MMWealth
Chartered Financial Planners

Keeping you informed matters

Economic review

April 2018

CHARTERED FINANCIAL PLANNERS CII

Outlook

Markets are caught between the opposing influences of the two defining aspects of modern life; economics and politics. Whilst the outlook for global growth appears robust, the rhetoric around trade imbalances should not be ignored.

The outlook for global growth is robust. The IMF and the OECD have recently reaffirmed or upgraded their economic assessments. Most recent lead indicators point to what the OECD refers to as "Stable Growth Momentum," i.e. well entrenched; not too hot and not too cold.

The global Purchasing Managers Index (PMI), a measure of real world business spending intentions, is at an index level of 54. This is not high but still well into expansion territory. The IMF estimates that Emerging Market growth will stabilise at around 5% whilst developed economies should experience real GDP growth of around 1.7% p.a. looking out to 2022. Global aggregate real GDP should be ticking along at 3.5-3.75% p.a. for the foreseeable future.

If this level of growth is achieved and sustained, it will be in line with growth rates achieved in the 1980s and 1990s but somewhat below that achieved in the runaway boom years up to 2008. Policymakers view this as "normalisation" after what has been a distinctly abnormal decade.

The outlier to this assessment is the United Kingdom where economic momentum is fading due to the uncertainties surrounding Britain's trading relationships with Europe (and the rest of the world) regarding our legal departure from European institutions some time after March next year.

One of the fears surrounding markets is the fear of a trade-war induced recession following the recent tariffs imposed by Donald Trump on steel and aluminium. An oddity of the US political system is that the president is tightly constrained in respect of domestic policy but in the field of foreign policy he is largely a free agent. The other fear is that since the current expansion is already the third longest on record, a recession is "overdue."

We would share concerns over the first issue but largely discount the second. Typically, US recessions are induced by the Federal Reserve when the supply side of the economy cannot keep pace with demand. The resulting inflation forces the Fed to raise interest rates – sometimes as in 1980, very sharply.

It tends to be forgotten that the recent record of the Federal Reserve, is one of success. The volatility of output and inflation is much reduced since the 1950s and 1960s and the period between recessions has lengthened. The Smoot-Hawley tariff of the 1930s did exacerbate the recession of the time turning recession into Depression. Evidence from history suggests that a trade war is a real downside risk to world prosperity.

So far, it seems that Mr Trump's bark is worse than his bite and, having secured the relevant headline for his base, he tends to back off. Ironically, the target of his trade actions – China – is currently running a broadly balanced trade policy and the victims of the tariff announcement turned out to be Canada and Mexico. In truth, the greatest trade miscreant remains Germany with its vast trade surplus.

An all-out trade war looks unlikely and though China and Europe have retaliated, their actions, so far, are largely symbolic.

Nonetheless, Trump's foreign and domestic policies are destabilising; with trade disruption abroad and fiscal stimulus via tax cuts for the very wealthiest at home. In this environment we would expect stockmarket volatility to rise alongside the downward pressure on valuations that uncertainty brings.

Much of the recent volatility in markets stems from a rise in uncertainty as the US abandons its position of leadership. This collides with a recognition that stronger global growth implies higher interest rates and therefore higher discount rates. However, whilst the global economy is still in expansion mode, solid economic growth remains our primary driver for the foreseeable future.

Key facts about the world

United Kingdom

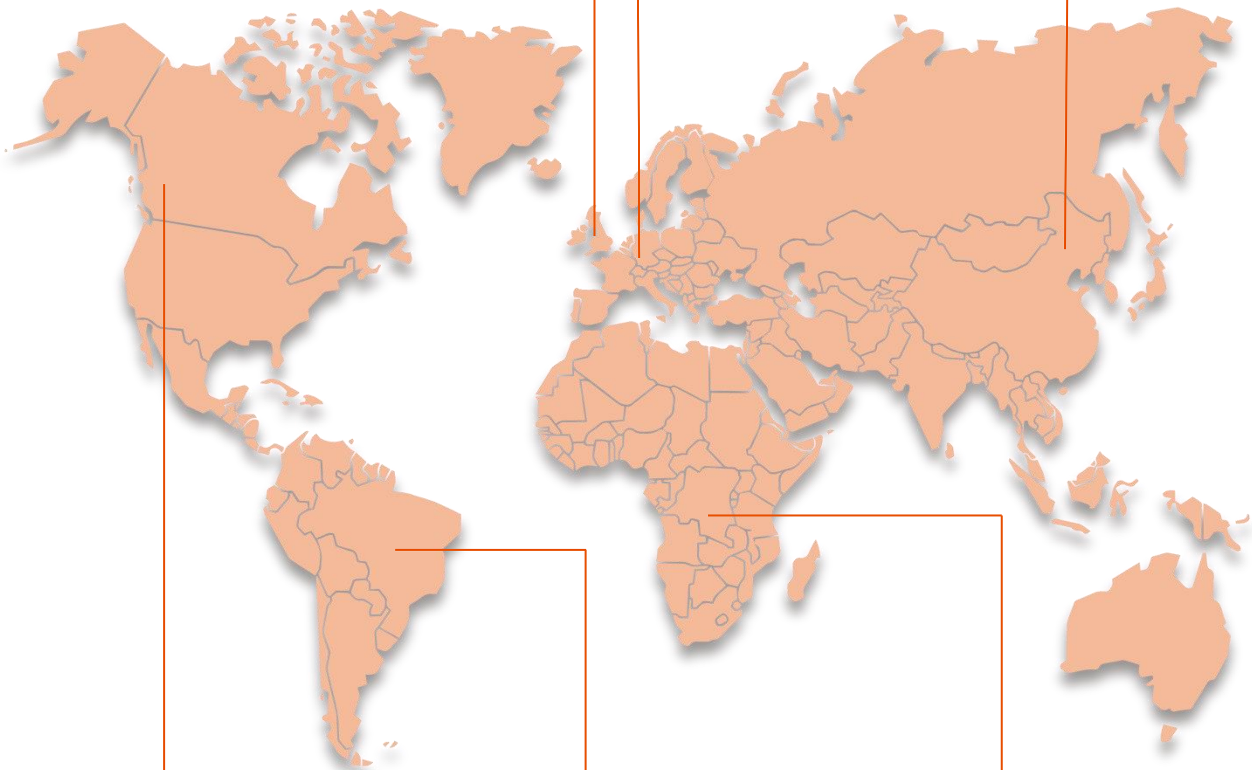
- UK economic growth is running behind other developed economies
- The Pound has risen against most people's expectations
- Brexit transition period has been agreed

Europe

- Italian elections have led to further political instability
- The central bank is still printing money to support the economy
- Brexit negotiations rely on an Irish border solution

Asia

- China is being forced to change its policies by the US
- The Japanese economy continues to struggle with low inflation even after four years of stimulus
- India's crackdown on black money reduced growth



North America

- Historic tax cut passed by Congress
- Protectionist rhetoric from President Trump will impact economy
- Global political tensions are rising and must be watched carefully

South America

- Oil price rises have helped the region recover from its recent downturn
- Uruguay has posted its 15th year of consecutive growth
- The Brazilian political environment remains volatile

Middle East & Africa

- The Syria conflict has the potential to destabilise global growth
- Jacob Zuma was removed as President of South Africa amid corruption claims
- The rise in oil prices has allowed countries to engage in conflicts

Q1 Performance Review

A volatile period after the strong returns produced in 2017

- Property exposure provided positive returns whilst other assets fell
- The Pound strengthened again, increasing volatility in our overseas exposure
- Index linked Gilts provided positive returns when equity markets fell
- Asian equities only fell marginally as their cheaper valuations helped preserve capital

During what turned out to be a volatile quarter it is no surprise that our lower risk exposure to fixed interest and property provided the best returns. In reality, only property provided positive returns during the first part of 2018.

It is important to remember that our strategies continue to be relatively defensively positioned with higher cash balances than would normally be the case.

Our holding in shorter dated High Yield bonds, AXA US Short Duration High Yield, was flat whilst the exposure to index linked bonds, rallied strongly during March as equity markets fell.

Credit spreads widened driven by investors' concerns about rising interest rates in the US and a tightening credit environment. Our lower risk holdings in aggregate returned between 1% and -1%.

Within the equity component of strategies there was a broad based fall with the majority of holdings losing around 5%.

Our UK equity exposure outperformed the falling market, however LF Woodford Equity Income again underperformed, falling 10% during the quarter against a market fall of 7%. This is not as we had expected as this fund generally performs better during periods of market volatility.

A key outlier was our holding in Fidelity Asia which fell 2%. This performance was driven by the low valuations in this region providing some protection against a backdrop of falling risk appetite.

We continue to find ourselves balancing risks with the undoubted opportunities available globally.

SECTOR	3 months	1 year to 31/03/18	1 year to 31/03/17	1 year to 31/03/16	1 year to 31/03/15	1 year to 31/03/14	5 years (annualised)
IA UK Gilts	0.09	0.25	7.55	2.55	15.36	-3.25	4.29
IA £ Corporate Bond	-1.32	1.76	9.45	-0.51	11.32	2.02	4.71
IA Emerging Markets	-3.12	8.86	35.55	-8.14	12.53	-11.08	6.29
IA UK Smaller Companies	-3.23	14.57	19.09	8.52	-2.09	29.75	13.47
IA Property	-3.40	2.07	7.27	3.26	16.27	2.04	6.05
IA Japan	-3.46	9.13	32.24	-2.13	24.36	-1.52	11.58
IA Europe Ex UK	-4.32	5.80	24.21	-1.48	6.77	17.44	10.18
IA Asia Pacific Ex Japan	-4.53	7.24	35.19	-7.55	19.78	-6.81	8.39
IA North America	-5.08	0.37	33.54	-0.36	25.29	10.13	13.01
IA UK All Companies	-5.80	2.80	18.07	-2.18	5.93	14.45	7.56
IA UK Equity Income	-6.07	0.41	15.26	-0.73	8.90	14.44	7.44

Source: Morningstar, bid-bid pricing. Net income reinvested.
Past performance is not a reliable indicator of future results.

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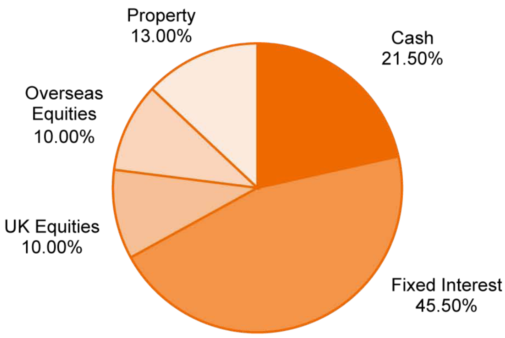
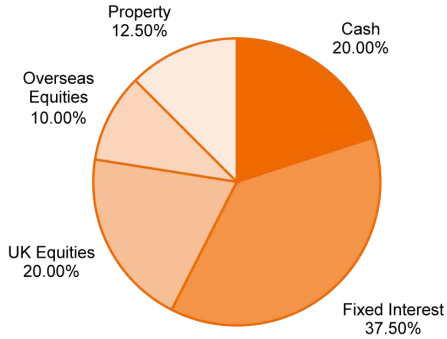
The positioning of our strategies

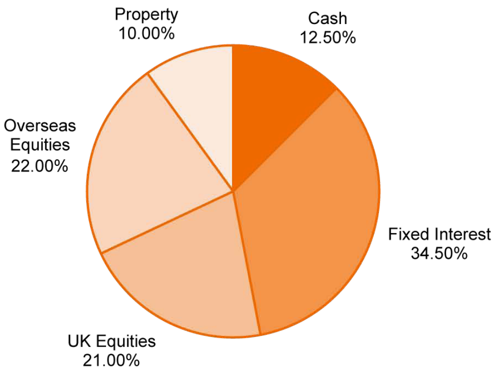
Very Conservative



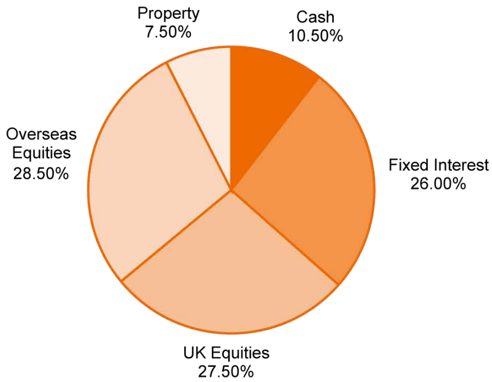
Conservative



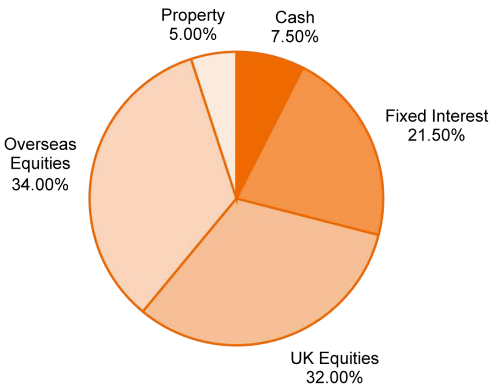
Cautious



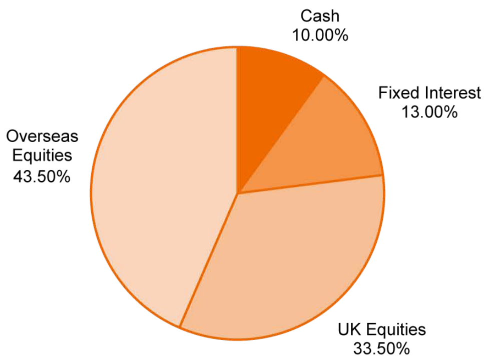
Balanced



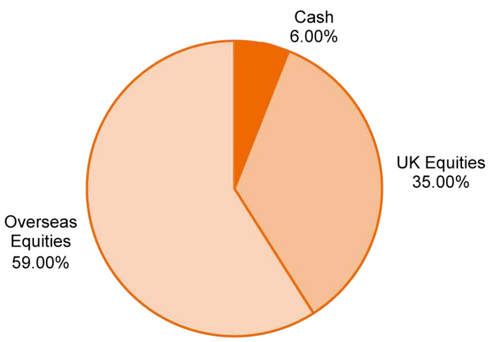
Growth



High Growth



Adventurous



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