



ARTORIUS WEALTH

# INVESTMENT ACTIVITY

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MANCHESTER

LONDON

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## A healthy portfolio addition

Whilst political risk of BREXIT, Budgets and the dance of the oil market can detain the thoughts of investors, we continue to explore investment opportunities to enhance the returns of our clients' portfolios. Most of the equity allocation within portfolios is made along regional lines, so much in the UK, so much in the US etc. Complementary to this as a 'traditional' way of investing, we look for themes that cross boundaries, that encompass opportunities best exploited via a global fund. For a balanced medium risk sterling portfolio this Thematic Global Equity style of investing accounts for 3% of the portfolio.

To date, the Strategic Asset Allocation to global equities comprised of exposure to the water sector (represented by the iShares Global Water UCITS ETF). This was chosen as a themed investment with the objective of benefitting from the necessity to build and upgrade water supply, treatment, processing and purification plants across much of the world. In addition, the ETF has a significant allocation to utility companies within the water sector, which are generally viewed as defensive equities which historically have performed well in those periods of equity market turbulence.

As of the 13th March 2017, we have invested additional equity themes within the global equities allocation of our discretionary portfolios.

The proposed inclusion of the healthcare sector will achieve two principal objectives:

- Give exposure to the healthcare sector as another thematic investment with good long-term fundamentals and drivers of equity performance.
- Provide additional diversification within client portfolios.

## The Attractions of the Healthcare Sector

The healthcare sector principally comprises of three sub-sectors, namely pharmaceuticals, biotechnology and medical equipment manufacturers. Related industries also include healthcare providers and other healthcare service orientated businesses.

This broad sector cannot easily be labelled as defensive or growth, as it is diverse and complex, including a wide variety of companies with some common characteristics, but many idiosyncrasies.

Certain constituents, such as the large established pharmaceutical companies, have a degree of defensive characteristics, for example revenues dependant on relatively secure government expenditure. In addition, they often provide investors with attractive dividend yields. In contrast, young developing biotechnology companies offer investors a quite different risk/reward trade off, with the ability when successful to generate significant shareholder value from new discoveries and resulting products/patents.

The healthcare sector has been at the forefront of improving living standards around the world for many decades and offers investors a number of key attractions, detailed below:

- The healthcare industry remains a beneficiary of an aging population globally and a desire to live life to the fullest in 'old-age'.
- Whilst government budgetary constraints are an issue, healthcare remains a priority for most governments around the world, including both the developed and the developing world.
- The developing countries in particular offer very good long-term growth potential for leading healthcare companies as a result of their growing populations, increasing wealth and greater awareness of health issues.
- The healthcare industry remains one of the key innovators, with a very large research and development budget across the industry and significant relationships with leading academic and scientific institutions.
- Patents offer a high degree of protection to investors and provide a key incentive for businesses to invest in new products/medicines.
- High barriers to entry and genuine global strength exhibited by many leading industry constituents.



## A Rising Interest Rate Environment

Investing in good long-term ideas also needs to take into account more prosaic matters such as interest rates, which may be key in terms of timing and capturing the most appropriate moment to initiate an investment.

The US Federal Reserve has increased the federal funds rate twice since the all-time low maintained for seven years from December 2008 to December 2015. Whilst the future course of US rates (both short-term rates and bond yields) is clearly not certain, many market indicators suggest the Fed will continue to raise interest rates in the face of inflationary pressures, seeking the over-used term of 'normalisation'.

In the event of rising US rates it is pertinent to look at how the healthcare sector performed during the last period of rising US interest rates, namely 2004-06. The steep rise in US rates in 2004-06 coincided with a sideways move in both the healthcare sector. Whilst the healthcare sector as a whole has performed relatively poorly since the Fed started to raise rates in December 2015. For us this opens the door to an opportunity to invest into the healthcare sector, for whilst more US interest rate increases are expected, the pace of US economic growth suggests that the likely extent of any rate cycle may be limited.

The table below details the relative historical performance of the US healthcare sectors within the US stock market during four different periods of the business cycle, as measured by the Institute of Supply Management (ISM) index, as well as the absolute performance of US equity market during each phase.

As the duration of economic cycle is now extended, as the last recession is over 8 years in the past, it is fair to assume we are at the latter stages of the economic cycle.

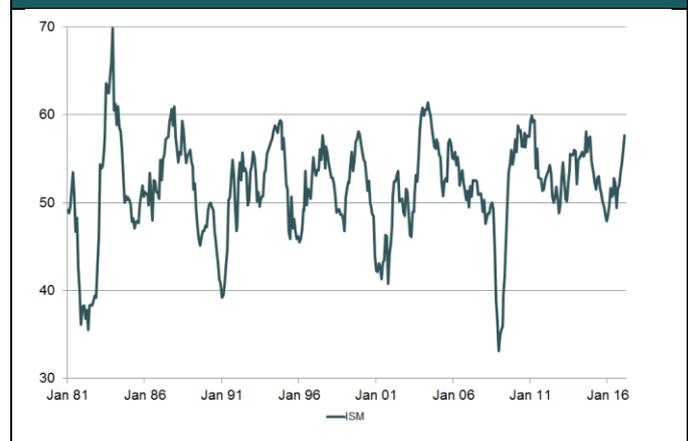
Given that assumption, when the ISM peaks and starts to move back to 50 (the growth -slowdown level) the healthcare sector holds its own against the US equity market, rising 1% relative to a market rising 8.9%.

If the US economy slows and the ISM dips below 50, due to the monetary tightening, possibly in 2018, the US equity market historically struggles in such an environment, historically flailing 5.4%, but in such an environment the Healthcare sector has actually risen and outperformed by 16%.



Source: Artorius Wealth, Credit Suisse

## The ISM economic indicator is suggesting that the US economy is nearing the peak



Source: Artorius Wealth, Bloomberg

We are now in the phase of the economic cycle where healthcare struggles, but with interest rates rising, and potentially set to rise quicker than previously expected, we believe we need to be positioned for the next turn of the cycle.



## How does healthcare perform across the US economic cycle as measured by the ISM?

Sector	Down cycle		Up cycle	
	Peak to 50	50 to trough	Trough to 50	50 to peak
Healthcare	1%	16%	1%	-2%
Market	8.9%	-5.4%	30.7%	15.2%

Source: Artorius Wealth, Credit Suisse

### Investment decision

The Investment Team have decided to allocate 50% of the Global Equity allocation to a Healthcare fund. The sector has historically performed well in the later parts of the economic cycle and appears not too have suffered greatly from rising US interest rates.

### Note

The particular securities to achieve direct healthcare exposure within discretionary portfolios are the Worldwide Healthcare Trust Ordinary Shares (quoted on the London Stock Exchange) and the Polar Healthcare Opportunities Fund (Irish registered

OEIC). The choice of security depends on the tax status of the particular client portfolio.

For example, offshore bonds and resident non-domiciled clients would be expected to incorporate the Polar fund. All UK resident on-shore portfolios will use Worldwide Healthcare Trust..

Both the funds recommended provide their respective managers with a very high degree of flexibility to allocate and switch between the sub-sectors of the healthcare sector, including on a global basis, free from any benchmark constraints. This is considered to be highly advantageous by the Artorius Investment Team as the fund management teams in question possess significant experience and have exhibited excellent past performance. This illustrates the diversification benefits of the two funds chosen to gain the healthcare exposure for Artorius clients.

The funds are neither pure biotechnology funds nor proxies for the staid large multi-national pharmaceutical companies.



## Asset Allocation Views

Equities	⊖	Fixed Income	⊖	Alternatives	⊖
US	⊖	Government	⊖	UK Real Estate	⊖
UK	⊖	Investment Grade	⊕	Infrastructure	⊖
Europe ex UK	⊖	High Yield	⊖	Private Equity	⊖
Japan	⊖	Emerging Market	⊖		
Pacific ex Japan	⊖	Cash	⊕		
Emerging Markets	⊕				

⊕ = Positive view  
 ⊖ = Negative view  
 ⊖ = Neutral

Source: Artorius Wealth

Our Tactical Asset Allocation (TAA) tilts to the SAA to reflect our shorter-term cyclical views. Actual client portfolios will vary according to mandate, benchmark, risk profile and the availability of individual asset classes in different regions.

## ASSET CLASS OVERVIEW

	SAA	Commentary	TAA
Global	3%	In contrast to our regional asset allocation, we have global equity themes of water and healthcare. As the global population grows, water resources are stretched and the water industry should benefit from increased expenditure. The Healthcare sector benefits from similar themes of large and more prosperous population and an aging population requiring higher levels of spending.	-

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Source: Artorius Wealth

Key: The numbers reflect a quantitative description of our tactical positions relative to the strategic benchmarks. Our Strategic Asset Allocation (SAA) solutions offer a blend of assets that over a medium term (5-7 years) will, in our view, provided the optimal mix of returns and risk at a given level of risk tolerance. Our Tactical Asset Allocation (TAA) tilts to the SAA reflect our shorter-term cyclical views. The SAA and TAA positions reflect a medium risk sterling on-shore based client portfolio. Views are subject to change and implementation in portfolios will reflect specific client requirements.



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