WISE FUNDS

TB Wise Multi-Asset Growth
Investment Review – Annual report
April 2020

Market Background

This annual report covers the year ended 29th February 2020. Since then, the world has been turned upside-down with the quick progression of the coronavirus (Covid-19), making the events that occurred during this report's period somewhat obsolete. We will still cover those in detail as they are relevant to the performance of our fund, but we will also give a brief update of our performance since the period ended and discuss the impact Covid-19 has had on our operations.

The year ended in February can be broadly split into three distinct periods. The first one, going from the end of February 2019 until the middle of August, witnessed a synchronised global economic slowdown with a broad-based deterioration of macro-economic indicators across both developed and emerging markets. This was led by political uncertainty and concerns that policy makers were proving increasingly impotent. Both of those factors -or at least the market's perception of them- improved later in the year, leading to a drastic turn-around in sentiment and markets' performance. This second phase lasted until the end of January 2020 when the third period started as Covid-19 made its appearance outside of China and quickly spread westward leading populations and businesses globally to one of the most dramatic upheavals in peacetime history.

Firstly, for the year until the middle of August, the world suffered a synchronised economic slowdown with both the supply and the demand sides affected in a slow downward spiral painting an overall end-of-cycle picture. The causes for such an uninspiring backdrop were manifold but can be narrowed down to two main categories: 1/political uncertainty and 2/ policy makers' impotence.

The first point has been a key part of the landscape for several years with a rise in populism and the re-emergence of strongman politics. The consequences of this phenomenon are increasingly being felt on world markets, however, as these characteristics become the norm and are no longer confined to small emerging countries. The trade wars launched by President Trump against, amongst others, Mexico, Canada, Europe and, most significantly, China, were having a real impact on global trade and consumer sentiment and proving detrimental on both sides of the battlefield. Closer to home, the Brexit issue threw the UK into a constitutional crisis. Europe was struggling with a mixture of political instability and weakening leadership. Key emerging markets such as India and Brazil were also going through political difficulties and changes. More than micro issues such as corporate earnings, health of balance sheets or quality of management, these macro factors dominated the investment landscape. This difficult first period of the year was also driven by policy makers' impotence. The rise in populism was accompanied by an increasing polarisation in the political landscape, itself leading to an increasing difficulty in getting legislation approved. With necessary political actions broadly in stalemate, central banks emerged as the only players with sufficient clout to prevent -or at least postpone- the next recession. There were growing doubts about their ability to do so, however, as they were perceived to be running out of ammunition, leading to their actions proving less and less effective. On the fiscal front, the polarised political landscape also made it difficult for governments to act despite very attractive interest rates.

In the autumn, the drivers mentioned above evolved gradually but the market's perception of them changed a lot more drastically. Political uncertainty started to abate on both sides of the Atlantic as Donald Trump, a year away from facing a re-election battle, increasingly started sending conciliatory signals to China with regards a trade agreement (having made his point domestically that he was willing to be tough on China, his electorate was starting to feel the pain of tariffs). In the UK, for the first time since the Brexit referendum, a draft exit agreement looked likely to be accepted by Parliament and a general election was called. On both fronts, some resolution to the political uncertainty was found before the end of the year with a trade agreement signed between the US and China, and an unexpected landslide victory for the Conservatives in the UK. The latter promised to put an end to the long Brexit procrastination that had paralysed the country for more than three years. Simultaneously, there were increasing signals pointing to a bottoming-out of the weak manufacturing data, giving hope that the lifting of the uncertainties above would translate into an economic rebound.

This sentiment prevailed until the middle of January when Covid-19 became an obvious key risk to people, businesses and economies, first in China and, towards the end of the reporting period, globally.

In terms of market performance, the confusing and distinct periods described above led to sometimes confusing reactions from investors. During the first period (synchronised economic slowdown led by political uncertainty), not only did global equities remain buoyant but so did sovereign bonds, leading to a third of global bonds yielding negative rates. This is an obvious contradiction as one cannot, at the same time, be willing to take equity risk and be so keen to protect one's assets that one is prepared to suffer a guaranteed loss on sovereign bonds. Similarly, this was a period when gold was the strongest asset class, illustrating how torn investors were with their positioning as they looked simultaneously for yield, protection and continued upside participation.

The second phase (lifting of political uncertainty) saw a more classical response with equities storming ahead, while bonds and gold gave back some of their gains from the earlier period. The improving economic data combined with greater clarity on the two main hurdles for sentiment (trade war and hard Brexit) convinced investors to de-risk their portfolios and invest their cash. More pleasingly -since it is a point we have made for a long time- so-called value stocks (i.e. companies that are cheap relative to their current asset value) started to outperform growth stocks (i.e. companies that are cheap relative to their future expected value). This can be explained by several factors such as the realisation that valuations of growth companies are stretched, higher interest rates making future returns less attractive compared to present ones, a greater abundance of growth making the higher growth companies less of a rarity or the flurry of cyclical companies presenting value compared to more defensive ones in the growth camp.

With the Value style cheaper relative to Growth than it had ever been since records began, we had high expectations that the outperformance of the former that started in August would be long-lasting. Unfortunately, Covid-19 quickly derailed this thesis at the start of 2020 and led to the fastest ever drop in global equities (it only took 22 trading sessions for equities to fall by more than 30%!). In a classic, somewhat pavlovian reaction, investors sold equities and credit and reverted back to the safety -at least perceived- of government bonds, gold and cash. Within equities, the expensive defensive growth companies outperformed more cyclical value names again, ignoring for the latter both the improved quality of balance-sheets since the previous crisis of 2008 and the significant margin of safety provided by cheaper valuations.

Performance

Looking at our performance for the year, the TB Wise Multi-Asset Growth fund was down 0.9% compared with a fall of 2.1% for the CBOE UK All Companies index and a gain of 1.7% for the UK Consumer Price Index (CPI), our two target benchmarks. Our comparative benchmark, the IA Flexible Investment sector, gained 4.5% over the year. Over 5 years, however, our fund was up 44.3%, comfortably beating both of its target benchmarks (+18.7% for the CBOE UK All Companies and +9.2% for the UK CPI), as well as its comparative benchmark (+26.8% for the IA Flexible Investment sector).

A. TB Wise Multi-Asset Growth B Acc
B. IA Flexible Sector
C. Cboe UK All Companies
D. UK Consumer Price Index (CPI)

27/02/2015 – 28/02/2020 Data from FE FundInfo 2020

Our relative performance closely followed the three distinct periods we described earlier. During the one from the end of February until the middle of August 2019, the fund was flat, broadly in line with the equity market but underperforming its peer group sharply (bottom 10% of our fund universe). Our lack of exposure to US equities and bonds proved costly. We avoided both of those areas of our investable universe on valuation grounds. US equities continued to be driven by a small subset of very large companies in the technology and consumer staples sectors, for which valuations don't seem to matter anymore, giving them very little margin of safety. As described earlier, bonds benefitted from a rush for protection at all costs during the summer months, leading to an increasing portion of the global bond market yielding negative rates (thus guaranteeing a loss when held until maturity). For both of those assets, the weakness in the pound versus the US dollar also proved a tailwind.

Our fund was much better positioned in the second phase of the year, when political uncertainty started lifting and the seeds of a cyclical rebound began to germinate. As explained earlier, that environment helped value managers outperform growth ones and our approach leads us to favour the former rather than the latter. We always prefer paying 75p for £1 worth of product, as opposed to paying £1.25 for £1 worth of product today with the expectation that it will be worth £2 in the future. Our broad asset allocation also helped in that context, especially our exposure to UK equities which had a very strong performance in the run-up to and immediately after the general election. During that second period, the fund performance was in the top 10% of the IA Flexible peer group.

Unfortunately, for the third phase, the panic selling that started in the last month of the reporting period, sent the fund back to the bottom 10%, hurt, once again, by our lack of exposure to government bonds and, to some extent, US equities. This relative performance was particularly disappointing though because about 20% of the fund was -and still is- exposed to defensive strategies that have been in the portfolio for the past 2.5 years precisely to protect us against a downturn (we hadn't predicted the shape such a downturn would take but had felt for a while that valuations in some parts of the market were so stretched that, at a the very least, a more volatile environment was likely at some point). Although, on the whole, those defensive managers did a great job and helped limit the downside, our large allocation to gold failed to do so initially, because the metal was used as a source of liquidity for investors needing to raise cash to cover losses elsewhere. Another factor explaining our relative underperformance was the large indiscriminate selling that occurred in the investment trust space where discounts became disconnected from the reality of the assets in the portfolio for a short period, exacerbating losses, at least optically (those short-term losses are only crystallised if positions are sold at those ludicrous prices, which we didn't do).

In terms of attribution for the year, despite some volatility in their performance as mentioned above, the fund's best performers were our two precious metal funds (Merian Gold & Silver and Blackrock Gold and General) which benefitted, at various stages throughout the year, from their defensiveness, inflation-hedge, relative attractiveness in a low-yielding environment and/or compelling valuations. The fund also benefitted from its exposure to two utilities and infrastructure funds, the Miton Global Infrastructure Income fund and the Ecofin Global Utilities and Infrastructure trust. Both of those funds were in the sweet spot of cheap, attractively yielding defensive assets with strong growth prospects.

On the negative side, the Woodford Patient Capital trust was our costliest position. The suspension of the Woodford Equity Income fund (an open-ended fund different in structure, objectives and investment universe from the investment trust we invest in) had ripple effects onto the trust that we owned , mainly due to uncertainty about future management, but also due to overlap in some of the private companies held across both funds. Although we remained of the view that the portfolio contained a number of strong and undervalued companies with significant upside potential, in October, the uncertainty regarding the future of Woodford Investment Management itself distracted too much from fundamentals, so we liquidated our position. Woodford Investment Management was subsequently replaced by the board of the trust.

Allocation Changes

As a team, we conducted close to 300 meetings with management of funds and companies during the period. In the current uncertain macro environment, the information we gain from our bottom-up research is invaluable and allows us to spot the discrepancies and dislocations that are common features of markets nowadays.

In terms of changes, we sold out of three funds last year. We already mentioned the Woodford Patient Capital trust. We also sold the Blackrock Gold & General fund and the TR Property trust. Both of those remain very high conviction managers for us and will, surely, reappear in the portfolio at some point, but were sold in order to take some profits after strong runs. We also added three new funds. The first two are from managers that we have known closely for years and that launched new funds. In our mind, this combination is ideal as we are getting access to top quality managers at a time when they are starting fresh again, having to prove themselves again as if they were novices. This tends to sharpen their minds even further! Those two funds were the Pacific G10 Macro Rates fund, a highly technical absolute return strategy investing across the interest rates markets, and the Somerset Emerging Markets Discovery fund, a fund investing in small and medium-sized companies in emerging markets. The third fund we added to the portfolio was the Oakley Capital Investment trust which is an attractively valued high-quality private equity strategy with multiple potential catalysts for an upside re-rating.

Otherwise, from a broad asset allocation standpoint, we have been gradually adding to our cyclical plays in the portfolio, across regions, as those show the greatest upside potential to us given their low starting valuations. We have also gradually added to our exposure in emerging markets, particularly Asia, which, there again, present attractive valuations and compelling growth prospects. Those additions were financed by sticking to our valuation discipline and taking regular profits from strongly performing holdings.

General Update

The TB Wise Multi-Asset Growth fund started the interim period with £51m of assets under management and finished with £57m, thanks to inflows for which we are very grateful.

We are pleased to report that the fund has received an Elite rating by Fund Calibre which we see as a recognition of the hard work we put daily into managing your assets and the strong track record that we have established over the past 15 years.

In terms of our team, we are excited to announce that Rick Ashworth has joined us as an analyst covering both funds and equities. He joins us from Citibank and will complement our existing set of skills nicely.

Covid-19 update and Outlook

The coronavirus (covid-19) situation has gone from bad to worse since the end of the reporting period. At the time of writing, about a quarter of the world's population is living in some form of lockdown (either partial or total) in order to slow the spread of the disease. Now that it has reached the US, the total number of cases is rising at an alarming pace (due to the size and the concentration of its population) and, in a rare historical case, the whole world (developed and emerging) is living with a synchronised fear of a common enemy. Glimmers of hope can be found, however. The main one is the return to normal in China and other Asian countries: lockdowns are being cautiously lifted, people and companies are coming back to work and economic activity is rebounding. In Europe, we are starting to see a positive impact from lockdown measures, following a similar pattern to China -albeit slower because of less draconian measures employed-, which let us contemplate the possibility of a return to some sort of normality in a matter of weeks as opposed to months. The unprecedented speed at which researchers have gathered resources is also starting to produce results, letting us envisage a permanent solution to this health crisis over the next 12 to 18 months.

From a market standpoint, after the fastest drop of more than 30% on record for global equities, those latter hopeful points are the ones investors have been focussing on since the end of March and we have seen a strong rebound since the low. This in no way means that we are out of the woods yet, but it is probably fair to say that the point of maximum uncertainty is now behind us. Markets are a discounting mechanism looking at present facts and future events. With the experience of the past few weeks, we certainly know more now about the virus and its impact on the global economy than we used to. We have also seen an unparalleled global response from governments and central banks, similar in size to the one deployed in 2008-09 but put in place in a matter of weeks rather than months or years. For example, the recently announced US fiscal stimulus is the equivalent to the one put in place over 2 years in 2008-09, while the ~75% increase expected in the Federal Reserve's balance sheet is equivalent to the total increase over the 10 years following the Great Financial Crisis. More support will certainly be required but what has already been announced gives a lot more comfort about how the economic impact of the virus will be mitigated.

The collapse of so-called risk assets through February and March feels, in many ways, as bad as or worse than 2008-09. Lows may be retested but, given the transitory nature of this crisis, the support put in place by authorities and the valuations currently on display, we are likely to look back at this period as one of the great investment opportunities for long-term investors.

In terms of portfolio activity, we don't think that now is the time to make heroic changes and the lack of liquidity makes it impossible to trust prices in any case. What we have done though is catch up with as many of our managers as possible. Key to our investment process is to understand and gain trust in our managers before investing. This focus on qualitative research helps in times like these because, when the good is sold with the bad, we need to have faith in the quality of our funds. We have been impressed by how our managers have reacted to this crisis, diligently analysing their portfolios, adjusting their positions when required and sticking to their processes. If we have done our work properly, we shouldn't need to make many changes to our portfolio ourselves as we know our clients' money is in good hands. Another encouraging factor is that our value bias pushes us towards managers used to focusing on risks and on balance sheet strength (value investors need to avoid value traps). While the selling has been indiscriminate so far, we believe that those managers who avoided the riskiest of companies will ultimately come out on top. Finally, we were reminded of the power of diversification, not only by asset classes but also geographically. As covid-19 progresses from East to West, the experience of our Asian managers is very different to our European ones for example.

Finally, from an operational standpoint, we are lucky enough to have a small and nimble team supported by a solid IT infrastructure. As such, as a precautionary measure, we all started working from home a week prior to the official lockdown was announced in the UK on March 23rd. All of our systems are cloud-based and we thus didn't experience any significant issue with doing our day job, which lends itself well to remote working. Our experience is similar to what we have observed with our investee managers. Moreover, a silver lining of all of us working from home is that our research work, which is the cornerstone of our investment approach, has been made somewhat easier as phone and video calls with company and fund managers are much easier to arrange!
As a team, we have learnt -and are still learning- how to make greater use of chats and video calls to communicate with one another. On that front though, it is undeniable that we are all missing the social interaction with our colleagues and this is something that no technology will ever be able to replace.
From a business standpoint, although the sharp drop in assets is of course having a direct impact on our profitability, the firm has been conservatively managed since its inception: we have never borrowed any money and have a very solid balance sheet with net cash available, which is helping us weather the current storm.

All that is left is for me to thank, personally and on behalf of the Wise Funds team, all our investors for their ongoing support. There will be better times ahead, and, in the meantime, we hope that you and your families are staying safe.

Please feel free to contact us if you would like a meeting or have any questions.

Vincent Ropers, Fund Manager
Wise Funds Limited,

Please note – this annual report the personal views of Vincent Ropers as at April 28th, 2020, and does not contain financial or investment advice.

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