AJ Bell

AJ Bell Passive funds – Q1 2019 review

Introduction

Welcome to the latest quarterly report for the AJ Bell managed funds.

Written by the team at AJ Bell Investments, this report analyses the funds' performance and brings you up to speed with the main market developments. It also tells you about any changes we made to the funds during the quarter.

Fund costs & charges

We're very pleased to report that in February 2019, we were able to reduce the cap on all our AJ Bell Passive funds' ongoing charges from 0.5% to 0.35%.

We've been able to reduce the cap by so much (30%) because the funds have grown in scale. Simply, the more people invest in the fund, the lower their running costs become. And we're committed to pass these savings on to you, the investor. As the funds grow larger in scale, you can expect the cap on the ongoing charges figure to fall even further.

Market performance

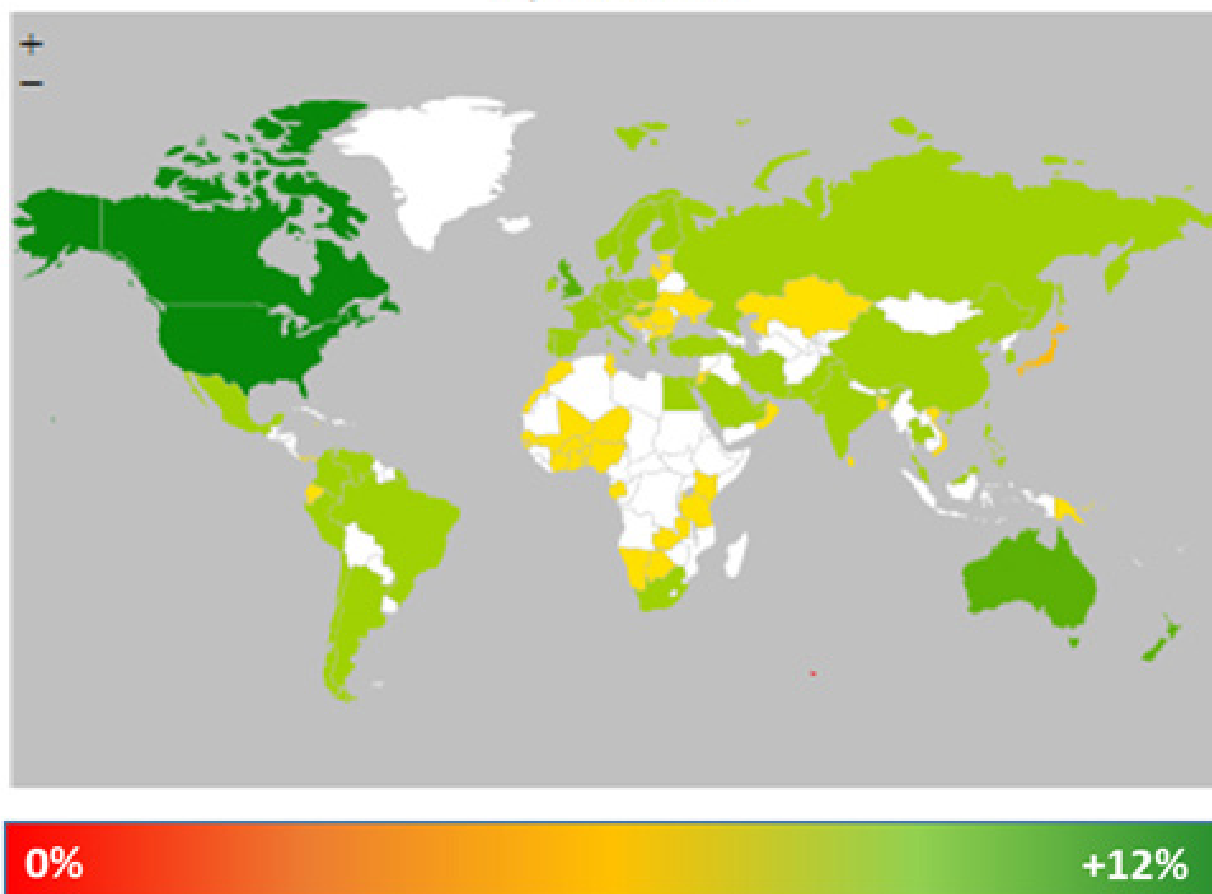
In sharp contrast to the end of 2018, the first quarter of this year saw all the major stock markets posting positive performance. That's despite relatively weak economic data and a challenging political landscape across a number of developed and emerging markets.

The aim of multi-asset funds such as ours is to combine different asset classes together to provide diversification to investors. The idea is that as some asset classes fall in value and reduce performance, others will rise and help make up for it. It's interesting, then, to see that in Q1, all four asset classes which make up our funds - shares, bonds, property and cash - posted positive returns.

US stock markets performed well in Q1, up over 11% in sterling terms, closely followed by UK and Asian stock markets, both up over 9%. European and Emerging Market shares both achieved similar returns of just under 8%, while Japanese markets were the laggard of the group, closing up 4%. The big winner among shares, however, wasn't a regional market but a sector - technology bounced back from a poor Q4 to achieve gains over 17% in sterling terms, helping those funds that sit higher up the risk scale and include technology allocation.

On bond markets, global high yield bonds were the best performer, returning over 6% in local currency terms. With the funds holding a currency hedged position, investors will receive the full 6% returns, rather than the 4% they would have received, if the returns were exposed to moves in sterling over the period. UK corporate bonds followed up as the next best performer, up over 4.5%, while UK government bonds (or gilts as they're known) had a respectable quarter, returning over 3% in the period. Gilts of shorter maturity were also positive, but it was at a much lower level, with them returning just over 0.5%. This weighed on the performance of our funds, in which these types of gilts are well represented – in our lowest-risk funds especially. That said, given the extreme overvaluation of UK gilts relative to history, we remain confident that our stance here will pay off and believe it's the right position to hold at this time, to protect our investors.

It was also a good quarter for another asset class that our funds invest in: property. Traditionally, property is an asset class that belongs in the realm of active funds, so it was pleasing to see that our passive property holdings performed well in the period, up around 7%. By comparison, active property funds - such as that offered by well-known property manager L&G – achieved returns of around 3%. In our funds, it's unlikely we will capture the full upside performance of the UK REIT sector, because of the way we implement our holding, which sees us combining a REIT ETF with index-linked gilts. However, our approach removes some of the leverage that investors in REITs are exposed to, so it was pleasing to deliver a strong return, while also controlling for the risks that are inherent to REITs.



Heat map of global stock market returns by region. Source: Bloomberg, AJ Bell

Moderately Cautious

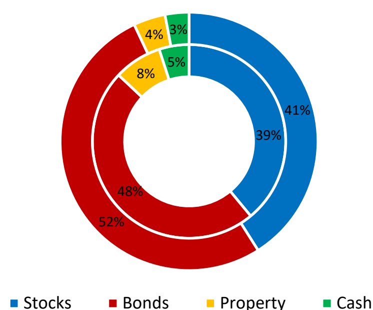
Performance

In Q1 the Moderately Cautious fund delivered a return of 5.16%, giving the fund a return of 5.27% over the last 12 months.

The Moderately Cautious fund has a significant portion - 55% - of its assets in cash and bonds. These asset classes performed positively over the period, albeit at a lower level than shares and property. A large segment of the fund's bond holdings is made up of UK corporate bonds, one of the best-performing areas of bond markets over the period. The fund also holds global high yield bonds, which posted attractive gains in the quarter too. Tempering performance was our tactical decision to allocate to shorter-dated gilts, which saw us miss out on some return versus the wider gilt market, as yields fell on longer-dated holdings more than on shorter-dated - likely due to the uncertainty around Brexit negotiations. Turning to the fund's stock market positions, a significant allocation to UK shares helped the fund, with both large cap and small cap showing good gains. But the largest contributor to performance was the fund's holding of US shares, which were the strongest riser in the period. Healthcare shares, one of the newer sectors added to the portfolio, detracted ever so slightly from returns, as Amazon announced it is planning to enter the space, unsettling investors who took it as a warning of lower prices for existing companies. Lastly, UK property provided good returns to the fund, with the sector up over 7% in Q1.

Activity

In the main, Q1 changes revolved around asset allocation, which saw us increase shares and bond weightings in the fund, while simultaneously decreasing property and cash weights. The changes can be seen in the graphics below, with the old weights innermost and the new weights represented by the outer ring:



Fund Name	Shares	Bonds	Property	Cash
AJ Bell M.Cautious Fund (Old Allocation)	39%	48%	8%	5%
AJ Bell M.Cautious Fund (New Allocation)	41%	52%	4%	3%

In addition to asset allocation changes, discussed in Q4, the team conducted a whole-of-market review of the passive fund space at the turn of the year and analysed a number of newly launched or re-priced ranges that hit the market. The ETF space is always developing: as an example, on average, the OCF (the fund running cost) of existing passive products tracking UK Stocks has fallen by 35% between 2013 and 2018. And if new entrants are included in the comparison, the cost of investing passively in UK stocks has fallen, on average, by 56%. This level of constant price competition is why we monitor the marketplace continually. As a result of our review, we also made a couple of switches to the fund's holdings. Typically, we change from one holding to another because it is better priced (both on an OCF and dealing basis) and/or tracks our desired asset classes better. These are the switches we made in the Moderately Cautious fund:

Asset Class	Old Holding	New Holding
Shares - Japan	X-trackers Nikkei 225 UCITS ETF	Lyxor Core MSCI Japan UCITS ETF
Shares - Europe ex.UK	Vanguard FTSE Developed Europe Ex-UK ETF	Xtrackers S&P Europe ex-UK UCITS ETF

Outlook

After a rough end to 2018, due to falling stock markets, it is pleasing to see the fund bounce back, with all asset classes it holds contributing to performance. The team are conscious that this is unlikely to be the case over the long term, and are continually monitoring global market developments. We remain ready to adjust the fund if we see signs of weakness or threats to the long-term prospects of the global economy that we believe could harm investor returns.

This report provides general information about the AJ Bell Passive funds. It should not be read or constructed as investment advice. It is your responsibility to assess your circumstances and make sure it is suitable for your needs.

The value of investments can go down as well as up and you may not get back your original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

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