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Keeping you informed matters

Economic review

October 2017

Outlook

In previous reports this year we have noted a growing divergence in the outlook for economic growth and the outlook for political stability. Whilst the economic environment is improving, political stability, as the recent events in Catalonia demonstrate, is visibly deteriorating.

The study of economics used to be wrapped up in the study of politics under the rubric of "political economy." Two sides of the same coin but if we view economics as the study of production, we can see politics as the study of wealth distribution or, perhaps more accurately, redistribution. Clearly, how the fruits of economic growth are divided is fundamental to investors.

We still think that the principal risks to the outlook are less economic than geo-political. Some of the obvious threats are almost too horrific to contemplate, with North Korea the principal risk in this respect, but in many economies, there has been a lurch to political extremes and/or populism along with a rise in nationalism.

Ironically, in most parts of the world, the environment is improving; the IMF, for example, recently reaffirmed its outlook for global growth this year of between 3.5% and 3.6%. Slowly but surely, the world economy is moving out of the decade-long shadow cast by the global financial crisis that started way back in 2008.

In the US, Janet Yellen and her colleagues are talking about a return to normal monetary policy whilst Mario Draghi at the ECB is thinking about reducing the European QE programme. In the UK, Mark Carney has been warning vocally about the impact of rate rises and the risks of excessive borrowing.

In previous eras, the threat of interest rate rises would be deeply worrying and indeed, for some asset classes, they certainly will be; chiefly, we believe in currency and fixed income markets. More broadly however, we would regard rising interest rates in this part of the business cycle as generally positive.

The principal reason for this is that rate rises point to a return to normality and the capacity of conventional monetary policy to regulate the economy. In technical terms, it signals a move away from the lower "zero bound" bringing about, strangely enough, lower "real" interest rates.

The second key point is that the tightening cycle that we are entering will be slow and measured. Crucially, it is not a late cycle development aimed at quashing inflation. Typically, central banks bring the economic party to an end when capacity is exhausted, credit creation is accelerating and inflation is rising. We are not there yet.

It is likely that the extent of the losses imposed on the global economy by the crisis of 2008 are still yet to be recovered. Higher rates do not reflect a desire to slow the economy they are simply a reflection of recovery from the crisis and the expectation of strengthening growth in the future. There is one significant exception to this benign picture and that is the outlook for the United Kingdom as the Brexit negotiations unfold.

One of the significant "tail-risks" we see with regard to Brexit reflects the old British disease of "Stagflation." This is not our central view but we believe that Mark Carney's recent interventions reflect his concerns about the international status and external value of the pound. At a time when the UK is putting its international trading partners under strain, it is potentially undermining the role of the City as a leading global financial centre.

If Brexit negotiations go badly or are protracted and businesses defer or cancel investment, then higher inflation will meet slower growth resulting in the risk of stagflation that clearly worries the Governor. By talking up the pound he hopes to defer or avoid raising interest rates to defend the pound. In this respect Britain presents a unique set of challenges and opportunities relative to the rest of the world.

Productivity growth has been poor over the past decade and this will need to change if higher wage growth is not to lead to unwanted inflation. Having said this, low productivity is not confined only to the UK and there could be a more deep rooted issue that is driving this across the developed world.

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Key facts about the world

United Kingdom

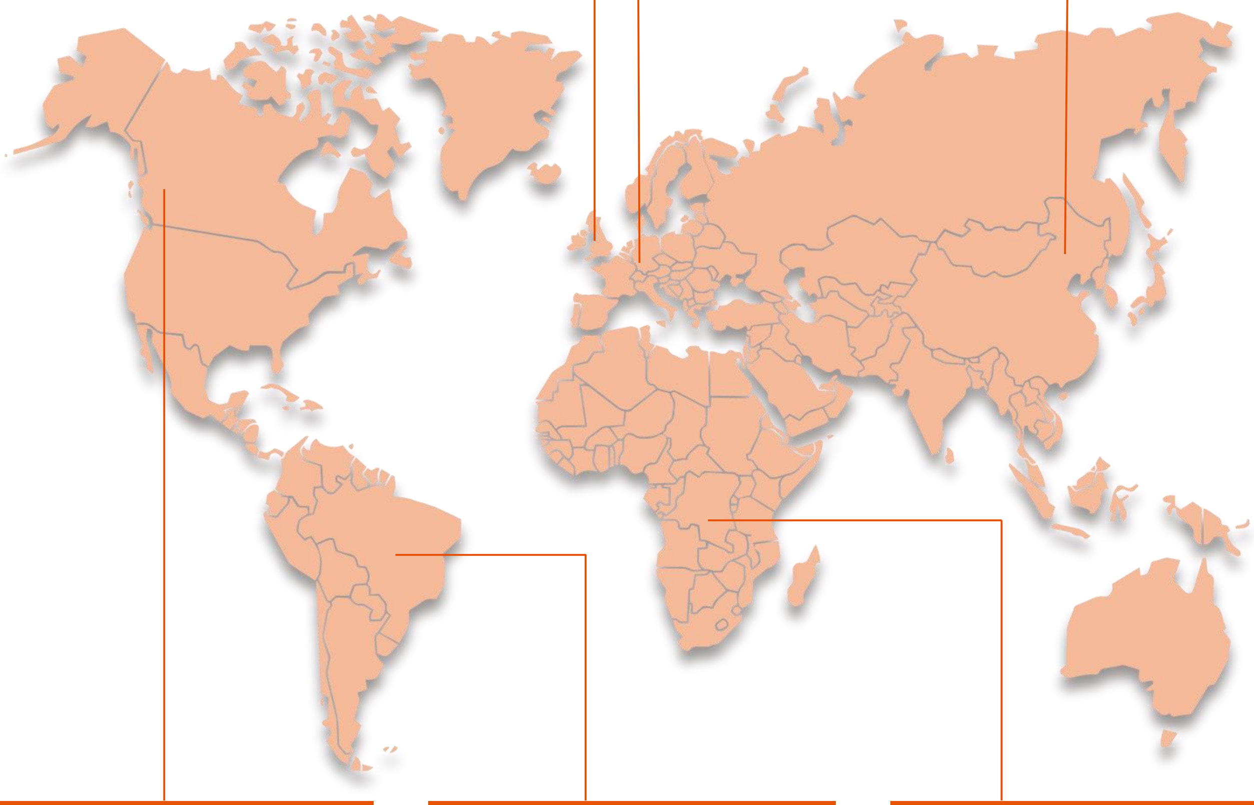
- Extended Brexit transition phase now expected
- Interest rate rise expected over coming months
- UK political scene remains volatile

Europe

- German election threw up far right surprise
- Economic growth has strengthened across the region
- Catalonian referendum brings political risks

Asia

- India continues to liberalise its economic model
- China has stabilised its economy following a period of transition
- Japanese PM has called a snap election this Autumn



North America

- US interest rates are expected to rise above inflation during 2018
- Corporate tax cut will fuel economy if passed
- Productivity remains weak as in all other developed economies

South America

- Mexico has tested markets by issuing its largest foreign bond
- Brazil’s economy is benefiting from the rise in oil prices above $50
- Latin American GDP is growing at its fastest rate for 3 years

Africa

- Mobile technology penetration is increasing at a faster rate than most other global regions
- Rising commodity prices will help South Africa
- The region continues to suffer from political issues in countries such as Uganda

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Q3 Performance Review

A flat period of returns for all strategies

- The Pound appreciated materially against the Euro and the US$
- Our holding in UK Smaller companies rose again
- Fixed interest exposure was volatile as the Bank of England signalled a rate rise
- European and Emerging Market equities rose
- Although US equities reached new highs, they were flat for UK investors as Sterling strengthened
- Again property exposure provided stability and positive returns ahead of fixed interest

Our range of strategies provided flat returns this quarter with very little variance in the underlying holdings other than within the UK equity allocation.

The Pound's strength broadened out from the US$ to all major currencies as its valuation became cheap even accounting for Brexit uncertainty. This strength muted returns from our overseas exposure. Having said this, the returns from all overseas holdings were positive even allowing for the currency movements. This again highlights the importance of global diversification in our strategies.

As the table below shows, equities provided the best returns, however US equities lagged all other equity sectors.

Within equities, returns were driven by regional allocations rather than any specific funds this quarter. The majority of our active UK equity funds, JO Hambro and Old Mutual, comfortably outperformed the UK equity market. They were rewarded for focusing on the current stage of the market cycle rather than any specific sector of the market which can fall out of favour in the shorter term.

The one UK equity holding that did lag this quarter was the CF Woodford Equity Income fund which actually fell in value. Neil Woodford manages this fund with a very strict value discipline and can exhibit performance that is at odds with the broader UK equity market during periods such as this. His long term track record and approach remains a diversifier in the strategies.

Cash weightings in our strategies remain high as we manage the more volatile environment driven by the uncertain political scene in the UK. The diversifying assets held, namely fixed interest and property, continue to help manage overall volatility within the MM Wealth strategies.

SECTOR	3 months	1 year to 30/09/17	1 year to 30/09/16	1 year to 30/09/15	1 year to 30/09/14	1 year to 30/09/13	5 years (annualised)
IA UK Smaller Companies	5.33	25.21	8.16	11.82	7.65	30.83	16.36
IA Global Emerging Markets	4.36	17.58	37.53	-13.57	3.81	1.39	8.02
IA Europe Excluding UK	3.00	21.95	19.22	3.57	4.08	27.27	14.81
IA UK All Companies	2.19	13.67	12.00	2.09	6.27	22.66	11.12
IA Japan	2.06	13.30	33.37	4.00	-0.54	32.46	15.67
IA Asia Pacific Ex. Japan	2.04	15.61	37.32	-7.39	7.13	7.26	11.06
IA £ High Yield	1.60	7.70	9.81	-1.10	5.97	9.84	6.37
IA UK Equity Income	1.23	10.84	11.54	4.11	8.04	21.63	11.08
IA North America	0.96	14.51	30.99	3.06	15.54	20.71	16.61
IA Property	0.36	3.06	12.94	8.10	7.65	7.76	7.86
IA £ Corporate Bond	0.30	0.77	12.97	3.36	7.22	3.61	5.50
IA UK Index Linked Gilts	-0.64	-6.83	28.59	10.04	8.43	5.45	8.56

Source: Morningstar, bid-bid pricing

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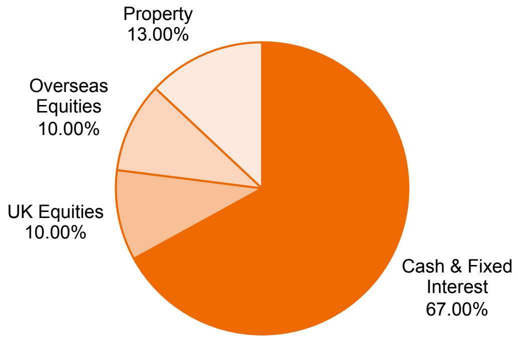
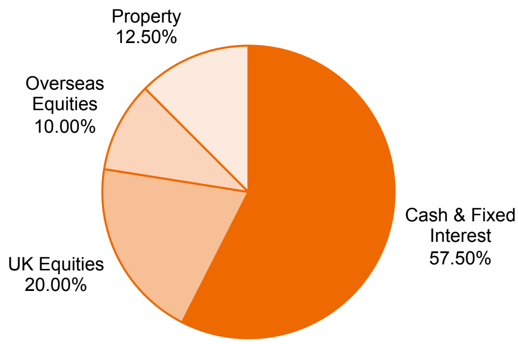
The positioning of our strategies

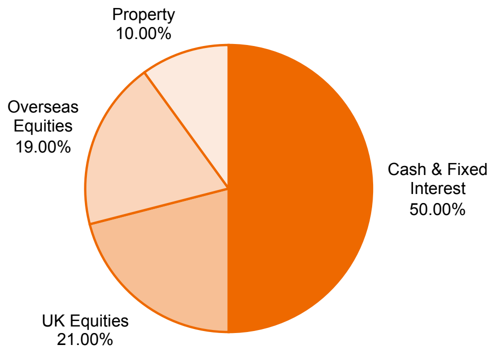
Very Conservative



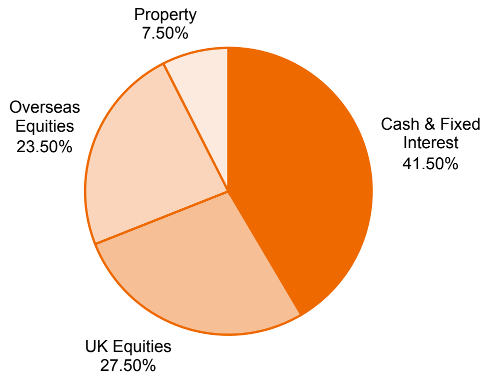
Conservative



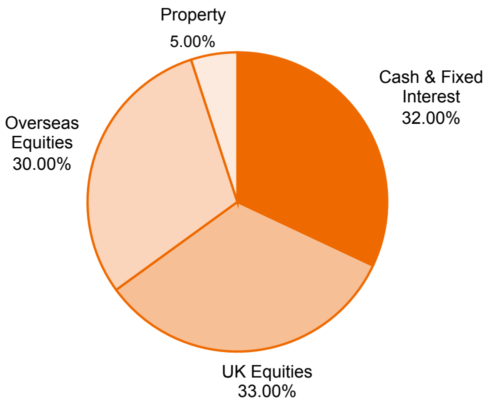
Cautious



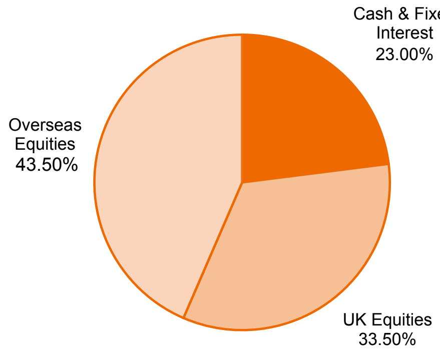
Balanced



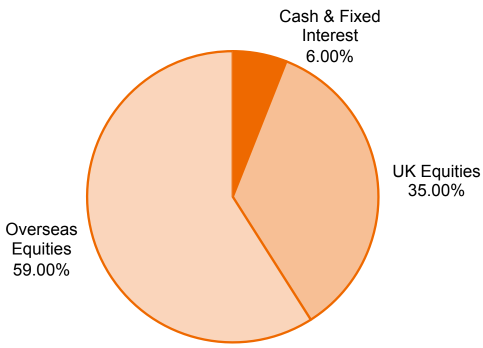
Growth



High Growth



Adventurous



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