DART CAPITAL

Investment Brief

July 2020

Introduction

Richard Whitehead
Chief Executive

It's been a frenetic three months as we adapted to a new way of working. We learnt quickly how to operate a business remotely and it would have been relatively easy for us to continue to work like this. However there is one thing to 'get by' working from home, there is quite another as to the long term quality of this type of working.

Our role as Investment Managers requires a collegiate team operating efficiently and effectively on behalf of our clients. This places considerable responsibility on young colleagues and requires tight supervision in our highly regulated world. Expecting such young people to work from a cramped flat in London is a very different experience to those of us with our own home offices, large gardens and surrounded by Hampshire countryside, particularly given the warm weather in April.

Thankfully we are now largely back to normal and many of my colleagues are working again from our modern and spacious offices in the City of London. As I have expressed with you in recent months our business leaders are in danger of forgetting about the personal development of younger staff in their belief that remote working is a force for good. As a father of two young daughters who are about to embark on their careers, it is vital we all think of wellbeing implications for this hugely motivated, educated and ambitious group within society who we will all depend on one day.

My colleagues have coped exceptionally well during lock-down from their shared flats and houses, even more so once we filled such properties with multiple screens and other technology necessary for each of them to perform their roles. As I said earlier, where appropriate, in recent weeks we took the decision to return gradually back to base so we can resume self-development and training for our younger colleagues, in particular. I know myself that the best learning I had early in my career was being shown from some superb individuals around me. However if we enter a second lock-down we of course will immediately revert back to working remotely.

On a different topic we are delighted to share with you that earlier this year Dart Capital helped to launch a new independent wealth management business called Heronsgate Capital. The business is led by Chris Sexton and Tony Wellby, both experienced and successful individuals, who until recently were directors of Saunderson House. Chris Sexton was the former Chief Investment Officer and he and I have known one another for a while. I am equally delighted that Chris agreed to sit on Dart Capital's monthly Investment Committee and thus has added input to the tactical positioning of our investment portfolios during the Covid-19 crisis.

Early signs are very encouraging for Heronsgate and we are enjoying the collaborative approach between the two companies. We have leant them key and experienced resource during the initial phase and they will use our regulatory permissions until such time as they would like to be directly authorised by the FCA. Further successes include the recent hiring of Gareth Parsons who has resigned from Saunderson House and will join Heronsgate in early 2021. Gareth was instrumental in building his client base within PwC. Working closely with these new colleagues will only add to the success of our business.

I hope you enjoy our latest Investment Brief and as always I welcome your thoughts and comments.

House View

Alexander George, CFA
Associate Director of Research

Following the partial recovery across equity markets, we have moved to boost the resiliency across our managed portfolios, with a modest trimming of equity exposure and addition of more overseas currency serving us in good stead should volatility pick up over coming months. Looking longer-term, government and Central Bank policy is increasingly focused on generating growth, even if that means eventually sparking inflation. With cash rates at zero and real-yields on government bonds set to remain firmly in negative territory for the foreseeable future, we believe that a portfolio comprised of equities, corporate bonds and diversifying assets, such as selective government bonds and gold, is best positioned to deliver inflation-beating returns when compared to the available alternatives.

Economic outlook

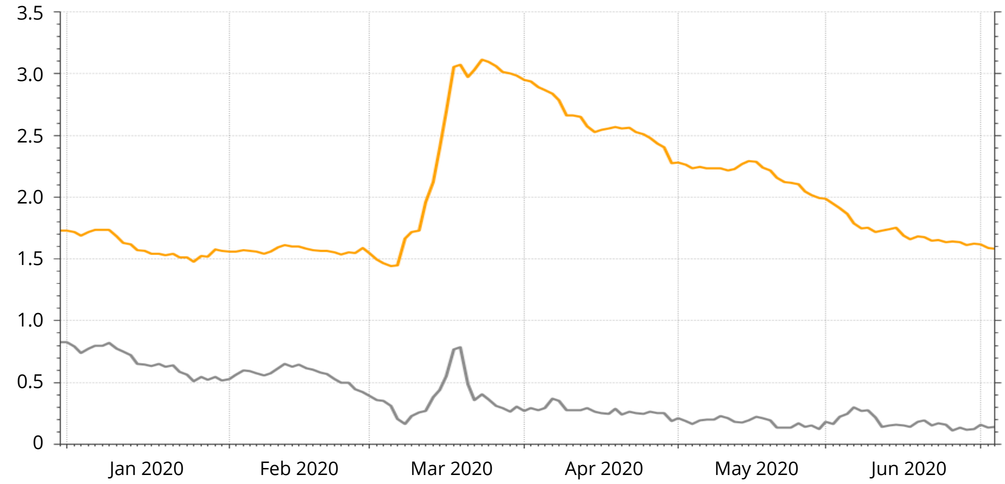
The huge declines in GDP experienced across developed economies over April and May was largely expected, albeit certainly eye catching, as government mandated shutdowns forced a whole range of industries to cease operation. We expect growth to recover over coming months as businesses are able to re-open, but output and employment will likely remain below pre-coronavirus levels until there is a widely available vaccine. Despite this sanguine backdrop, stock markets remain forward looking and could well move significantly higher should the outlook improve, particularly given the huge stimulus support being provided by the world's major Central Banks.

Fixed Income

Developed market government bonds continue to offer little value in absolute terms, other than as a risk-off hedge for the equity exposure within portfolios, with minimal compensation for owning long-dated government paper. Against this backdrop we retain a significant exposure to short-dated Gilts (with a maturity of less than 5 years) which act as a liquidity buffer within our portfolios and, in late June, we allied this holding with a new position in 7-10 year US Treasuries. US Treasuries still provide a decent yield pick-up on equivalent-maturity UK Gilts, and as a result have the potential to deliver greater capital gains in a risk-off scenario where government bond yields move even closer to zero.

As outlined in our last House View, we used the sell-off in corporate bonds over March to boost our already substantial exposure to this area of the market when yields on short-dated sterling credit were pushing towards 3.5% amidst the market turbulence. Pleasingly, having been in a state of distress at that time, corporate bonds have rallied strongly over the last three months with yields on short-dated corporates pushing back down to around 1.5%, driven largely by the expansion of Central Bank bond buying programmes and the prospect of re-opening of the US and European economies helping to bolster sentiment.

Declining yields on corporate bonds helped drive strong returns in this area of the market



ICE bofA 1-5 Year Sterling Corporate Index Yield

UK 10 Year Gilt Yield

Source: Refinitiv Datastream

Equities

Despite the bounce-back in markets, equities remain attractively valued compared to high quality bonds and we retain an overweight position when compared to our strategic weightings. From a UK perspective, this is demonstrated by the fact that bellwether stocks such as Unilever and Diageo trade on normalised free cash flow yields of around 4% with these profits and distributions to shareholders likely to grow as the global economy expands over coming decades. This compares favourably to equivalent government and corporate bonds which yield less than 1% and 2% respectively at this time. Valuations within the more cyclical sectors of the equity market, such as banks and energy, are even more attractive still, but this has to be balanced against the greater risks these sectors face, and we retain a tilt towards areas of the market with stronger growth prospects, such as healthcare and branded consumer goods.

The high quality US stocks we identified in our last House View have rallied strongly, with stocks such as Microsoft and Visa now back at, or close to, all-time high share prices having experienced 30%-40% drawdowns in March. Whilst these stocks will invariably lag during those periods when lower quality stocks are outperforming, we believe that companies with high and sustainable returns-on-capital will remain in demand from investors.

In contrast, we are more concerned about, and have minimal exposure to, the more speculative side of the US market where the environment is looking increasingly reminiscent of the dot-com boom of the late 1990s, with fast growth, often unprofitable, technology-driven companies seeing huge share price gains as traders clamour to identify the "next Amazon". Whilst some of these companies will eventually become profitable entities, we believe that much scepticism is required as many of these companies appear to have no discernible competitive advantage within their respective industries, and have demonstrated no ability to generate sizeable profits.

One notable change we made over the quarter was to un-hedge the GBP-hedged US and global equity positions we had taken during the market upheaval of March when the Pound fell below $1.20, with these un-hedging moves taking place when sterling stood at just over $1.25 in early May and June respectively. With the uncertainty around the Brexit negotiations, and the Pound's tendency to depreciate during equity market sell-offs, we believe that these moves could well help protect portfolios in the event that markets become more turbulent over coming months.

Commodities

We have held physical gold across our managed portfolios since July 2016 with the precious metal acting as a safe haven asset during turbulent market environments and so it has proven this year with the gold price moving significantly higher as further cuts in interest rates, and the expansion of Quantitative Easing, in the response to the current crisis have helped fuel demand for the precious metal. Looking ahead, whilst the recent policy actions of Central Banks bolster the long-term investment case for gold, there is a risk that the traders who have helped push up the gold price over recent months become sellers should the outlook for the global economy improve.

Closing thoughts

Having increased our equity allocation to a maximum overweight position during the market sell-off, now that markets have regained much of their first quarter losses we have tilted our managed portfolios to a slightly more resilient stance. This should hold us in good stead should the market environment become more challenging.

Market Commentary – Q2 2020

Alexander George, CFA
Associate Director of Research

UK

Revised data showed that the UK economy shrank 2.2% over the first quarter (January-March), even though the economic shutdown was only in place for the final week of the period. Unsurprisingly survey data – which aims to provide a more up-to-date view of the strength of the economy - released over the quarter re-enforced this bleak picture with April's PMI survey figures the weakest on record as companies across large swathes of the economy were forced to cease operating.

The government's response to the crisis has been extensive, with the very generous furlough scheme – which covers 80% of the salary of employees on the scheme up to £2500 per month – helping to support businesses through this period of inactivity. However, this support has certainly come at a price, with the UK's budget deficit set to rise to c.£300bn this year according to figures from the Office of Budgetary Responsibility (OBR) with the government debt/GDP ratio set to exceed 100% by the end of the year. Despite this surge in borrowing, Gilt yields edged lower over the quarter, with the weak outlook for growth, as well as the bond buying programme from the Bank of England (BoE) – which was expanded by a further £100bn in the BoE's Monetary Policy Committee (MPC) June meeting – helping to supress yields at the long-end of the yield curve. The 10 year Gilt ended the quarter with a yield of only 0.17%.

Pleasingly, unlike in the US, the virus is largely under control in the UK at this time and a bounce-back in activity is expected over the third quarter as the UK economy continues its re-emergence from hibernation, with the re-opening of restaurants and pubs on the 4th July the next stage in the government's re-opening plans. The UK market slightly lagged most other regional markets, owing largely to its lower exposure to the high flying technology sector, with MSCI UK All-Cap gaining 9% in capital return terms over the quarter.

US

As of writing, the US continues to grapple with growing numbers of coronavirus cases across the south and west of the country, as several states which never enforced extensive lockdowns suffering the biggest outbreaks. Despite this, the government response is expected to remain localised, with the local shutdowns already reinforced in states such as Arizona, whilst re-openings are allowed to continue in states, such as New York, where new case growth is muted. Having suffered c.30 million job losses since the start of March, there have been signs that US firms have started to re-hire workers, with the payroll data released in early June beating estimates handily with over 2.5 million jobs added causing a sharp rally across global equity markets and a weakening of government bond prices. Alongside the existing $2trn CARES (Coronavirus Aid, Relief, and Economic Security) Act which passed through Congress in March and included c.$500bn in direct payments to households, a further stimulus is expected to be announced later this summer in order to support the economy.

In an attempt to maintain orderly functioning of credit markets, the US Federal Reserve continue to expand their balance sheet over the quarter, with their announcement in April that they will now buy sub-investment grade “High Yield” bonds, in addition to their existing purchases of US Treasuries and investment grade bonds. The aim of these moves have been to ensure that borrowing costs, which had started to spike during the market turbulence of March, remain manageable, even for those companies which have seen revenues decline substantially as a result of the economic lockdown. In addition to their liquidity injections into the bond market, the Federal Reserve have outlined that they will likely not raise interest rates until 2022.

The US market has led the market rebound, with the ample liquidity flowing into many of the mega-cap stocks which are less clearly affected, and in some cases even benefitting from, the current economic slump. Microsoft and Amazon were two such stocks, gaining 29% and 41% respectively, with Microsoft benefitting from a surge in usage of its cloud computing services and use of it suite of Microsoft Office products, whilst the latter has unsurprisingly seen a strong pick-up in online orders and its own web services operation. The S&P 500 enjoyed an exceptionally strong quarter, gaining 20% in US Dollar terms. Treasury yields inched lower over the quarter, as the lack of inflationary pressure and the Federal Reserve’s commitment to not raising interest rates until at least 2022 have helped suppress yields.

Eurozone

Having been the epicentre of the western outbreak of coronavirus in February, Italy has, alongside other European hotspots such as Spain and Germany, seen a precipitous fall in new virus cases since their respective peaks in March, and were able to gradually re-open elements of their economy through the quarter. The European Union Commission have set out a €1.85 trillion coronavirus response plan composed of a €750 billion recovery plan and €1.1 trillion budget over the next seven years. The approval of the plan helped to boost the Euro which gained 2.5% against the US Dollar over the period, as well as European stocks with MSCI Europe ex-UK gaining 13.6% in local currency terms.

Asia

In contrast to the western economies, survey data from the Chinese economy has been reasonably upbeat with both the services and manufacturing sectors returning to growth following the 6.8% contraction in the economy over the first quarter. Chinese stocks performed broadly in-line with other regions over the quarter, with MSCI China A gaining 14.7% in local currency terms.

Commodities

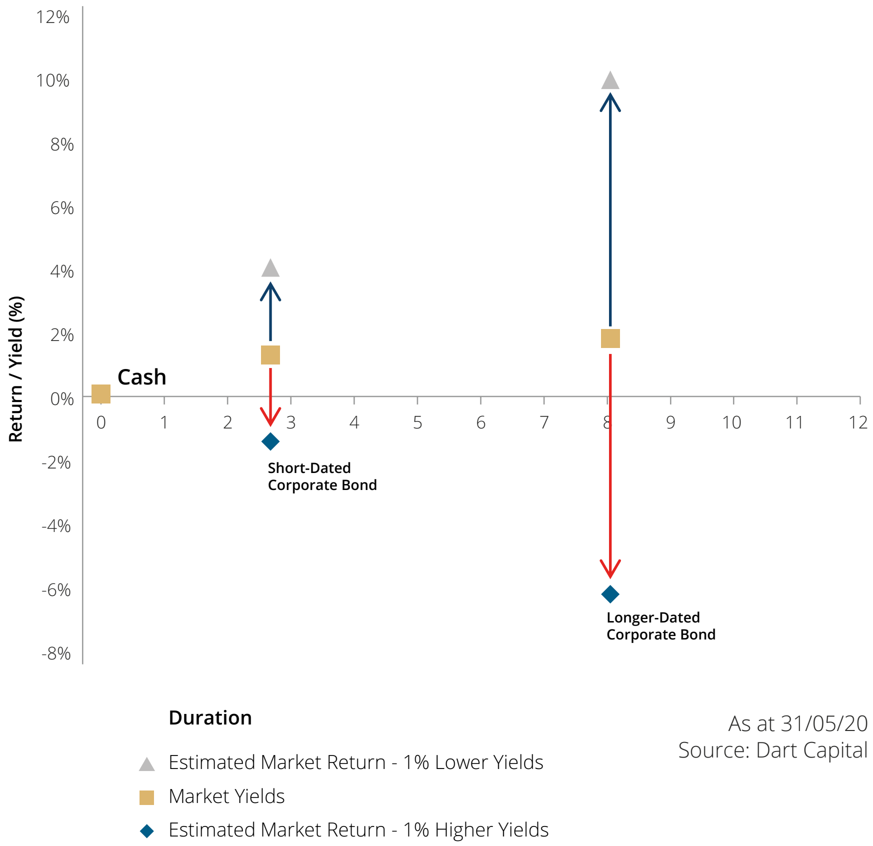
Having suffered a precipitous fall in April with the price of a widely traded oil futures contract fell into negative territory, the oil price rallied through the second half of the quarter as expectations over output cuts and hopes over the re-opening of western economies helped push prices back up. The oil price, as measured by Brent Crude, ended the quarter $18 higher at $41 per barrel. The gold price gained 13.3% in US Dollar terms over the quarter to end the quarter at $1780 per oz, aided by the strong investor flows aided by government bond yields declining towards zero across developed markets. Industrial metals have been surprisingly resilient this year, with demand from China – which accounts for around half of global demand for many of the major industrial metals – remaining relatively robust. Iron ore, which is the main input into steel, saw its price rise $14 over the quarter to end the period at $102.

Fund Spotlight Short Dated Corporate Bonds

Michael High
Investment Analyst

Whilst not the most glamourous of areas in the world of finance, short dated corporate bonds have historically and continue to, provide a reliable and sustainable source of income for portfolios. In this low rate environment we find ourselves in, with government bonds and consequently bank deposits offering very low returns compared to historical averages, we believe it is prudent to have a core allocation across portfolios to short dated investment grade corporate bonds which can provide a relatively attractive yield in the current market environment. When looking to allocate to corporate bonds we do so primarily through two funds, the L&G Short Dated Sterling Corporate Bond, a low-fee passive fund, and the Threadneedle Sterling Short Dated Corporate Bond fund, an active approach. Notably, both of these funds invest in corporate bonds issued in sterling as to ensure the investment carries no currency risk and typically look to allocate to bonds maturing over the next 5 years in order to reduce the interest rate risk of the investment as shown below.

Impact of a change in yields on corporate bonds



As at 31/05/20
Source: Dart Capital

As always there is no such thing as a free lunch and with the higher yield offered by corporate bonds relative to government bonds comes higher credit risk. Credit risk is the possibility of a loss resulting from a company failing to repay (or defaulting on) the owed principal and interest on a bond. Notably, with Central Banks globally supporting the fixed income market through their quantitative easing programs, the credit risk associated with investment grade bonds is reduced. Bond ratings reflect a company's credit risk and are expressed as letters ranging from 'AAA', which is the highest grade, to 'C', which is the lowest grade as shown below alongside the breakdown of our two short dated corporate bonds funds:

L&G
Short Dated Sterling Corporate Bond
Credit Rating (%)

AAA	2.0
AA	11.6
A	31.7
BBB	54.4
BB	0.3

As at 31/05/20
Source: Legal & General

Threadneedle
Sterling Short Dated Corporate Bond
Credit Rating (%)

AAA	3.3
AA	5.2
A	16.8
BBB	63.0
BB	9.1
Cash	2.6

As at 31/05/20
Source: Columbia Threadneedle

AAA and AA:
High credit-quality investment grade
(often government bonds)

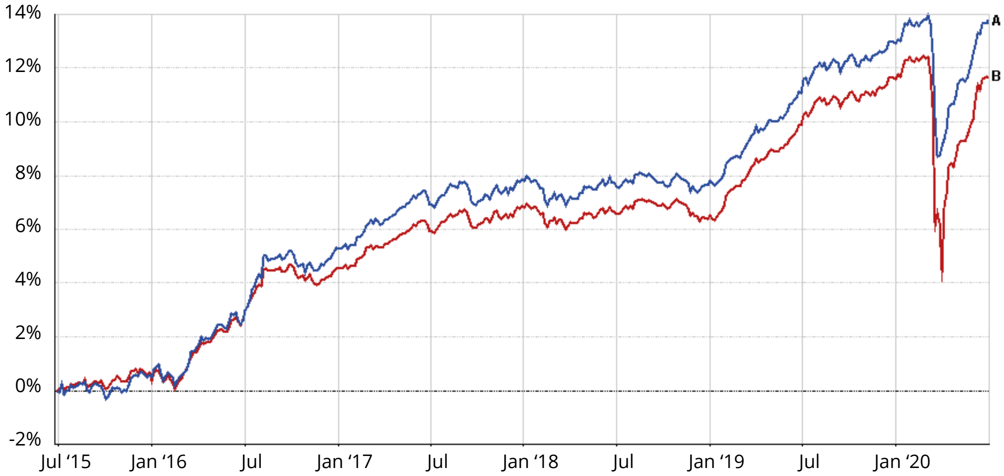
AA to BBB:
Medium credit-quality investment grade

BB and below:
Low credit-quality (non-investment grade)

Notably, the Threadneedle fund has the ability to invest up to 20% of the fund in sub-investment grade bonds although this allocation is only 9% currently and tends not to exceed 10%. The Threadneedle team allocate to this area with the aim of exploiting the fact that bonds nearing maturity issued by high yield companies offer higher prospective returns than investment grade, but often have a similar level of default risk to an investment grade bond on account of the shorter period to maturity.

Both funds have offered an attractive return profile over recent years and despite falling notably earlier this year, have bounced in a timely fashion, broadly in line with our expectations.

Performance of our Short Dated Corporate Bond funds over the last 5 years



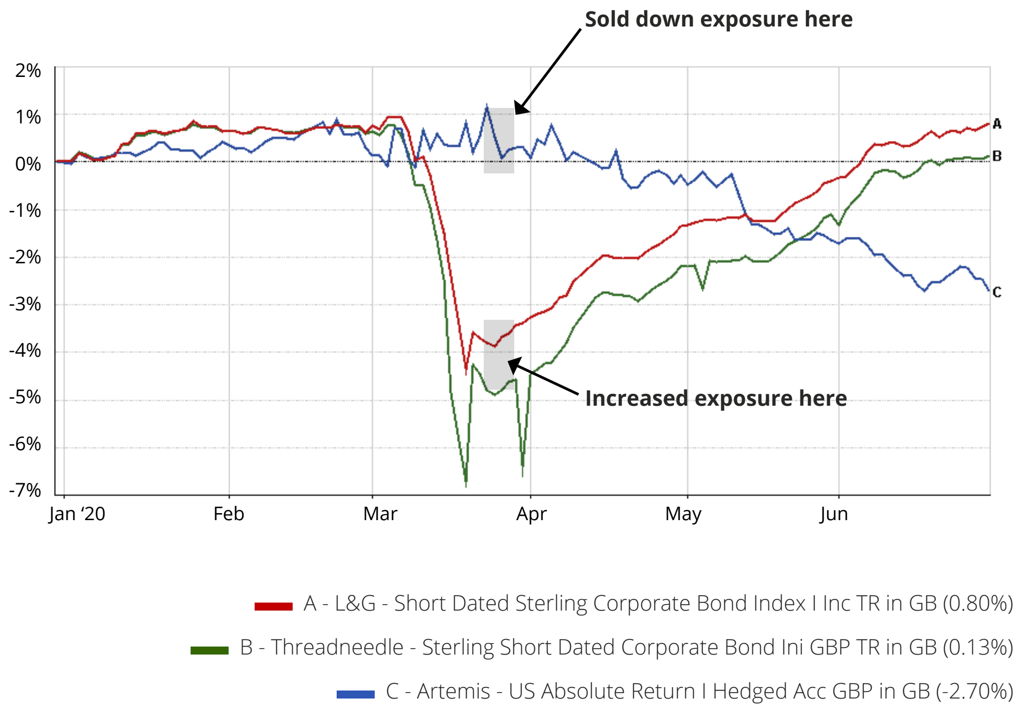
A - L&G - Short Dated Sterling Corporate Bond Index I Inc TR in GB (13.81%)

B - Threadneedle - Sterling Short Dated Corporate Bond Ini GBP TR in GB (11.71%)

30/06/2015 - 30/06/2020
Data from FE fundinfo 2020

Amidst the considerable market volatility earlier this year we saw the corporate bond market enter its own liquidity induced sell-off. During the market panic corporate bond funds saw significant outflows and were forced to sell bonds indiscriminately, creating a spike in bid-ask spreads as liquidity evaporated. Effectively, markets began to price in considerably higher default rates and we took the opportunity in mid-March to increase our exposure to this area of the market by selling down exposure to an absolute return fund that had yielded a positive return year to date. The market has since rebounded, as shown below:

Performance of our Short Dated Corporate Bond funds and Long/Short equity fund over the last two quarters



31/12/2019 - 30/06/2020
Data from FE fundinfo 2020

Who will fund our Chancellor's spending spree post Covid-19?

Chris Bellchambers
Director

....as the days and weeks tick on and we get used to hearing of further government and central bank stimulus packages both for businesses and workers the question is starting to turn to how, and possibly more importantly, who, is going to eventually pay for the ballooning debt that has been taken on due to the Covid-19 pandemic. With the current UK government initially setting out an annual borrowing target of £55bn this financial year (Apr-20 – Apr-21) those numbers have been dwarfed by reality in a world where economic support became the only option. With £100bn of additional borrowing in April & May alone and with April's borrowing being higher than any month during the global financial crisis such a cost will one day have to be repaid. Such relative cost was mirrored by governments overseas who joined forces with central banks in an attempt to stop the spread of the virus by shutting down economies and in effect, "suspend" world economies. This current economic backdrop is very different from where they hoped to be just a few months ago with less borrowing, an end to austerity and at the very least a perceived effort to redistribute wealth from London and the South to the Midlands and the North in order to repay voters from the new found support in traditional Labour strongholds.

So, how do we pay for this debt? Unemployment must surely rise as furlough begins to be withdrawn and it is sadly accepted that this recession is thus likely to hurt the youth "millennials" harder than previous recessions. Sectors like hospitality and tourism are on their knees so an increase in taxes such as VAT would only make this worse. The current tax system has two main categories; proportional and progressive. As the names imply proportional taxation covers taxes such as VAT where we all pay the same whilst progressive taxation encompasses income tax. The logic with the latter being the more you earn the more tax you pay and the greater burden you are able to shoulder as you move through the income tax bands. Capital gains tax (CGT) also fits this as lower rate tax payers pay a lower rate of tax than higher earners and once the annual exemption is factored in and the generous annual ISA allowance very few will ever need to pay such tax. So, how may this change? Whilst the government's perception and message has very much been "we are all in this together" we all assume the tax burden will fall on those who are perceived to better afford it. They may therefore look at the tax bandings, reducing the income level at which the additional rate of tax (45%) kicks in or increase top levels of income tax (again) to 50%, whether temporary or permanently. Currently sitting at earnings in excess of £150k reducing this would capture more earners and you may recall this was very much a Jeremy Corbyn plan as it was seen that earnings at this level which are mainly seen in London and the South would be an attractive prospect to “level-up” the divide between the North and South. CGT could also come under threat as the attractive 20% tax on gains for higher rate tax payers could be brought into line with income tax, again, a tax that demonstrates this government is committed to retaining its new previous Labour voters and not being perceived as a party simply for the middle-class. Capital gains tax used to mirror income tax rates.

There is also likely to be a balancing act between the employed and self-employed as the forced government shut down led to cries from the self-employed for financial support. However at the same time highly taxed employees screamed foul play aimed at much lower taxpaying self-employed small family businesses with their perceived over-enthusiastic book keeping. Is this the moment this government takes on the self-employed? Like Teresa May who tried and failed previously in her disastrous election manifesto, is the momentum for fair play now going to balance how the self-employed are taxed? This would be another sure fire way to increase tax, take immediately from those that have benefited from government support and historically paid less into the system.

As I listened to the end of our chancellors summer budget current fears around wealth tax seem to have been put on the backburner, however, there is no denying that a huge and popular infrastructure spend funded by more affluent areas of society will continue to rear its head. Especially as it is well supported by the current shadow chancellor Anneliese Dodds.

In a world full of uncertainties one thing remains certain, we are left with more questions than answers and the possibility that manifesto promises of yesteryear have meant in a post Covid-19 world - all bets could be off.

MiFID II – Costs and Charges Statement 2019

We will shortly be making your costs and charges statement for the year ended 31 December 2019 available via your online portal https://dart.ajbcs.co.uk. Your statement will appear under the documents tab. If you have any trouble logging in, please contact your usual portfolio manager.

We have prepared a guide to help you understand how costs and charges are represented in your statement.

Should you have any queries or if you would like to go through the costs and charges in more detail, please do not hesitate to contact to us.

This guide aims to help you understand the information set out in your Costs and Charges Statement. The statement includes details of management fees, custody fees, transaction charges (Service charges) and costs deducted from the investments in your portfolio by product providers (Investment product costs).

The front page of your statement shows:

- client and portfolio name
- report name and reporting period

All subsequent pages show:

- client and portfolio name and reporting period at the top of the page
- portfolio reference and information provider at the bottom of the page

'Total costs and charges summary' page shows:

1. **'Total costs and charges'** – includes total cost and charges deducted from your portfolio by charge type in value and %

   Service charges - includes Dart's annual Management fee (including VAT) and A J Bell's annual Custody fee

   Investment product costs – includes costs deducted by product providers from the investments in your portfolio

2. **'Cumulative effect of charges on returns'** – these percentages are based on the return for the period and show the impact of costs and charges on your return

3. **'Charge type'** – includes a more detailed breakdown of each charge in value and %. For further details as to the type of service charge or investment product cost please refer to the **'Table of definitions'** page of your statement

4. **'Table of definitions'** page shows the charge types and a detailed breakdown of the types of service charges and investment product costs.

[Client and Portfolio Name] - 1 January 2019 to 31 December 2019

DART CAPITAL

Total costs and charges summary

This statement confirms the actual costs and charges incurred within your portfolio for the period shown. If you opened your account or introduced or removed assets during the period, the charges shown will relate only to the time they were held in your portfolio.

The 'Service charges' sections show fees charged for investment management and, where applicable, financial advice. They also include charges payable to AJ Bell Securities Limited for custody and any dealing related costs.

The 'Investment product costs' sections show costs charged and deducted by the investment product providers from within the underlying investments held in your portfolio.

Note:
All Service charges are taken from the cash held within your portfolio or nominated account.
All Investment product costs are deducted directly from your investment by the provider.

1

Total costs and charges 1.		
Charge type	**£ value**	**Percentage**
Service charges		
Investment product costs		
Total		

2

Cumulative effect of charges on returns 2.	
Return before the deduction of charges	
Return after the deduction of charges	
Effect of charges on return	

The cumulative effect of charges is based on your actual total return in the period. Future investment performance is not guaranteed and the value of your investments can go down as well as up. The table below shows a detailed breakdown of costs and charges incurred across the different categories:

3

Charge type 3.	Service charges		Investment product costs		Total costs and charges	
	£ value	**Percentage**	**£ value**	**Percentage**	**£ value**	**Percentage**
One-off charges						
Ongoing charges						
Transaction charges						
Incidental costs						
Total						

Portfolio No. [ ]   Page [x of x]   Information provided by AJ Bell Securities

[Client and Portfolio Name] - 1 January 2019 to 31 December 2019

DART CAPITAL

4

Table of definitions

Charge type	Service charges	Investment product costs
One-off charges	Initial adviser fee	Initial or entry charge
Ongoing charges	Investment management fees, advice fees and custody charges	Ongoing Fund Charge – the annual costs charged by the investment product provider for managing and operating the investment
Transaction charges	Dealing charge, Stamp Duty and other Government taxes, PTM levy, exchange fees, FX charges on transactions, dividends and corporate action events	The costs of buying and selling the underlying investments over the year and any dilution levy applied to a purchase or sale made within your portfolio
Incidental costs	Payment fees	Other charges made by the investment product provider, including performance fees

Notes

Other administration charges may apply to your accounts that are not included here, for example SIPP administration charges. For full details of SIPP administration charges, please refer to the AJ Bell Investcentre website or your current SIPP provider.

We've made every effort to include all charges in this statement. Please note there may be some gaps where we weren't able to obtain the relevant charging information from the investment product provider. If this applies to a part of your statement, you'll see a dash ("-") rather than a number. Any value in your statement that is zero ("0") means no charge was applied.

Investment product costs have been provided to us by third parties and may not be accurate. Where the investment product provider has not supplied post-sale costs, we have used the pre-sale equivalent where this is available to us.

Portfolio No. [ ]   Page [x of x]   Information provided by AJ Bell Securities

Example report

Investment Managers

Richard Whitehead
richard.whitehead@dartcapital.com

Chris Bellchambers
chris.bellchambers@dartcapital.com

Andrew Savage
andrew.savage@dartcapital.com

Research Team

Alexander George
alexander.george@dartcapital.com

Michael High
michael.high@dartcapital.com

Dart Capital
61 Queen Street London EC4R 1EB
Tel: 020 7283 1117
Fax: 020 7283 0891