TOWN CLOSE
Financial Planning

ICM MINUTES
December 2019

future proofing your finances

ICM MINUTES, DECEMBER 2019

This document reflects the discussions held at the Town Close Financial Planning Investment Committee Meeting that took place on

16th December 2019

Macro Overview

As usual, we caught up on the current economic and political picture and confirmed when/how future portfolio changes might arise.

There are no changes arising from this ICM. We still await a significant drop in equities in order to buy them cheaply using the allocation of bonds each portfolio has; we can't and won't guess when that might happen.

For those interested, here is the transcript of the meeting:

UK Election

We did not expect such a strong election result, but did expect the result.

We wait with bated breath to see what Labour do to themselves. The UK electorate seem to have outright rejected socialism again, have the Labour party listened? Judging by the comments from Jeremy Corbyn and John McDonnell, it appears not. Unless they do, we can't see Labour sorting themselves out for 2024.

The pound rallied strongly on the election result. UK small and mid-cap companies are the main beneficiaries to the end of UK political deadlock.

Overall, global equities are fine. The major narrative affecting the market is political uncertainty and a good amount of that left the room on 12 December.

The central banks believe the global economy is stabilising and so we don't expect a change in monetary policy. The Federal Reserve is likely to pause for a long time. The Bank of Japan can't do any more than it has already done. We don't expect any major changes from the Bank of England.

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Inflation is stable and we expect this strong UK Government will go the distance. Boris Johnson now has a free run in all matters domestic, international and Brexit.

The market still feels that this version of Brexit is relatively hard, and they are still to be convinced that Brexit is good for the UK economy. That means elevated volatility in 2020 is very likely.

US/China

The other major narrative is the US/China trade war that has two strands to it.

The first is sorting out tariffs, by which we mean an agreement not to impose tariffs, not a free trade agreement.

The second part is the broader US objective for China to stop being a communist country – China are not willing to do that. Massive state subsidies and control of key industries in China is the Chinese and communist way, it's not stopping any time soon.

Donald Trump wants US companies to use other low-cost bases in the region that aren't (or are much less) communist, Vietnam for example. These other countries aren't part of the trade war and the US administration sees clearly that using them means the US not losing their intellectual property and know-how. Companies that will lose out are those that keep ties with China and then want to sell their goods back to the US.

Separately, impeachment is a red herring. This Republican majority senate simply won't impeach this Republican President, leaving Donald Trump under next-to-no political pressure and surely re-elected in 2020.

The Chinese know this and know they have a lot to lose.

The trade war is not as bad as people are making out. The world will not be less globalised as a result and we see some sort of deal concluding before the 2020 elections.

The TCFP Model Portfolio

For now, our 80/20 equity/bond split is relatively neutral and the right place to be. We are tilted towards large cap over small cap and developed markets over emerging markets. Our regional exposure only changes in line with changes in the various constituents resulting from their relative sizes.

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We're aiming to grab as much global growth as we can, as cheaply as possible. Improving global economics and investment cost control are the only two pegs we can hang our hats on with any certainty.

Global growth, as reflected in the increasing value of the largest 8,500 companies or so, is what will produce the returns that beat inflation and keep your financial plan on track.

That increasing value comes about from the profits that these companies make and share with you. They result from the billions of rational decisions their millions of employees make each year to keep their customers happy and, therefore, themselves employed and their families fed, clothed and sheltered.

That's rationality writ large compared to how politicians and other so-called leaders behave. You're invested in the mass rationality of your fellow humans.

Our next portfolio move will, most likely, be to more equities. But not before there's a large, healthy and sustained decline in equities. We were almost there in January this year after the Christmas 2018 blowout, but the recovery in prices was so swift and large we didn't have time to act.

From that Christmas low the US stock market, as represented by the S&P 500, has closed at a record high 20+ times.

The next significant and sustained drop in equities is in the post, we just don't know when it will arrive. That's why we retain a lot of flexibility to act as the situation suggests: We can reduce bonds or move to/from global equities into small cap and emerging markets.

Asset prices are maybe a bit elevated which can mean lower expected returns going forward. Currently, equities are priced to deliver c. 6% pa for the next 7 years or so. But they could easily under- or over-shoot this figure.

The one thing we can continue to guarantee is volatility (the amount by which your account values shift around) and the resultant uncomfortable periods.

We do what we can to help you through the rougher water. You all have cash balances to cover your short-term needs. That's what keeps you afloat during the worst of times and means you don't have to rush for the lifeboats.

Also, reduced expected returns shouldn't adversely affect your financial plans given we use a conservative net return of 3.5% pa (0.5% pa above inflation) in our forecasts.

And that was the meeting. The next will be in March where we might be slightly more expectant about announcing portfolio changes than we have been in 2020.

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