DART CAPITAL

Market Commentary

August 2020

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It was another positive month for equity markets, supported by continued government fiscal and monetary policy measures. Within portfolios, now that markets have recovered much of their losses from the first quarter, our focus has shifted to boosting overall resiliency whilst still taking advantage of the opportunities on offer across markets. Most notably, over recent weeks we have tilted the equity exposure of portfolios towards international stocks operating in less cyclical sectors which have been broadly left behind in this summer's tech-heavy market rally. Furthermore, following their strong credit rally from the market lows of March, we have reduced exposure to lower quality corporate bonds which will be significantly exposed should there be further lockdowns later this winter.

Market dynamics

The rebound in equity markets has been increasingly lopsided over the last few months, with technology stocks – led by the US market's mega-cap "FAAMGs" (Facebook, Amazon, Apple, Microsoft and Google) – pushing through all-time highs whilst those companies which are more exposed to the "real economy" lagging the broader market indices. Having added exposure to the former through the sell-off in the first quarter when valuations were far lower than they are now, over recent days we have – on the margin – tilted our equity allocation towards companies in the healthcare and consumer goods sectors which have not participated in the rally over recent months.

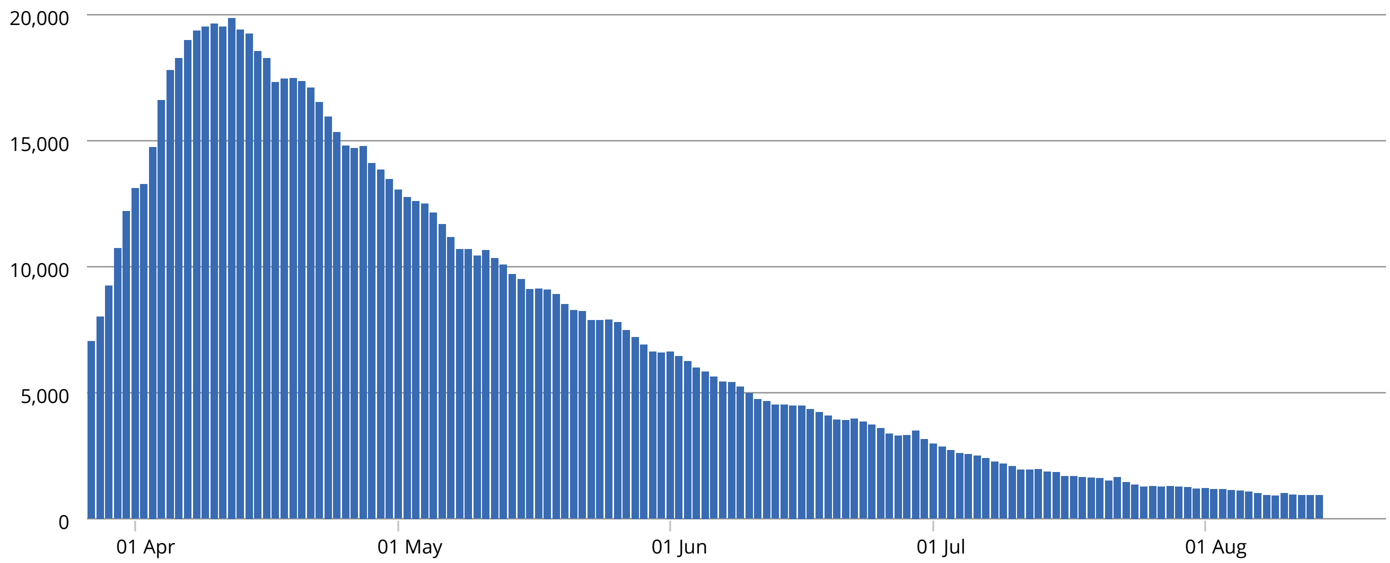
Although many technology companies have certainly benefitted from the accelerated shift to the online economy this year, we do note that share prices in this area have moved well ahead of the improvement in underlying company profitability. Given the magnitude of some of the share price gains – Apple and Amazon shares gained 41% and 25% respectively over July and August alone – it is notable that there has been a sharp pick-up in retail and institutional investors alike speculating in the leading technology stocks through the purchase of call options which provide a leveraged exposure to the share prices of these companies. Evidence suggests that the sheer weight of these trades (which effectively force option dealers to buy the underlying stock) has likely helped fuel some of these explosive share price gains. In contrast to the exuberance in the US market, healthcare stocks such as Roche and Procter & Gamble have largely trodden water since May, despite delivering resilient earnings and operating in industries which are broadly insulated from the challenging economic environment.

COVID-19 Update

Having for much of the summer been the world's hotspot for coronavirus cases, the outbreak across the southern and western US states has started to abate with declining hospitalisations (which remains our preferred measure for assessing the severity of outbreaks) across most US states. Unfortunately, the direction of travel is less positive in Europe where cases and hospitalisations have started to pick-up (albeit with the latter rising at a slower pace) and governments have started to tighten restrictions on activity as a result. Although we believe it is unlikely that cities such as London - which saw a significant proportion of the population infected during the first wave in March and April – will see hospitalisations rise to a level comparable to that time, we are wary that the reaction function of governments has been permanently altered. This is well demonstrated by the UK government which, having not acted fast enough in March, have now lowered the bar for further intervention in the economy by such a degree that widespread lockdowns seem almost inevitable this winter.

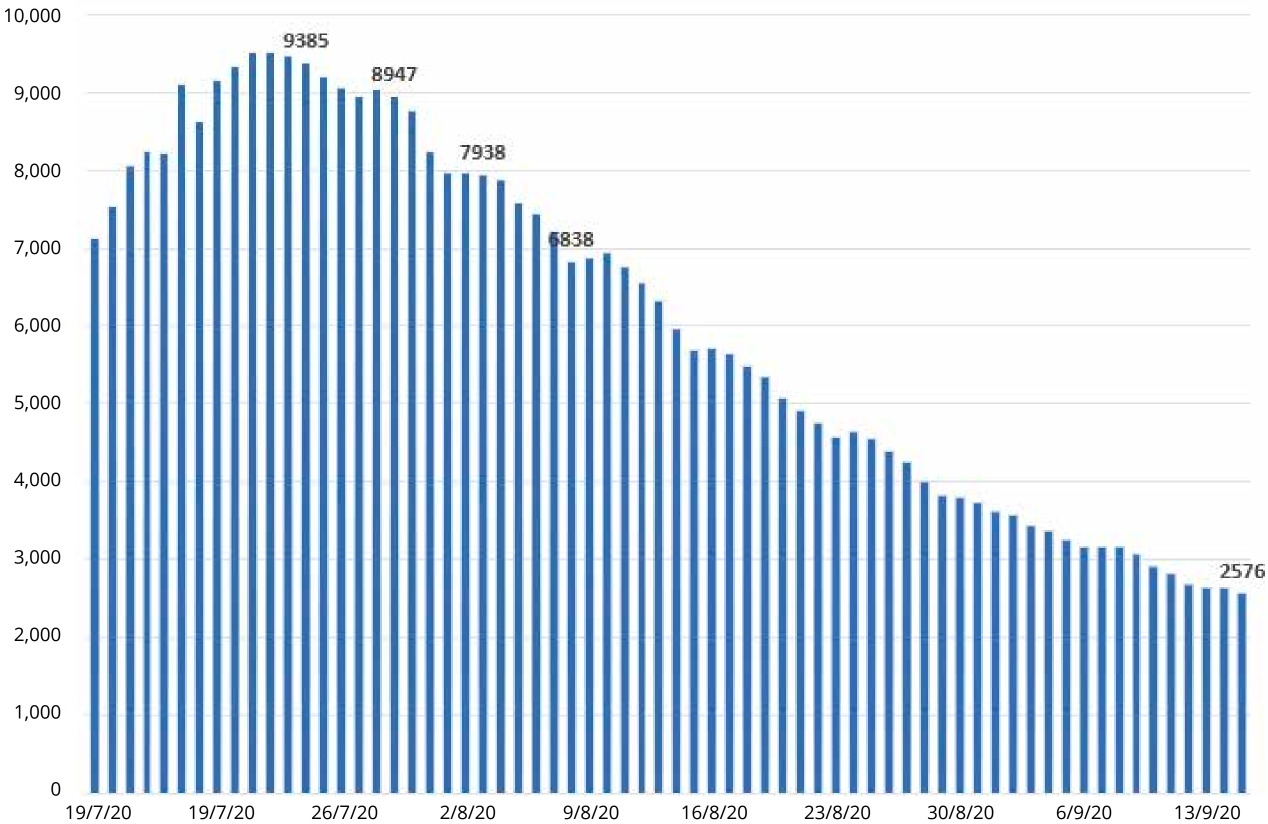
On a more positive note, we believe that governments are overly fixated on the growing case count in their countries whilst underappreciating the declining fatality rate of virus cases, with the far better understanding of how to treat the virus helping lessen the proportion of very serious cases. This reduction in death rate, as well as the prospect of a vaccine by early next year which could be applied across the most vulnerable elements of society, provide us with some hope that a return closer to economic normality will come by the middle of next year.

Despite rising cases, UK hospitalisations are still very low when compared to the peak in April



Source: UK government

Whilst hard hit southern US states, such as Florida (shown below) have finally seen a steady decline in current COVID hospitalisations



Source: Florida Department of Health

UK

Following GDP data for the second quarter which was predictably poor given stringent lockdown restrictions were in place for much of the period, it is promising that the domestic economy has picked up significantly over July and August with the most recent survey data indicating that the services sector is firmly back in expansion territory (albeit operating at a far lower base level of output than was the case at the start of the year). The improved sentiment towards the UK economy was reflected in currency markets, with the Pound gaining ground on both the US Dollar and the Euro to end the month at $1.34 and €1.12 respectively. UK equities had a reasonable month, with MSCI UK All-Cap gaining 1.6% over the month in capital return terms whilst, bolstered by the improvement in domestic data, small and mid-cap stocks outperformed with the NUMIS Smaller Companies plus AIM index gaining 6.1% on the same basis.

US

The upcoming US election has started to come into focus, with most political commentators anticipating a fractious outcome regardless of which candidate wins. Whilst a Biden victory would likely lead to slightly higher corporate taxes, we believe it would largely be offset by a less aggressive stance on China and a pick-up in fiscal spending with government stimulus directed towards putting more money into the hands of lower income households which are more likely to recycle that capital back into the real economy.

In a move which has been signposted for some time, the US Federal Reserve outlined plans to target average inflation over the long run, a move which implies they are more likely to allow inflation to run above this level for a sustained period of time before they raise interest rates as and when inflationary pressures return. The prospect that interest rates will remain lower for longer – as well as the move down in the US Dollar - helped boost US stocks over the month with the S&P 500 gaining 7% in US Dollar terms.

Eurozone

The Eurozone recovery slowed somewhat through the month of August as indicated by initial survey data released towards the end of the month, hampered by the uptick in COVID cases in various parts of the currency bloc. Whilst manufacturing output continued to rise, the services sector saw no significant improvement from the levels experienced through July. MSCI Europe ex-UK gained 3% in local currency terms.

Asia

Policy stimulus has helped drive a rebound in activity in China, with the country's construction and manufacturing sectors both firmly back in expansion territory according to survey data released over the month. Chinese stocks took a breather over the month following a very strong run, with MSCI China H, which reflects the performance of Chinese stocks listed in Hong Kong, ending the month down 1.3% in local currency terms.

Asset Class Performance – End August 2020 (in Sterling terms)

Asset Class	Dart Capital Position	1 Month	3 Months	12 Months	Index
Cash	↘	+0.01%	+0.02%	+0.45%	Bank Of England Base Rate in GBP
Fixed Interest	↗	-3.79%	-3.58%	+0.30%	L&G All Stocks Gilt Index Trust I Inc in GBP
Equities – UK	↗	+1.63%	-1.50%	-17.08%	MSCI UK All Cap in GBP
Equities – International	↗	+4.00%	+6.35%	+5.27%	MSCI All Country World Index ex UK in GBP
Property	↘	+0.05%	-0.36%	-2.91%	FE UK Property Proxy in GBP
Alternatives	↘	+0.01%	+0.02%	+0.45%	Bank of England Base Rate in GBP

Benchmarks are capital return which excludes income
Month to 31 August 2020
All performance data supplied by Financial Express Analytics
Dart Capital positions based on Dart Capital mid risk strategy

↗ Overweight
→ Neutral
↘ Underweight