Oakwood FINANCIAL ADVISORS

2018

Summer Newsletter

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Intro

Attractive values

While politics can create short-term volatility and uncertainty in markets, one key lesson from the 2017 and early 2018, is to pay more attention to economic issues and less to political issues. Global equities provided further gains in the first half of the year but equities are approaching values last seen back before the dotcom bubble burst in 1999/2000.

In euro terms the MSCI World Index of shares rose by 3.3%. The return was flattered by the euro's weakness against the US dollar, where it slipped 2.8% over the six months. In dollar terms the equity gain was a rather more subdued 0.4%.

Financial headache

The strength of the US economy is also causing the Fed (US central bank) to gradually remove the financial adrenaline from the party. The US fiscal stimulus should keep growing going strong into 2019, but once the fiscal sugar rush wears off, at around the same time that tighter monetary policy could start to bite, the economy could be left nursing a hangover heading into 2020.

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Market Review

Global Markets

The market background was characterised by increasing nervousness and risk aversion on the part of investors. Outside of the US, leading economic indicators have retreated from their robust levels of 2017, especially in the Eurozone.

Trade skirmishes

The Trump-stoked trade tensions between the US and the rest of the world have raised fears of a more pronounced slowdown, should the trade skirmishes escalate.

Fears provoked

Within the US, economic growth activity continues very strongly, largely thanks to the additional stimulus from the tax-cutting package introduced last year. However, it has provoked market fears that the Fed may have to respond by tightening more aggressively than previously expected.

Investor caution was evident in the behaviour of some individual asset classes with Emerging markets equities and bonds down 4.0% in both cases.

Small positive yields

Eurozone equities also lagged the global trend, reacting to the signs of domestic slowdown and some fears of renewed instability in the Eurozone. Euro bond yields remained very stable, allowing small positive returns to be made from both nominal sovereigns and inflation-linked bonds. Investment-grade euro corporate bonds lagged a little, down 0.6%, because of the general upward movement in credit spreads.

Irish Commercial Property

Attractive Scenario

Irish property was broadly stable in capital terms, with investment returns driven by underlying income. The Dublin office market, by far the most important segment for most property funds, is demonstrating robust supply/demand dynamics. Take-up of new space has risen strongly year-on-year while prime rental levels remain at €60 - €65 per square foot. Concerns over a potential overhang of new buildings in the next couple of years will be greatly allayed if tenant demand maintains its current strength, supported by a healthy domestic economy and Ireland's continued attraction for inward foreign investment.

With property fund returns coming in at an average of 2.3% year to date the expectation for the remainder of 2018 and early 2019 is for a similar pattern due to the continued strong demand and limited supply.

Market Review

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Caution advised

In summary, it's hard not to be concerned with current equity valuations. Overall markets are still positive but the warning light is flashing. The gradual withdrawal of central bank monetary stimulus will be an issue, as it has helped fuel the rise in equity values. This coupled with the popularity of passive investing has poured petrol on equity flames and one has to question the current value in the market.

Market Returns Year to Date 30.06.2018

Index	Returns (€)
Global Equities (MSCI World)	3.3% ↑
Eurozone Equities (MSCI)	-0.4% ↓
Emerging Markets Equities (MSCI)	-4.0% ↓
UK FTSE 100	-0.4% ↓
ISEQ (Ireland)	4.8% ↑
Eurozone Inflation-Linked Bonds (BarCap Euro)	0.6% ↑
Eurozone Government Bonds (Merrill Lynch)	1.1% ↑
Commodities (DJ UBS Commoditises)	2.8% ↑
Irish Commercial Property	4.7% ↑
Euro v USD	-2.8% ↓

Looking forward

Bulls

Those bullish on markets generally argue that the current low level of long-term interest rates have helped make assets - like equities - look like good value.

Bears

Those bearish on markets argue that asset prices have been hyped up by central bank intervention and that when the liquidity that has fuelled these excesses is removed equity prices will fall back significantly in a bear market.

Global debt levels are now far higher than at the onset of the Global Credit Crisis and this has to be an issue.

Long or Short term objectives

A diversified portfolio with equities, property, short dated bonds and alternative investment types can reduce the likelihood of ups and downs. If you have lots of equity you will likely have lots of volatility, simple! However, if you are investing for the long term you need some exposure to equities to get positive returns and this should not be an issue.

Investing in alternative assets

Prudent diversification
In building an investment portfolio diversification is a key requirement in order to reduce risk. Equities should make up the main part of your portfolio but their performance is usually dependent on a healthy economic backdrop.

Changed Scene
In a normal world, we would be able to buy risk-free government bonds and obtain a return over inflation. But, today, we cannot. Alternative assets tend to be less dependent on the economy and can provide diversification of risk within a portfolio.

Improved return, lower risk
Alternative assets are assets that can produce a return above inflation but without the same risks as mainstream equities. Examples of alternative assets are renewable energy such as infrastructure, hydroelectricity, wind farms and wave energy. They offer diversification and hence the potential to reduce risk.

Low returns
Short-dated government bonds (similar in nature to bank deposits), long-dated government bonds and inflation-linked government bonds are all risk-free alternative assets as the returns they normally deliver to an investor are not dependent on a positive economic backdrop. In today's unusual world, however, and particularly in the Eurozone, none of these risk-free assets provide any return.

Lower level of risk
There are many different fund options which can offer exposure to alterative assets. It's important to point out that alternative assets, as with equities, have their own risks; it's just that they are not the same risks as general equities. Alternative assets offer return opportunities that are (mostly) uncorrelated to general equities.

The long-dated nature of infrastructure investments may be a good match for an investors longer-term objectives.

Investing - Points to note

Compounding Works Miracles

Start early and invest regularly.

Compound interest has been called the eighth wonder of the world. Its power is so great that even missing out on a few years of saving and growth can make an enormous difference to your eventual returns. Starting to save at the age of 25 and investing €5,000 per year in an investment that grows at 5% a year would leave you with nearly €300,000 more by the age of 65 than if you started at 35, even though overall you would only have invested an extra €50,000.

Cash Underperforms Over The Long Term

Cash left on the side-lines earns very little over the long run. Investors who have parked their cash in the bank have missed out on the impressive performance that would have come with staying invested over the long term. However the anomaly here is that having missed out on the growth in markets in recent years, now may be a good time to hold cash due to current equity values.

Diversification Works

The last 10 years have been a volatile and tumultuous ride for investors, with natural disasters, geopolitical conflicts and a major financial crisis. Yet despite these difficulties, the worst-performing asset classes have been cash and commodities. A well-diversified portfolio, including stocks, bonds, property with some alternative assets, has returned above 8% per year over this time.

Clarity of thought

Don’t be confused

When investing funds or planning for retirement, it can be easy to feel overwhelmed by the relentless stream of news about markets. Being bombarded with data and headlines presented as impactful to your financial well-being can evoke strong emotional responses from even the most experienced investors.

Identify the genuine issue

The majority of headline grabbing events have no real impact on markets. As advisors we are always alert to events that can genuinely affect our clients. Brexit is a prime example of a headline event that has had a negligible impact on global markets. While it will have an impact from an Irish perspective (agriculture being a prime example) from an investor’s perspective it’s negligible. Markets have perceived it as a UK problem more so than a European problem.

Headlines from the ”lost decade” (generally viewed as 1999 – 2009 from a stock market perspective) can help illustrate several periods that may have led market participants to question their approach.

- **May 1999**
  Dow Jones Industrial Average Closes Above 11,000 for the First Time
- **April 2000**
  In Less Than a Month, Nearly a Trillion Dollars of Stock Value Evaporates
- **October 2002**
  Nasdaq Hits a Bear-Market Low of 1,114
- **September 2005**
  Home Prices Post Record Gains
- **September 2008**
  Lehman Files for Bankruptcy, Merrill Lynch Is Sold

Holding your nerve

While these events are now a decade or more behind us, they can still serve as an important reminder for investors today. For many, feelings of elation or despair can accompany headlines like these. We should remember that markets can be volatile and recognise that, in the moment, doing nothing may feel paralysing. Throughout these ups and downs, however, if one had hypothetically invested €10,000 in for example US stocks in May 1999 and stayed invested, that investment would be worth approximately €28,000 today.

Purposeful action

A hypothetical €10,000 invested on April 30, 1999, and tracking the MSCI World Index (net div), would have grown to €20,999 on June 30, 2018.

Exhibit 1: Hypothetical Growth of Wealth in the MSCI World Index
May 1999–March 2018

 Not representative of an actual investment. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Performance of a hypothetical investment does not reflect transaction costs, taxes, or returns that any investor actually attained and may not reflect the true costs, including management fees, of an actual portfolio. Changes in any assumption may have a material impact on the hypothetical returns presented.

Look beyond the misleading headlines

When faced with short-term noise, it is easy to lose sight of the potential long-term benefits of staying invested. While no one has a crystal ball, adopting a long-term perspective can help change how investors view market volatility and help them look beyond the headlines.

Stay true to your plan

Part of being able to avoid giving in to emotion during periods of uncertainty is having an appropriate asset allocation that is aligned with an investor's willingness and ability to bear risk. It also helps to remember that if returns were guaranteed, you would not expect to earn a premium. Creating a portfolio investors are comfortable with, understanding that uncertainty is a part of investing, and sticking to a plan will ultimately lead to a better investment experience.

Achieving our goals

However, as with many aspects of life, we can all benefit from a bit of help in reaching our goals. The best athletes in the world work closely with a coach to increase their odds of winning, and many successful professionals rely on the assistance of a mentor or career coach to help them manage the obstacles that arise during a career. Why? They understand that the wisdom of an experienced professional, combined with the discipline to forge ahead during challenging times, can keep them on the right track. Our job as your financial adviser is to help you on the path to achieving your financial goals.