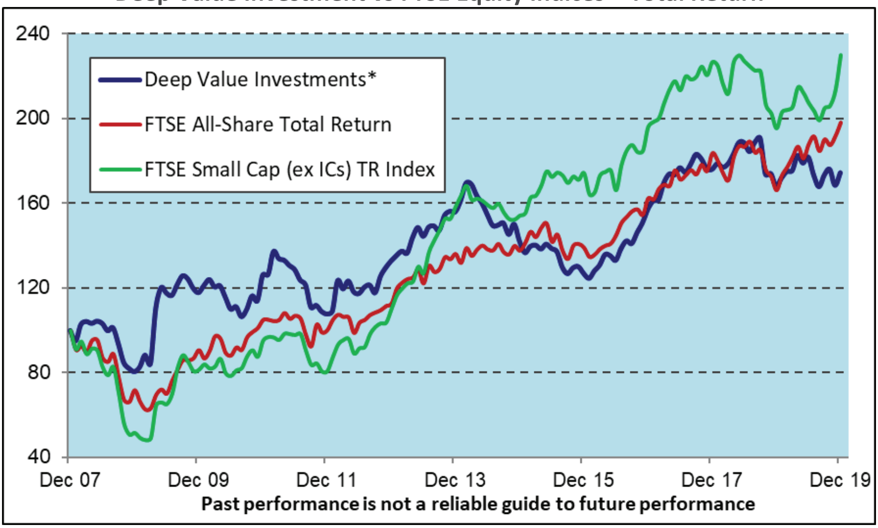
The post-Election bounce helped the overall portfolio, notably the big property companies, while our largest holding, **Cenkos Securities**, gained 30% during December. The announcement that a previous board member and founder of the company had taken a 7% stake, was enough to push the shares higher. His timing may be seen as opportune, with the return of a stable and business-friendly Government. Performance over 2019 has been volatile and disappointing, value as an asset class has struggled to participate in the general market uptrend. That may be so, but buying assets at a discount when so much else seems to be fully valued should make sense.

**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 3.7% | -4.5% | 12.0% | 23.7% | -10.7% | -8.8% |

*Source: Church House - bid price to bid price, accumulation shares*

**Deep Value Investment vs FTSE Equity Indices – Total Return**




*Source: Church House, Bloomberg. *'Deep Value Investments' represents the CH Deep Value Fund, an offshore unregulated scheme, until Feb. 2012 then The Deep Value Investments Fund.*

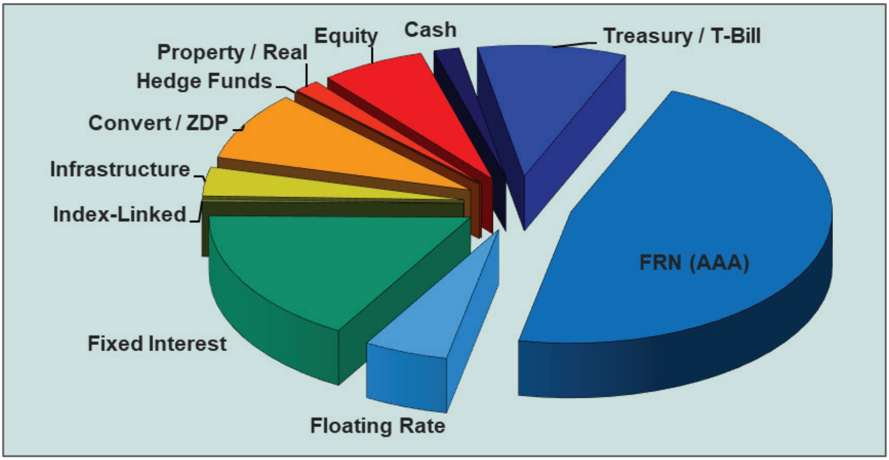
## CH TENAX - ABSOLUTE RETURN STRATEGIES

| | 31 Dec 2019 | 30 Sep 2019 | Quarter | 2019 |
|---|---|---|---|---|
| Tenax Absolute Return* | 156.9 | 155.6 | +0.8% | +3.4% |

**Bid price to bid price, class 'A' accumulation shares* Portfolio value: £436m
*The management fee in Tenax is charged to income*

The Tenax Absolute Return Strategies' portfolio has continued to attract outside interest as one of the few funds genuinely seeking absolute returns, hence the continued growth in scale. If the small recovery in interest rates continues, we should see more opportunities, for the moment the portfolio's disposition is still risk averse:

**CH Tenax Fund – Allocation to Asset Classes – 31 December 2019**




*Source: Church House*

October was a quiet month for transactions, we added one floating rate note (FRN) issue from **CIBC** (Canadian Imperial Bank of Commerce), paying us SONIA+48bp and a modest amount of conventional fixed interest stock from **CK Hutchison Group**, both new issues during the month. Otherwise, we had the opportunity to add to our two relatively new energy efficiency holdings: **Gresham House Energy Storage Fund** and **SDCL Energy Efficiency Income Trust**, both of which came to the market to raise further funds. A new addition to the portfolio is a position in the **Hipgnosis Songs Fund,** which also raised funds during the month. In the equity portion, we took profits in our UK mid-cap exposure after a buoyant month. November was also quiet as we awaited developments in the Election. The only transactions of any scale were the establishment of two new triple-A FRN positions, issues from **Santander UK** and the **Yorkshire Building Society** and reduction in an existing **Export Development Canada** FRN. We reduced exposure to **Euroclear** 1¼% stock 2024, added to our **Remgro** convertible holding and to the zero dividend preference share issue from **Aberforth** (though this involved four separate trades over the month).

**Top Holdings - 31 December 2019**

We are not showing the top holdings for this portfolio as they are all short-dated Treasury instruments and FRNs, which is not very informative. We will happily send details of the full portfolio to anyone who would like to see.

We remained quiet over the first ten days of December in the run up to the Election, but the strength in sterling in the final days led us to start to rebuild the foreign currency exposure in the portfolio: we bought US dollars and euro. We utilised some of this to acquire US dollar FRNs from **Goldman Sachs** and **JPMorgan**. Otherwise, we took some profit from our **Swiss Re** convertible holding and added further to two of the zero dividend preference holdings.

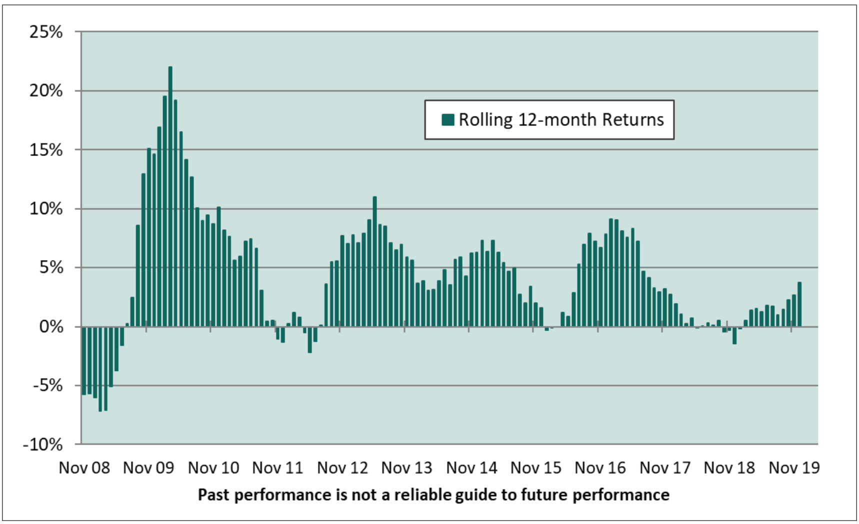
Post-Election there were some sharp moves: we reduced our UK property exposure into this. **Land Securities** stock price jumped 10% (adding to a solid recovery from the August lows); we sold part of this holding. In contrast, a number of the major international stocks were adversely affected. We acquired new positions in a number including **Diageo** and **Royal Dutch Shell**, and latterly added a position in **Unilever** whose stock was knocked back after they reduced sales guidance. The sterling floating rate note market remained active and we added two new holdings from **Lloyds Bank** and the **Yorkshire Building Society** at issue.

**Calendar Year Performance:**

| 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| 3.4% | -1.7% | 2.5% | 7.6% | 1.3% | 6.0% |

*Source: Church House Investments, NAV to NAV, accumulation shares*

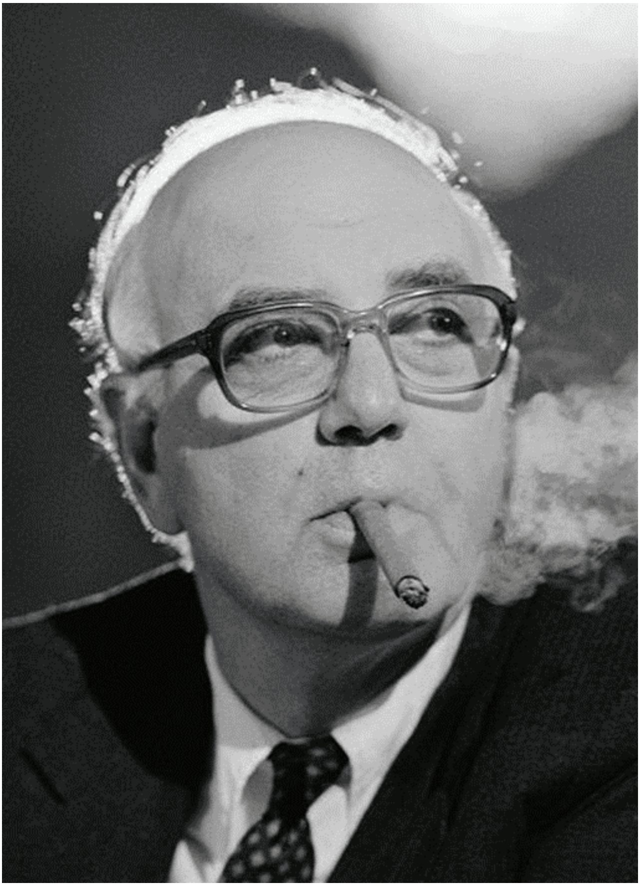
**CH Tenax Absolute Return Rolling Annual Returns**




*Source: Church House, Tenax B shares*

# Paul Volker

1927 - 2019



Paul Volker, Chairman of the Federal Reserve from August 1979 to August 1987 and slayer of the inflation dragon, died in December aged 92. In 1971, under the Nixon administration, he had a major role in the decision to suspend convertibility of US dollars into gold. Latterly, he served under President Obama as Chairman of the Economic Recovery Advisory Board.


**Church House Investment Management**

www.ch-investments.co.uk

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