US Enhanced Equity Fund

MONTHLY REPORT

28th August 2020 – FOR PROFESSIONAL INVESTORS ONLY

Monthly Review

The US equity market posted its best August returns in 34 years, making new all time highs in the process. The index was up 7.5% over the month and was led higher by technology stocks. While second quarter earnings showed better than expected growth for many of these companies, their stock prices have moved quickly to reflect this. Apple now has a $2 trillion market capitalisation and the stock trades on 32 times 2021 projected earnings. The stock has traded on an average forward multiple of 15 times over the last 10 years. One could therefore make an argument for some major constiuents of the US market to be at the frothy end of valuations. Two further anecdotes follow:

- Netflix share price is equivalent to approximately USD 1,000 per subscriber. Subscriptions are around USD 10 per month, or USD 120 per year. They spend a lot of money on their own material. They don't show adverts. Current EPS is close to 60.
- Amazon's current EPS is close to 73 based on next year's earnings. For Amazon to grow it will need to invest. Clearly an amazing company, but is this valuation excessively high?

Having said this, we are still positive on US equities over the long term, albeit perhaps less bullish than some.

The Fund is positioned to optimize returns within wide ranges of index performances over various time periods. The ranges are deliberately wide because accurately predicting markets is fiendishly difficult. Given the recent advance of US large cap stocks it is true to say that the upper end of the ranges we are targeting are now looking more likely than they have done in the past. In the short-term, the Fund can lag the market if either end of the targeted ranges are challenged and this is what has happened since the market started recovering strongly after its March nadir. In addition, implied volatility has risen recently even as the market has been rising. It has been reasonably well documented that retail investors in the US (and Softbank!) have been buying upside calls on tech names which has driven volatility up at an index level to a degree. The Fund suffers in the short-term if volatility increases, but over the long-term volatility levels have no impact on the return of the investments within the Fund.

The recent underperformance of the Fund does mean however that the outperformance relative to the broader market from here is potentially strong over the medium to long-term, even in the event of markets rallying further.

On average, the investments within the Fund have a further three years to run, and the table below estimates how the Fund will perfrom relative to the market over the next three years:

Market performance*	-40%	-30%	-20%	-10%	0%	+10%	+20%	+30%	+40%
3 months	1.72%	3.08%	3.51%	2.69%	0.37%	-3.50%	-8.75%	-15.13%	-22.39%
1 year	1.75%	3.64%	4.71%	4.67%	3.33%	-0.42%	-6.12%	-12.88%	-20.47%
2 years	1.57%	4.33%	6.07%	6.75%	6.14%	2.90%	-3.17%	-10.59%	-18.78%
3 years	-0.98%	4.22%	6.89%	8.58%	8.83%	6.12%	-0.72%	-8.93%	-17.82%

* Performance of Solactive US Large Cap Index

So, for example, if the market is at the same level as is now in three years time, the Fund is likely to outperform the broader market by approximately 8.83%. The Fund begins to underperform the market in the long-term if we see a further 20% rally from here over the next three years.

It is also true that in the event of a correction, which appears to be happening in early September, the Fund is likely to outperform the market.

	Since Launch	5 years	3 years	1 year	6 months	3 months
A Accumulation Share Class (GBP)	112.35%	118.94%	39.53%	7.75%	11.81%	2.62%
US Large Cap[1]	116.88%	121.71%	45.51%	12.46%	15.66%	7.34%
Sector[2]	82.07%	87.73%	32.64%	7.50%	12.69%	5.93%

[1]Performance of Solactive US Large Cap Index
[2]Performance of FO Equity – USA Sector

To summarise, the Fund is well positioned for a short-term correction and steady growth over the medium to long-term. As we look more broadly at US equities, earnings should start to improve for the more cyclical sectors. This potential shift in relative growth rates could present a problem for the growthier parts of the market. We believe that by combining the market's expectation of future profits and applying a robust set of scenarios for forward multiples we can enhance investor returns.

Disclaimer

Past performance is not a guide to future returns.All data is sourced from Atlantic House, Bloomberg and FE Analytics. The data is as at the date of this factsheet and has been reviewed and approved by Atlantic House.

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Note, Calculations do not consider credit spread movements of the issuers of the securities. The MTM of the securities and therefore the NAV of the Fund will decrease as credit spreads widen and vice versa if spreads narrow.

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