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Monthly Monitor

April 2019

Are we in the Twilight Zone?

Appian funds captured the recovery in global assets over the last quarter.

Appian Value Fund	+ 7.6%
Appian Ethical Value Fund	+8.0%
Appian Equity Fund	+13.6%
Appian Small Companies Fund	+9.5%

The question now is: Where do markets go next?

January was a time to be positive.

Our January outlook piece, entitled "[Darkest before the Dawn](#)" highlighted the reasons to be positive for 2019, namely that valuations were attractive within the equity space after the great de-rating of 2018 – a lot of negativity in terms of slowing economic growth was priced into the market. This ability to invest in companies with attractive valuations underpinned our decision in the first week of January to increase the equity weighting in our multi-asset funds from 43% to 50%.

It shouldn't have been a surprise to see central banks change course.

As the quarter unfolded, the key positive to emerge was that central banks have become

more dovish and this has outweighed the negatives that have emerged since, most notably slowing economic growth which is turning into slowing earnings growth. This wasn't a surprise to us as there was evidence mounting that the global economy was slowing and this does not coexist with a rising interest rate environment.

The surprise was the speed of the recovery.

Our decision to take up our equity weighting in January was not based on the expectation that the first quarter would turn out to be the best quarter for equity markets in twenty years. It was, however, based on a belief that we were buying companies at valuation levels from which it should be possible to generate attractive long-term returns. In truth, whilst not surprised by the direction of equity markets so far this year, we have been surprised by the speed.

There are reasons to be cautious now.

There are some reasons to be cautious after a quarter like the one we just had. A key one is obvious; stocks are not as cheap as they were three months ago. The nature of the rally has also been a little disconcerting as it has occurred amid continued falls in long-term bond yields. This has led to many in the market saying a recession is imminent. Whilst we don't share this view it is clear that this concern is driving investor positioning as investors continue to pile into fixed income with equities much less in favour. It is estimated that there is \$10 trillion of negative yielding debt in the financial system, and the only rationale for this is fear. This fear is also influencing equity markets, with record valuations being applied to so called "bond proxies" and "growth style equities". This begs the question, are we in the twilight zone (defined as an unusual place between reality and fantasy) with people chasing equities because they fear a recession?

Our concern is that if this consensus view of subdued economies, low inflation, low interest rates and high valuations for some asset classes gets broken, volatility will return to financial assets. We could be facing into a strange environment, where a pick-up in economic growth pushes yields higher causing losses to accrue to fixed income investors and those significant pockets of the equity market which are overvalued.

There are also reasons to be optimistic.

The main reason we have for being optimistic today is based on our bottom-up process of stock selection. Whilst we recognise there are considerable valuation problems in parts of the equity market, this isn't where we are invested today. We continue to find opportunities to invest in quality companies that trade at attractive valuations. The average dividend yield on our large cap equities is 3.9% and 3.2% on our small cap equities. These dividends are expected to grow this year by 5.2% and 6.3% despite the slowing economy. With portfolios consisting of attractively valued equities which offer strong and growing dividends, made up of businesses making good returns and with strong balance sheets, it is difficult to be pessimistic.

So, to answer the question – where to now?

We have become somewhat more cautious as there's no denying that after the recent rally in equity markets, they don't have the same cushion they had to withstand fears that may hit markets. Fears that could exert themselves through the remainder of the year include a

resumption of central bank tightening or a geopolitical shock. In recognition of these risks we have sold down our equity weighting in the multi-asset funds from 52% to 44%. When we consider the risks, this appears prudent but we are torn because we recognise the long-term value that exists within our equity portfolios.

The right question may not be is there a recession coming because there will be a recession someday but rather are you holding the right assets. We remain confident in the quality of our assets and the valuations they are trading on and this leads us, on balance, to being optimistic on the outlook for the remainder of the year.

Appian Conference Call

Appian will be hosting the next Market Update call on the 4th of April 10 am with Chief Investment Officer - Niall Dineen and Senior Relationship Manager - John Flavin.

The team will be discussing the future of Equity Markets after a strong first quarter.

If you would like to submit a question for the team, please forward it by email to Anna Hadfield at: anna.hadfield@appianasset.ie



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Appian Unit Fund Prices

2 April 2019

Appian Value Fund	149.12
Appian Equity Fund	194.03
Appian SCOF	180.65
Appian Liquidity Fund	104.70
Appian Ethical Value Fund	104.50
Appian Burlington Property Fund	120.74*

For more detailed information on each of our funds click [here](#)

**Price at 31, December 2018. Price update due April 8th 2019.*

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