Appian Asset Management

Monthly Monitor

January 2019

Darkest Before the Dawn?

It's doubtful whether it really is darkest before the dawn, but the analogy does apply to financial markets. Whilst in the long term, financial markets are driven by the underlying fundamentals, in the short term they are susceptible to extreme bouts of optimism and pessimism. We exit 2018 with all major asset classes showing negative returns and many commentators calling it the worst year for financial assets since 1931.

There are plenty of reasons being put forward for the poor performance and the dominant theme throughout the year has been increased levels of volatility driven by interest rate normalisation and trade conflicts. There is plenty of truth in the fact that these are not factors conducive to positive financial returns, however the real story is that the mood in the market has gone full circle from outright positivity to complete doom and gloom. The epicentre of this gloom is the fear of a recession. People are still bruised from the Financial crisis of 2008/2009 but the next recession, when it comes won't be as deep as this as the same excesses such as soaring housing markets are not as prevalent today and banking systems are better capitalised, meaning that a recession today is unlikely to trigger a financial crisis.

The culmination of this fear was in December when equity markets fell sharply, dragging most global indices into bear market territory. After a decade of asset prices being in positive territory since the financial crisis, its not a surprise that exuberance grew within markets to such a level that a correction would occur. The Appian Value Fund remained in positive territory throughout the first 11 months of the year but fell into negative territory during December as equity markets went into meltdown, resulting in all the major indices finishing the year in negative territory. The S+P finished the year off 6% whilst the Dax was off 18%, the Eurostoxx 50 was off 15% and closer to home, the ISEQ was off 22%. The Fund finished the year down 3.4%

We were cautious during 2018, taking money away from parts of the market where excessive optimism had taken hold, most notably US growth stocks. However, real value appeared in individual stocks during the year making it difficult for us to be negative on equities. These valuation opportunities have allowed us to put together a portfolio of quality equities that offer a dividend yield of 4.1% and are carrying almost no debt. Holding 30% cash since February has allowed us to avail of these opportunities. However, the reality is that when markets go into meltdown, fundamentals and valuation become irrelevant in the short term as fear takes hold and everyone presses the sell button. Whilst our equities out performed during the recent downdraft, there was no escaping the indiscriminate selling of December.

During the year, we exited our holdings in bonds. This proved to be the correct decision as interest rates started to rise. Heading in to 2019, we are holding on to this position as whilst there is a real possibility that central bankers pause their rate hikes until the economy is on a firmer footing, the only place where yields are really tempting is the US and chasing yield in the US brings the risk of taking currency losses if the US dollar weakens. Government bonds in Europe continue to offer no value and corporate credit markets remain mispriced in our opinion.

2018 was a year when the benefits of having alternative assets came to the fore. These assets are in our portfolios for their diversification to traditional financial assets. Whilst equities and fixed income struggled during the year, we saw positive returns from our property, forestry assets and our infrastructure assets.

As we head into 2019, the picture is markedly different from where we started 2018. Financial markets started 2018 amid extreme optimism and this was most evident within the global equity market which started the year on a price earnings ratio of 20x. Today this is 15x and if you are prepared to ignore the parts of the market where valuations remain stretched, equities are even more enticing. Appian Equity portfolios today have P/E's around 11x. These are levels from which we believe it is possible to generate solid long-term returns.

Whilst the backdrop is more supportive than twelve months ago with the excess optimism out of the market and valuations rebased, we do think there are risks out there, which we call the "known unknowns". "Known unknowns" are things that we know we don't know. The major one is the full ramifications of the impact of rising interest rates which will undoubtedly burst some asset bubbles across the globe. The end outcome of the changing political landscape as illustrated by the rise of Donald Trump and "Brexit" are also unknowns which we continue to monitor.

We approach 2019 optimistic that the environment is positive for asset returns and whilst volatility will be around, it may not be as bad as feared as financial markets have already digested many negative factors during 2018 such as rising interest rates, slowing economic growth and a trade war

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Appian Unit Fund Prices

2 January 2019

Appian Value Fund	**138.64**
Appian Equity Fund	**170.80**
Appian SCOF	**164.99**
Appian Liquidity Fund	**104.90**
Appian Ethical Value Fund	**96.76**
Appian Burlington Property Fund	**120.74**

For more detailed information on each of our funds click **here**

Investment Team

Niall Dineen
Chief Investment Officer

John Mattimoe
Senior Fund Manager

Pat Kilduff
Senior Fund Manager

Click here for more information about our Investment Team

Contact our **Client Relationship** Team

Kevin Menton
Director
Tel: (01) 662 3989 *direct*
Click here to email Kevin

John Flavin
Senior Relationship Manager
Tel: (01) 662 4053 *direct*
Click here to email John

Ian Naughton
Client Relationship Manager
Tel: (01) 662 3986
Click here to email Ian

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