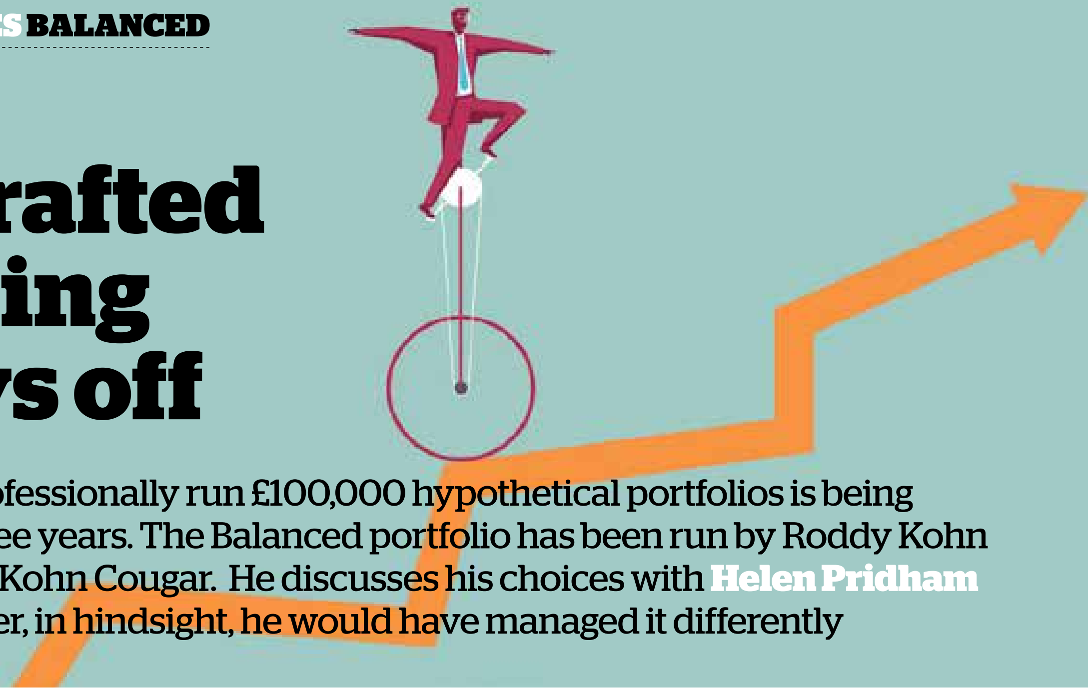
PORTFOLIO CHOICES **BALANCED**



Well-crafted balancing act pays off

The third of our professionally run £100,000 hypothetical portfolios is being wound up after three years. The Balanced portfolio has been run by Roddy Kohn of wealth manager Kohn Cougar. He discusses his choices with Helen Pridham and reflects whether, in hindsight, he would have managed it differently

Managing a portfolio is not just about choosing the right constituents initially, but also about knowing when and if to sell holdings, and what to replace them with. Too much switching can erode value, but hanging on to funds past their sell-by date can also be counter-productive. Kohn's approach, despite a challenging three years, has been mainly to stick with his initial choices. Overall it has paid off, with the portfolio achieving a total return of over 32 per cent – outpacing other indices, most notably the FTSE All-Share index.

The challenge he faced right from the start was that traditionally a balanced portfolio would have included fixed interest securities, but Kohn felt that there was such a lack of value in the bond sector at the time that it did not make sense to include them in the portfolio. Yet looking back, he concedes that contrary to his expectations, 'gilts defied gravity over the three years, returning over 24 per cent'.

In place of bonds, he decided to hold some cash initially and an increased weighting to commercial property.

Despite a blip following the Brexit vote last year, both of the property holdings – **Segro** and **Picton Property Income** – have comfortably outperformed the fixed interest sector as well as being strong performers within their own sector. Both are up around 40 per cent in capital terms, with total returns boosted by dividends, especially in the case of Picton, which has a yield of 4 per cent. Picton benefited from its high exposure to London and the South East. Meanwhile, Segro has profited from its edge-of-town warehousing in view of the increased demand for online purchasing.

A year after the portfolio was set up, Kohn decided to use his £10,000 cash reserve to buy a holding in **ETFS Brent 1 Month Oil Securities**. Having watched the price of oil decrease sharply in previous months, he believed the fall had been overdone and that the price of oil would bounce back before too long. But it has taken longer than he expected. Despite a strong recovery over the last year, the ETF is still down 16 per cent on the price he paid for it. However, its diversification attributes mean Kohn is willing to be patient with the fund.

How the Kohn Cougar portfolio compares

	Change over 3 months (%)	Change since inception (%)
Kohn Cougar's Balanced Portfolio	6.9	32.3
FTSE WMA Stock Market Balanced Index	6.1	32.2
IA mixed inv 40-85% shares sector average	5.5	24.1
FTSE All-Share Index	7.9	22.1

Notes: Returns include income to 1 March 2017

Currency switching

The only other change he made to the portfolio was that after six months he decided to swap Jupiter European Special Situations for **Liontrust** (previously Argonaut) **European Enhanced Income**. Kohn's rationale for the switch at the time was that the majority of the Argonaut fund was hedged into sterling, whereas the Jupiter fund was unhedged. At the time, the euro had been losing ground against sterling and Kohn expected this trend to continue. Since the Brexit vote, the tables have turned, but Kohn says it was also the manager's value-driven approach that held the fund back.

The portfolio's biggest winner over the three years was **3i Group**, the internationally diversified private equity and venture capital investment trust. Over the period its share price has increased by 66 per cent and it has produced a total return of 79 per cent with dividends included. Kohn has been a long-term supporter of this trust, especially since Simon Burrows was appointed as its chief executive in May 2012. Burrows has successfully slimmed down and refocused 3i, and it is now trading on a premium to net asset value of over 20 per cent.

Balanced portfolio finishes ahead of the FTSE

Fund name	Price at inception (£)	Quantity purchased	Current price (£)	Quarterly change (%)	Current value (£)	Total dividends* (£)
Personal Assets	329.00	46	406.10	4.9	18,680.60	£652.07
JOHCM UK Equity Income	2.74	5,475	3.23	8.4	17,695.20	
iShares MSCI World	20.96	715	31.45	7.7	22,485.32	£882.69
JOHCM Japan (Sterling Hedged)	1.41	7,108	1.64	3.4	11,642.90	
Segro plc Ord 10p	3.57	2,800	4.94	18.1	13,826.40	£1,136.80
97 Group	4.18	2,390	6.94	1.9	16,586.60	£1,307.33
Picton Property Income	0.57	8,785	0.82	8.5	7,203.70	£773.03
Liontrust European Enhanced Income a)	1.45	6,717	1.65	5.6	11,066.26	
ETFS Brent 1 month Oil b)	23.26	429	19.57	6.1	8,395.69	
Total				**6.9**	**127,582.67**	**£4,751.92**

Notes: Investments purchased on 4 March 2014 unless otherwise stated. A charge to cover dealing costs is deducted each time a holding is bought or sold. Investment trusts are on mid prices. *Total includes income from previous holdings, less any cash used for reinvestment. a) Purchased in September 2014 from proceeds of Jupiter European Special Situations, name changed to Liontrust in July 16. b) Purchased in February 2015 from cash and income held in portfolio. **Source:** Kohn Cougar as at 1 March 2017

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The two largest holdings in the portfolio throughout the period were **iShares MSCI World** and **Personal Assets**. Each was included for different reasons. Kohn wanted to buy iShares MSCI World Index, the second best performer in the portfolio in capital terms, partly to gain exposure to the US stock market. The fund, a low-cost tracker ETF, has a 54 per cent weighting to the US. Kohn's rationale was that because many active managers fail to outperform the US market, he preferred to gain exposure through a tracker. The MSCI World Index also covers 22 other developed markets.

Sterling benefits

The changing fortunes of sterling also helped this holding over the three years. As Kohn points out: 'along with strong returns from the US market, the 34.6 per cent fall in the value of sterling against the dollar since the portfolio's inception has benefited the fund'.

Kohn describes Personal Assets trust as his 'contrarian play' in the portfolio. He says that the manager Sebastian Lyon is notoriously cautious and the trust's portfolio reflects this, with 53 per cent invested in gold, cash and index-linked gilts. Despite its contrarian stance, the trust returned 28 per cent in total over the three years. Kohn points out that one of the reasons he decided to overweight this trust was because of the portfolio's lack of exposure to conventional fixed interest stocks.

Another large holding in the portfolio at outset was the **JOHCM UK Equity Income** fund, which Kohn concedes has underperformed over the three years. He explains: 'Clive Beagles and James Lowen's value style was not in vogue over the first two years. Overvalued defensive sectors powered ahead instead. However, over the last six months the fund has started to recover, and we believe this trend will continue and the fund will benefit.' It was currency hedging that held another of the portfolio's holdings back. The **JOHCM Japan Hedge** suffered mainly as a result of the yen being hedged.

Although the portfolio might have performed better if Kohn had done things differently, he is satisfied with its overall performance. His conclusion: '[With hindsight]... would we have done things differently? The long answer is: No.'

Track the portfolio at www.moneyobserver.com/portfolio-ideas/balanced-portfolio

TACTICAL ASSET ALLOCATOR

Cash tsunami waits on market sidelines

Even the bad news is being interpreted positively by the stock markets; yet despite the bullish euphoria there are value opportunities in Europe and China, says Ceri Jones

In the lead-up to Donald Trump's address on Capitol Hill – which was widely touted as taking on the importance of a State of the Union speech – we heard of little else but that the president would have to produce some hard detail on his plans for tax cuts and infrastructure spend to keep the bull run intact. The speech came and went, albeit in a more presidential and moderate tone than we have come to expect from the new president, but absolutely nothing was learned in terms of the detail and timings of the stimulus measures.

Did the markets mind? Not a jot. They merely turned attention away from the Trump rally and began to focus on the Federal Reserve's clarification on rate hikes.

Surely investors should be less sanguine. Cuts of 20 per cent in corporate tax could already be priced into stocks, but even when Trump reveals details of his fiscal spending plans and tax cuts, Congress will still have to approve the policy changes and could be blocked by the fiscal hawks who opposed hiking the debt ceiling when the Republicans dominated both houses. There is very little agreement on the way forward on issues such as border-adjustable tax.

> **There has been little detail from Trump on promised tax cuts and spending plans**

Republican difficulties

A recent Goldman Sachs note suggests that the difficulty the Republican majority is having with Obamacare could force the lawmakers 'to scale back their ambitions in other areas as well, such as tax reform'. It has particular credence as the investment bank has an inside line to the White House via former executives sent to advise. The Dodd-Frank Financial Reform Act, for example, could be far harder to roll back than it appears.

The markets are having little of it, however. Even concerns regarding sluggish wage growth, the low labour participation rate, low productivity and technological challenges such as artificial intelligence have been assimilated as good news that will prevent the Fed from raising interest rates too swiftly.

It could be that the main factor keeping the markets on course is the knowledge that a wall of cash is waiting on the sidelines for a deployment opportunity. When there are plenty of buyers just waiting for a sell-off, and the alternative is zero from cash or negative bond returns, investors are blind to all but the good news. There has also been a welcome uptick in corporate earnings, which are now predicted to rise 12 per cent from last year – a major improvement on the declines of 2015 and 2016.

So, despite the Russian revelations, resigning ministers, tensions with North Korea over the missile launches, a US carrier fleet patrolling the South China Sea and Trump's stance on Iran and Israel, not to mention his twitter outbursts and his attacks on the media, the S&P 500 continues to advance. At time of writing it trades at about 25 times earnings, well above its long-term average of about 16.

If we are right, and the markets are being buoyed by the cash sloshing around the system looking for a home, then some value opportunities could be lifted by strong investment inflows. Europe is currently attractive on valuation measures relative to other developed markets,

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