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Keeping you informed matters

Economic review

April 2017

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Outlook

The current outlook is very much a tale of two parts. The economic problems that have dominated discussions such as this since 2008, though not entirely fixed, are clearly abating. However, the policy risks to that visible improvement are equally clearly increasing.

The economic picture has improved over recent months with the global economy showing the first real signs of a self-sustaining economic cycle since 2008.

Having said this, a group of economists have recently created a series of “uncertainty indices” that attempts to measure the level of economic uncertainty using news reports, the range of economic forecasts and proposed legislative changes. They find that in the US, for example, the level of policy uncertainty is running at twice the level of the last 23 years. Remember, that period includes the two Gulf wars and the credit crisis.

The point is that markets generally dislike uncertainty because businesses need to be able to plan and invest over long time horizons with some degree of confidence in the outlook. Whatever the outcome of the Trump presidency and the actuality of Brexit, the uncertainty will tend to depress investment, employment and output until the fog lifts and the outlook becomes clearer.

That said, the underlying macro-economic environment is clearly on an improving trend. The global composite lead indicators point to a synchronised growth picture encompassing both East and West. Moreover, the slightly shorter-term Purchasing Manager Index surveys (or PMIs) point to much the same thing. New order growth is accelerating in the US, with the Japanese manufacturing sector at its strongest in three years and European PMIs are reading at positive levels not seen for some time.

The demand picture is as healthy as it has been since the 2008 problems exploded. US growth is estimated to accelerate from 2.4% this year to 2.8% in 2018. Euro growth will be somewhat slower at around 1.6% and Japan should grow at something approaching 1.2% in 2017. Coupled with China and India, this means that the world economy should be growing at circa 3% in 2017/18.

Nevertheless, that rate of growth still represents a significant distance from the Trump target of 4%, a figure last achieved in the US in the 1980s.

The issue of political uncertainty around Trump and Brexit is further amplified this year by a raft of European elections. In the quarter just gone, the Dutch saw off a challenge by Geert Wilders, of the Far Right, when Mark Rutte, of the more conventional Centre-Right, secured sufficient votes to form a coalition. This was received positively by the markets.

In fact, the European economy has been surprising economists recently and has provided strong support to the global economy. Apart from the difficult negotiations over Brexit, the next significant test for Europe will be the Presidential and Parliamentary elections in France being held in April and June of this year respectively.

We find ourselves in a situation where macro-economic risks appear to be diminishing but political risks are rising. What are the potential impacts?

Firstly, we are likely to see elevated exchange rate volatility as political uncertainties affect the probable trajectory of interest rate rises in the future.

Secondly, since our last review we have seen yield curves steepen across the developed world in anticipation of interest rate rises. However, political uncertainties will keep investors close to the very best sovereign bonds and we will probably see strong rallies in government bond prices from time to time albeit with a bias toward a higher level of absolute yields as the 2008 crisis recedes from memory.

Thirdly, equity markets will continue to be volatile. They are caught between an improving macro-economic picture, deep political uncertainty and a period of gently rising interest rates.

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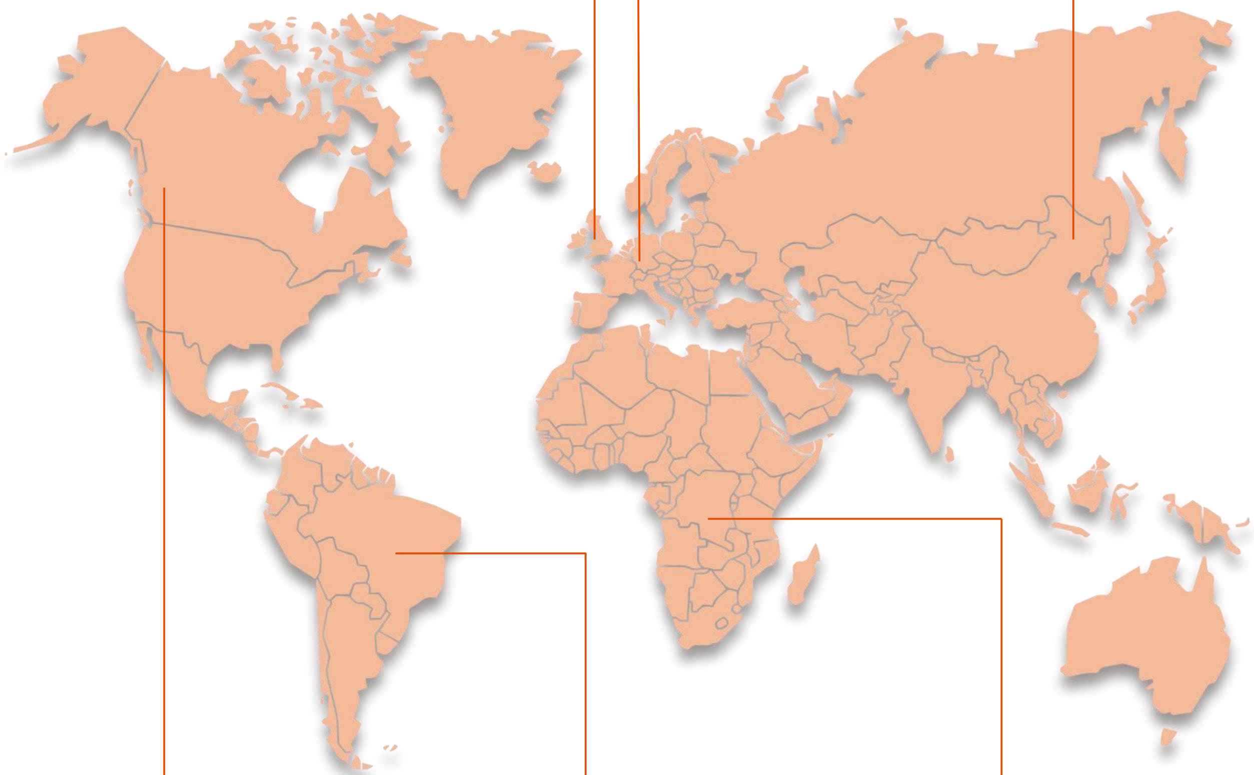
Key facts about the world

United Kingdom
- Brexit has formally been triggered
- Scottish politics will complicate matters
- Inflation is rising and above the set targets

Europe
- Brexit will test solidarity of the region's countries
- Economic growth picture, and unemployment rates, are improving markedly
- Dutch elections suggest moves to the centre ground

Asia
- China has moved from a net exporter to a net importer
- The Indian economy is now growing faster than China

Japanese policies appear to be working to raise inflation rates



North America
- The Federal Reserve has raised interest rates
- President Trump is having little success in passing his policies
- The economic environment inherited by Trump is already robust

South America
- Brazil has benefitted from the rebound in the oil price to over $50 p.b.
- The Mexican Peso has actually risen following the election of Trump
- The region is benefitting from stronger economic growth around the world

Africa
- The South African political landscape has deteriorated
- The Rand has devalued and could potentially destabilise the country
- There is no end in sight for the conflict in Syria, creating uncertainty for the northern countries

Q1 performance review

All holdings provided positive returns

- The best returns came from Emerging Market equities with the JPM Emerging Markets fund returning 12%
- Asian assets performed well as currency gains added to rising market returns
- UK Smaller and mid sized companies performed better than their larger counterparts
- Index linked government bonds provided better returns than other fixed interest
- Property behaved as we expected following a difficult period in 2016

All holdings within our strategies provided positive returns during the quarter. There was, however, no clear overriding theme that drove returns.

The Pound strengthened marginally against the US$ and Euro, however it fell against Asian and Emerging Markets currencies. This depreciation added to strong returns from some individual markets such as India, Taiwan and China. The JPM Emerging Markets fund returned nearly 12% whilst the Stewart Asia Pacific fund also returned over 10%.

UK smaller and mid sized companies performed better than their larger counterparts driven primarily by the improving economic environment globally. This is somewhat at odds with the narrative around Brexit; as an example, even accounting for the initial fall after the Brexit vote, the Old Mutual UK Smaller Companies fund has returned 29% over twelve months, 6% higher than the broader UK equity market.

The fixed interest and property assets provided diversification during periods of equity market volatility during the quarter. Even though the UK Federal Reserve raised interest rates, our fixed interest investments provided positive returns during the quarter. This is a reminder that rising interest rates are not the only driver of fixed interest returns as the yield provided is a significant portion of the total return an investor receives.

Our cash weightings remained high during the quarter and these also helped manage the overall volatility of our strategies whilst not materially detracting from returns. Risk management is as important as returns in our opinion for the coming months as investors assess the implications of the stronger economic growth on the interest rate environment alongside the political changes we are experiencing across the developed world.

SECTOR	3 months	1 year to 31/03/17	1 year to 31/03/16	1 year to 31/03/15	1 year to 31/03/14	1 year to 31/03/13	5 years (annualised)
IA Asia Pacific Ex Japan	11.55	29.24	-7.55	19.78	-6.81	16.60	10.47
IA Global Emerging Markets	11.01	30.82	-8.14	12.53	-11.08	8.66	6.86
IA UK Smaller Companies	7.36	14.80	8.52	-2.09	29.75	18.72	15.98
IA Europe Excluding UK	6.19	23.21	-1.48	6.77	17.44	19.73	13.26
IA UK All Companies	4.54	17.66	-2.18	5.93	14.45	17.58	11.10
IA North America	4.53	38.72	-0.36	25.29	10.13	17.50	17.02
IA UK Equity Income	4.31	14.24	-0.73	8.90	14.44	19.22	11.44
IA Japan	4.29	37.39	-2.13	24.36	-1.52	15.13	13.27
IA £ Corporate Bond	2.03	9.77	-0.51	11.32	2.02	12.40	7.26
IA UK Index Linked Gilts	1.57	25.61	0.79	19.25	-4.50	10.20	8.99
IA Property	1.24	7.87	3.26	16.27	2.04	12.73	9.62

Source: Morningstar, bid-bid pricing, net income

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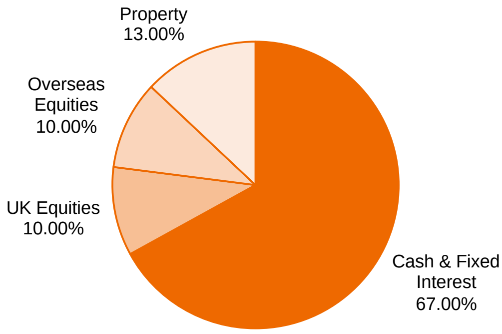
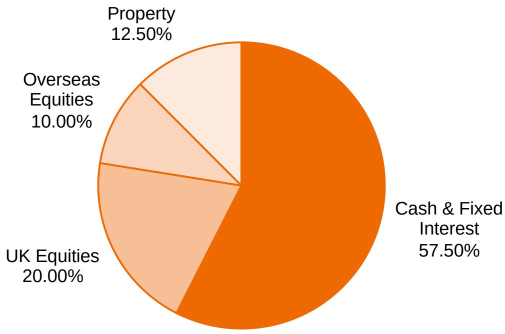
The positioning of our strategies

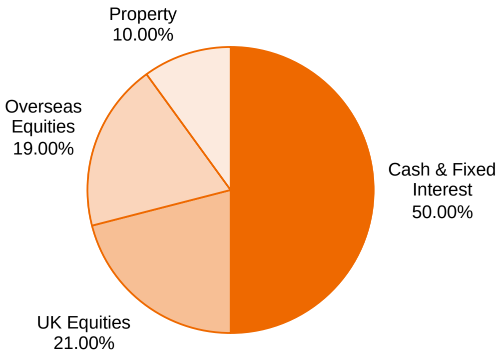
Very Conservative



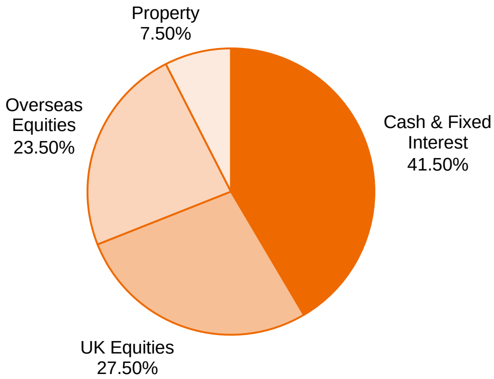
Conservative



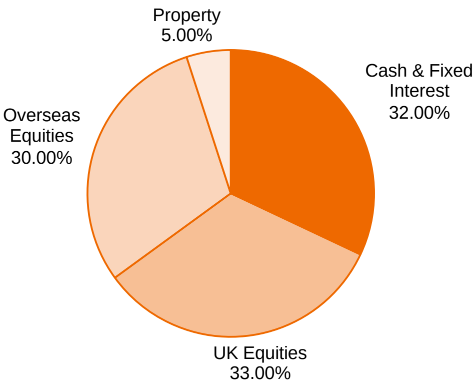
Cautious



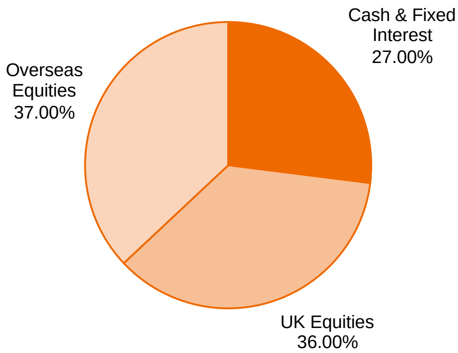
Balanced



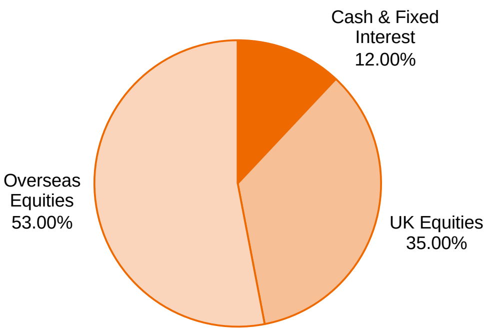
Growth



High Growth



Adventurous



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