MONTHLY UPDATE

SUMMARY:

September was generally a disappointing month for UK investors, as most markets fell in UK sterling terms as currency movements proved a significant driver of returns. Here in the UK, sterling strengthened versus the US dollar following indications from the Bank of England that a rise in interest rates was imminent. This led to a fall in the FTSE 100, where most companies do their business outside of the UK.

In the US, hurricanes Harvey and Irma led to a deterioration in economic data and forward-looking activity indicators. Markets however were relatively sanguine, believing the impact to be transitory, and this was supported by statements from the Federal Reserve.

In the EU the prospect of tightening monetary policy following hints from Mario Draghi regarding quantitative easing pushed up the value of the euro, leading this to be one of the few markets where UK investors made a positive return. The euro then slightly weakened following the German elections, which saw a weaker than expected performance from Angela Merkel's party, the Christian Democratic Union (CDU). Meanwhile in Japan, inflation jumped to 0.7 per cent, while industrial production figures were better than expected. However, all eyes were on a snap general election called by Prime Minister Shinzo Abe for October.

This month saw seven issues picked up by our governance tool; however, none of these were considered critical issues and we do not feel investors need to take any action.

SUMMARY OF GOVERNANCE FINDINGS:

	This Month	Last Month	Since Last Review
Total Events	7	4	7
Critical Events	0	0	0
Noteworthy Events	7	4	7
No. Removed from FE Invest Approved List	0	0	0

CRITICAL EVENTS:

These are events that require immediate action. This will centre on funds that have been removed from our short list because we feel there is a significant risk of them performing in a way that would be extremely detrimental to their present and future value.

- There are no critical events this month.

NOTEWORTHY EVENTS:

These are events that we deemed serious enough to warrant further investigation.

Fund Name: Fidelity American Special Situations
Event: We have identified a change in the fund's behaviour, which has seen it become increasingly correlated to its benchmark and sector.
Investigation – Analysis of fund: Year-to-date, the IT sector has seen strong outperformance while the energy sector has seen poor performance on the back of falling oil prices. In September, US equity markets saw a sector rotation from technology into energy stocks. The fund has the largest exposure to the IT sector in line with the S&P 500 benchmark's high exposure to IT, so the fund's correlation saw a sharp increase. The IA North America sector also holds the largest proportion in IT, which underperformed, so again resulted in the change.
Conclusion: We do not believe investors need to take any action.

Fund Name: Henderson Global Care Managed
Event: Nick Anderson is no longer listed as co-manager; however, Hamish Chamberlayne remains.
Investigation – Spoke to manager: We met with Henderson in August and Hamish Chamberlayne informed us of Nick Anderson's plan to leave. He assured us there wouldn't be any change to the process and that we could expect the same behaviour from the fund going forwards. Anderson has left fund management altogether to experience another industry. A new manager will be joining as the Janus merger takes shape.
Conclusion: We do not believe investors need to take any action.

Fund Name: JOHCM UK Opportunities
Event: The fund has moved from the IA UK All Companies sector to the IA Specialist sector.
Investigation – Spoke to manager: The Investment Association has removed the JOHCM UK Opportunities from the IA UK All Companies sector simply because of its current high allocation to cash (the fund needed to be 80 per cent invested). The manager has maintained a cautious stance on UK equities since 2013 (expecting a market correction) and continues to remain true to the fund's investment thesis by opting to stay away from overvalued stocks and adding to cash. The cash position is not to offset any expected fund outflows.
Conclusion: We believe the current positioning is consistent with the manager's strategy; nevertheless, those looking to be fully invested in the market may want to consider other options.

Fund Name: M&G Corporate Bond
Event: We have identified a change in the fund's behaviour, which has seen it become increasingly closely correlated to its sector peers.
Investigation – Analysis of fund: This is a combination of two factors. First, the correlation between funds in the sector has increased, and the sector is behaving more like the corporate bond index. Second, M&G Corporate Bond behaved less like the sector from November to March during the reflation trade following the election of Donald Trump as US president. That period is becoming less significant as time passes.
Conclusion: The manager has not changed his strategy; in fact, the positioning of the fund is very similar to the start of the year. This is a result of changing market conditions and investors do not need to take any action.

Fund Name: M&G Emerging Markets Bond
Event: We have identified a change in the fund's behaviour, which has seen it become increasingly closely correlated to its sector peers.

Investigation – Analysis of fund: This is a continuation of a trend we noted in July. There has been a large increase in the correlation of emerging market local currency debt to US dollar-denominated emerging market debt since mid-2016. This is due to the relative stability of the local currencies, which has been supporting investment in their debt markets. As a result, the correlation between the sector and the indices has risen as the different types of fund in the sector – local currency, hard currency and blended – all behave more similarly.
Conclusion: The investment process has not changed – this is a result of market conditions. There is no need for investors to take any action.

Fund Name: Schroder US Smaller Companies
Event: We have identified a change in the fund's behaviour, which has seen it become increasingly closely correlated to its sector peers.
Investigation – Analysis of fund: US small caps outperformed the broader market significantly in September due to both political chatter around US tax reform and optimistic comments from the Federal Reserve. Small caps benefit from corporate tax cuts, given their domestic focus, so they often pay higher taxes and tend not to be exposed to revenues in countries with different lower tax regimes. The Federal Reserve's hawkish tone was also positive for US small caps, where they came across as optimistic on the economy ahead of a potential rate rise in December. Small caps are more closely linked to the health of the US economy. The rally in small caps was broad-based rather than stock-specific and, hence, the correlation to the benchmark and sector rose in September.
Conclusion: We do not believe investors need to take any action.

Group Name: Vanguard
Event: Vanguard has announced its intention to move to swing pricing instead of using dilution levies in its funds.
Investigation – Spoke to manager: Vanguard believes the introduction of full swing pricing will better protect existing investors from the effects of dilution because of subscription or redemption requests. It believes this process is more efficient than a dilution levy. Additionally, it appears that some platforms found it difficult to implement the dilution levy. Therefore, the potential for increased tracking error and tracking difference is high. This will be reflected in our FE Passive Rating as these ratios are the two main components of the calculation. Any deterioration in the funds tracking ability will be captured.
Conclusion: No immediate action. We believe long-term investors are better protected, but tracking might deteriorate. We will wait for any change to FE Passive Rating of Vanguard passive funds before taking any action.

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GOVERNANCE UPDATE 5 OCTOBER 2017

BAILLIE GIFFORD'S SARAH WHITLEY ANNOUNCES RETIREMENT

COMMENTARY

Baillie Gifford have announced the planned retirement of Sarah Whitley, Partner and Head of Japanese Equities on 30 April 2018.

While Sarah Whitley and Matthew Brett are the official co-managers on the Baillie Gifford Japanese Fund, Matthew has typically taken the lead on the fund. Sarah Whitley is the sole Portfolio Manager on the Japan Trust but Matthew Brett does support Sarah in managing this fund too. Note that both Baillie Gifford Japanese and Japan Trust follow the same strategy. Post Sarah's retirement, Matthew Brett will take over full portfolio management responsibilities of Baillie Gifford Japanese and Japan Trust. Praveen Kumar (Portfolio Manager of Baillie Gifford Japanese Smaller Companies and Shin Nippon Trust) will assist Matthew Brett as deputy fund manager. Donald Farquharson will assume Sarah's responsibilities as head of the Japanese team and continue to manage the Japan Growth strategy.

As with everyone on the team, Matthew spends most of his time researching individual investment opportunities and this will not change. Each of the strategies Matthew is involved with use the team's idea generation so there is significant overlap at the stock level. Baillie Gifford's investment approach across their fund range is low-turnover in nature which means that the additional fund management time required to manage the strategies is limited. Baillie Gifford's team approach to managing funds means that key man risk is not that significant.

We remain comfortable with our Buy rating on both Baillie Gifford Japanese and Japanese Smaller Companies. We are scheduled to meet with the Japanese Equity team in the coming weeks to get greater colour on the additional responsibilities that Matthew Brett will be taking on.

Biographies

Sarah Whitley, Partner and Head of Japanese Equities

Sarah graduated with a BA in Experimental Psychology from Oxford University in 1980. She joined Baillie Gifford in the same year and became a Partner in 1986. She joined the Japanese Equities team in 1982 and in 2001 became head of the team. Sarah is the longest standing partner at Baillie Gifford, having spent 37 years with the firm, and has managed the Baillie Gifford Japan Trust since 2001.

Matthew Brett, CFA, Investment Manager

Matthew graduated BA (Hons) in Natural Sciences (Psychology) from Cambridge University in 2000 and holds a PhD in Psychology from Bristol University. He joined Baillie Gifford in September 2003 and is an Investment Manager in the Japanese Equity Team. Matthew is a CFA charter holder. Matthew manages the Baillie Gifford Japanese fund with Sarah. He also co-manages the Baillie Gifford Global Select Fund (alongside 3 other investment managers) and Baillie Gifford Japanese Income Growth (co-managed with Karen See).

Praveen Kumar, Investment Manager

Praveen graduated BEng in Computer Science from Bangalore University in 2001, and an MBA in Finance from the University of Cambridge in 2008. He previously worked for FKI Logistex before joining Baillie Gifford in 2008. After completing the investment graduate trainee programme Praveen joined the Japanese Equity Team as an Investment Manager in 2011. Praveen currently manages the Baillie Gifford Japanese Smaller Companies and the Shin Nippon Trust.

Donald Farquharson, Investment Manager

Donald Farquharson received an M.A. (Hons) in Arabic Studies from The University of St. Andrews in 1987. He joined Baillie Gifford in 2008 and is a member of the Japanese equity team. Previously, Donald was a Fund Manager and Head of Pan Pacific Equity at Schroders, and was also part of the firm's Japanese equity team for 17 years. He also served at Stern Brothers & Co. has extensive investment experience. Donald manages the Japan Growth fund.