FP FINANCIAL PARTNERS

July 2017

Asset Allocation Dashboard

Positive   Neutral   Negative

Asset class	View	Change	Comments		
Equities			Positive	Negative	Our view
Developed equities	Neutral	⟷	As we move into Q2 earnings season consensus expectations remain robust for both sales and continued earnings growth Valuations are slightly rich by historical standards but low yields warrant the higher multiple, and valuations are not stretched relative to DM sovereign bonds or credit In aggregate central banks maintain a largely accommodative stance which continues to support risk markets globally	The global macroeconomic environment is more uncertain than risk and volatility markets might suggest through market pricing. Markets have continued to perform strongly and there is a risk of momentum stalling if earnings disappoint. Geopolitical and electoral risks remain a source of volatility, albeit more contained than earlier in the year.	At these valuation levels we continue to believe a neutral allocation is appropriate. Valuations are not cheap but central bank policy remains supportive for risk assets and on a relative value basis vs both sovereign bonds and credit, equity returns remain attractive over the medium term. More elevated volatility should be expected in the future with policy and politics remaining central to risk pricing.
UK equities Relative to developed	Neutral	⟷	Valuations remain reasonable today with the low level of sterling continuing to support UK businesses, more so the exporters and those that earn their revenues overseas. Low base rates should keep risk appetite and equity prices buoyed in the near term and relative to Gilts and UK corporate bonds UK equities remain an attractive proposition, particularly when viewed on a real forward return basis.	The UK continues to face uncertain times with regard to Brexit and the government's arguably looser grip on the negotiations since the UK election. In the smaller cap indexes where businesses are more domestically exposed, one could argue that this risk may be under-priced today and if the earnings fail to materialise then the market looks expensive. The consumer and consumer facing sectors look increasingly pressured from a squeeze in real wages and challenges to the traditional high street from online retailers. The UK market remains disproportionately exposed to moves in commodity prices	Return expectations today are now at more modest levels. With sterling still looking somewhat cheap, further sustained currency weakness seems less likely, particularly in light of a more hawkish tone from certain members of the MPC. Brexit risks are now firmly focused on the negotiations and any ensuing trade deals that come from them. These risks will remain for some time and will affect business confidence and investment. The market remains disproportionately sensitive to commodity prices and we are cognisant of further oil price weakness.
European equities Relative to developed	Neutral	⟷	The Central Bank continues to purchase corporate debt as part of its expansive QE program, albeit at a lower monthly rate than in Q1 Valuations remain attractive against the backdrop of generationally low yields and potential for meaningful earnings growth is very real with European manufacturing indicators supporting strong future growth. Political risk has subsided for now and this backdrop should continue to be supportive of European equities.	The ECB has now reduced the size of their monthly bond purchases and the market is expecting further reductions at the end of the year. This may cause some repricing of risk, albeit for the right reasons. The banking sector remains under pressure, although recently we have seen efforts from governments and the Single Resolution Board to actively manage the systemic risk posed by underperformers. The Euro's continued march higher – nearly 10% against the Dollar this year – may dampen future earnings if not kept in check. Political risks remain in Europe, albeit much reduced.	European equity valuations have compressed in recent months but remain reasonable at current levels, especially when viewed against corporate and sovereign European bond markets. With lingering European political risks and a growing recognition that negative rates do more harm than good, we remain cautious but optimistic today and would look to add on weakness.

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🟩 Positive 🟨 Neutral 🟥 Negative

Asset class	View	Change	Comments		
Equities			**Positive**	**Negative**	**Our view**
US equities Relative to developed	🟥	↔	The broad US economic outlook remains solid. Consumer confidence remains high, jobs growth continues - and economic indicators suggest reasonable growth over the medium term. With Q2 earnings season under way we are currently on trend for another quarter of double digit earnings growth. The Trump administration's expected (but increasingly challenged) program of fiscal spending and tax cuts will benefit certain corporates and sectors as well as the consumer.	The US remains one of the most expensive equity regions in aggregate, with high expectations already priced in. With profit margins having peaked, US equity requires meaningful and sustained earnings growth to justify today's valuation. The Fed's interest rate policy will remain a potential source of uncertainty and renewed dollar strength could be a headwind to future earnings. There are increasing risks to the policies underpinning the 'Trump trade', which has arguably partially unwound, and this may increase risk premia for US equities.	Still the most expensive regional equity market in our valuation framework, but not outlandish on a relative basis and at these yields, and driven at the headline index level this year by technology names. Monetary policy remains a key swing factor for the US; the forward path of monetary is well flagged but inflation may increasingly disappoint. On the political front we continue to observe how the Trump administration's policies unfold or face increasing challenges; There are still many unknowns.
Japanese equities Relative to developed	🟩	↔	Valuations remain attractive in Japan and our return expectations remain one of the higher of the developed market regions. BoJ purchases of equity through ETF structures, as well as the continuing purchase of JGBs, should support prices as long as policy action remains accommodative. Yen weakness would be a boost to export oriented Japanese equities.	A strengthening yen is a problem for exporters and leaves equities exposed to the currency In real terms the currency is not expensive so there is room for this to happen, but it is likely to come in a risk off situation when the yen traditionally offers some protection as offshore capital is repatriated. Longer term, Japan remains in a difficult position with an ageing population, low/no inflation and little or no economic growth. This could hold domestic equities down.	We continue to rate this market as a green today with attractive valuations and the government's continuing program to increase equity allocations within pension portfolios and their policy initiatives to improve working practices and corporate governance. The government's pro liquidity policies are welcome but the yen's safe haven currency status could impede returns.
Emerging market equities	🟩	↔	Valuations remain attractive in emerging markets despite strong near term performance. Leading indicators continue to support reasonable growth expectations in isolation as well as versus DM economies. Global policy action remains supportive towards riskier assets. After adjusting lower over the last few years EM currencies in aggregate remain cheap in real terms, which should be supportive for EM assets more broadly.	The asset class may face near term headwinds from any renewed bouts of US dollar strength following a period of weakness. The continued moderation in Chinese growth and the economic transition taking place there is a risk to EM more broadly, particularly in the face of tightening financial conditions and efforts to contain excessive credit growth on the Chinese mainland. US trade policy may prove to be a headwind to certain companies and countries should trade agreements be revoked or tariffs introduced. Considerable political risks remain and warrant some discount, add to that increasing geopolitical tensions which may affect markets more broadly	Valuations are attractive in absolute and relative terms. With slowly improving fundamentals and improving appetite for EM assets among investors, we continue to like the prospective long term returns offered by the asset class today. This remains a volatile section of the equity market -care is required on position sizing – and evolving global trade and tariff policy remains a risk.

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Positive Neutral Negative

Asset class	View	Change	Comments		
Fixed income			**Positive**	**Negative**	**Our view**
Government		↔	DM policy remains broadly accommodative in aggregate across DM economies. Bond yields today are under less upward pressure as inflation appears to be rolling over in most regions. High quality government paper remains the ultimate haven in times of elevated risk aversion Real treasury yields do not look unreasonable if growth remains muted and inflation is contained. Moderating inflation expectations have been supporting bond valuations of late.	Extraordinary monetary policy continues to support artificially low bond yields and long term government bonds remain expensive in our view. The reflationary theme has more recently come under pressure but upside risks nonetheless remain and can have mark to market implications for rate sensitive securities.	Despite on-going supportive policy actions, on a medium term outlook the majority of government bond yields remain unattractive and the asymmetric risk of potential returns from this asset class remains elevated. There are some relative value opportunities for the more sophisticated investors but it is mostly the diversifying attributes of the higher quality sovereign bonds that warrant any holding today.
Index-linked Relative to government		↔	Realised levels of inflation in the developed world today are low or rising, while forward looking inflation expectations have more recently rolled over making inflation breakevens in aggregate look a little cheap. Given the historical stickiness of inflation at levels above breakeven inflation rates, inflation linked bonds in select markets look better value today than fixed rate government bonds.	Inflation linked bonds remain vulnerable to weak economic news flow and renewed weakness in commodity prices. Real yields in the UK are extremely negative and should be expected to rise as monetary policy normalises, causing MTM losses. It is difficult to use inflation linked bonds without accepting the higher duration risk that comes with most inflation linked bond funds. Inflation linked bonds can be more technically driven.	Like their nominal counterparts, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond, at these levels they do provide some protection against higher realised future inflation, and a cushion to the pure rate risk. In aggregate we think inflation linked bonds are reasonably valued today, with some markets offering better value than others.
Investment grade Relative to government		↔	Investment grade spreads are fairly priced today. At current levels we think investors are adequately paid for the fundamental risk of owning higher quality corporate bonds. IG corporate bonds provide some diversification to riskier assets with their embedded rate risk and higher beta to sovereign bonds. Whilst already quite expensive, European investment grade bonds should stay well supported with the ECB as a committed buyer.	In absolute terms the duration component of investment grade bonds may prove to be a headwind should government bond yields move higher than what is currently priced in. There are market concerns over liquidity but investors are somewhat compensated for this in the current spread. Financials make up a large part of the investment grade bond universe and we recognise the impact of lower sovereign rates on banks margins and profitability if base rates fall further. The US market – the largest regional allocation within the global asset class – is more progressed through the credit cycle today and leverage, whilst not at punitive levels, has been rising.	Investment grade debt remains a decent play against government bonds and an efficient way to earn a higher quality spread whilst retaining some underlying rate protection and traditional diversification. We are cognisant of any debt issuance to support share buybacks, high aggregate debt levels, and increased balance sheet leverage. Asset class duration remains near the highs meaning investors are more sensitive to rate moves today than in the past. We retain a neutral rating today and like the balance it provides in a multi asset portfolio.

Positive   Neutral   Negative

Asset class	View	Change	Comments		
Fixed income			Positive	Negative	Our view
High yield	Neutral	↑	High yield spreads in both the US and Europe offer a fair pick up versus treasuries today. Default rates remain low in non-energy sectors and recovery rates are below long term averages. The ever present 'search for yield' will continue to provide support to this asset class.	Spread tightening has levelled off but remain somewhat tight. All in yields in European HY paper makes the asset class an uncompelling proposition today. The large proportion of energy related issuers could again impact US index returns if the oil price fails to hold current levels and defaults pick up in the sector. Furthermore, the credit cycle is now somewhat extended in the US.	We prefer short duration to core high yield today as scenario analysis suggests a better risk return. On the basis of expected returns we prefer US over Europe today.
Loans	Neutral	↔	Long term some value remains and the spread available on loans is attractive with the additional benefit of a floating rate coupon. Seniority over unsecured high yield bonds also provides additional capital security if defaults pick up unexpectedly. Loans have limited exposure to the energy sector where the risk of capital impairment has been highest in recent years.	Loans sit in a less liquid part of the corporate debt market with wider bid/offer spreads whilst fundamental risks are much the same as for high yield. Covenant protection remains low. We are mindful of sector concentration in healthcare and technology and the use of new issue loan proceeds for acquisitive purposes.	We retain a modestly favourable view on the asset class and today prefer it to high yield bonds in portfolios which can own the asset class. Hold exposure if appropriate to mandate. The floating rate nature of the asset class will be accretive when interest rates rise more meaningfully.
Emerging market debt	Neutral	↔	Spreads and yields today on hard currency denominated emerging markets remain reasonably attractive when considering duration, reinvestment risks and opportunities in other asset classes. In aggregate the sovereign issuers that comprise the EMD universe today have higher currency reserves and more free floating currencies that should prevent a meltdown like that seen during previous EM debt crises, and aggregate rating quality is better. With the real effective level of EM currencies remaining near lows, this should provide some support to hard currency spreads and local bonds will benefit from any dollar weakness.	In the short term, EMD remains sensitive to disappointing growth, bad economic data, a stronger dollar and 'risk aversion' trades as witnessed post-election. Oil price falls will benefit net oil importers to the detriment of EM economies that export and a strong US dollar makes these obligations more difficult to service, although not unmanageably so yet. The large weight of the resources sector in a number of EM economies leaves them exposed to slower Chinese growth and their transitioning economy. The quality of the universe remains investment grade overall but has been deteriorating.	EMD is sensitive to global macro news, especially markets with current account deficits or a reliance on oil exports. Moderate allocations are recommended at current valuations. Currency risks warrant some caution and as with high yield we favour combining a core duration strategy with a short duration exposure at this time. Both flavours of sovereign debt should provide reasonable real returns and a decent pick up to DM sovereigns over the longer term
Convertible bonds	Neutral	↔	Convertible valuations in aggregate remain reasonably attractive today. Following several years of suppressed volatility we expect some pick up going forward which is usually good for convertible bonds	The call optionality embedded in converts ultimately only has real value if markets increase and the particular stocks in question participate in these moves. The US convertibles market has recently exhibited a high 'delta' meaning it is more exposed to a repricing in US equities today than it would have been in the past.	Convertible bonds are priced about fair value to their constituent parts. The asset class should always have a place in a multi asset portfolio given the upside participation and downside bond floor and the asymmetric properties they possess, arguably more so today given the extended run we've had in equity markets.

Positive Neutral Negative

Asset class	View	View	Comments		
Alternatives			Positive	Negative	Our view
Commodities	Neutral	⟷	Commodity prices are primarily supply and demand driven, and idiosyncratic factors will drive commodity prices as much or more so than the global economic cycle, which remains intact but subdued.. Commodities can provide an inflation hedge in client portfolios. Gold can also provide a hedge against event risk in what has become a macro environment sensitive to policy error and news flow. With the US Dollar coming off cyclical highs in real effective terms, commodities have room to price higher should the Greenback continue to weaken.	Strength of final demand is still questionable especially with respect to China where commodity imports have slowed, growth continues to moderate and policy has been tightened in recent months. It is difficult to take a direct exposure to commodities and commodity curves will influence returns vehicles that invest via commodity futures, often negatively. The asset class more broadly remains prone to bouts of dollar strength that may accompany changing Fed rate expectations. When rates move more meaningfully higher the opportunity cost of taking commodity exposure is higher and commodities may see outflows.	Commodities remain sensitive to negative news on global growth. With inflation risk at the lower end of historical levels there is little upward pressure on underlying prices at present. The dollar will likely be the single biggest influence on future returns for the asset class as a whole.
Property (UK)	Neutral	⟷	Yields and returns remain reasonably attractive, more so outside the capital, and comfortably above what can be achieved in higher quality UK bonds today. Any renewed pressure on sterling would likely see additional support for property from the overseas buyer.	The UK's economic outlook remains uncertain as the Brexit negotiations slowly move forward We have warned in the past of the dangers of liquidity mismatch and this continues to be a risk in this sector. As a longer duration asset class property remains susceptible to any repricing in long terms bond yields.	Income is attractive versus gilts but there is limited room for capital growth. We also recognise the 'search for yield' lends support to the asset class.

Asset class	View	Change	
Currencies			
USDGBP	Neutral	⟷	The Dollar has continued its weak run of form year to date as the 'Trump trade' deflates and inflation fails to gain a hold. The Dollar still looks expensive in real terms though so the weak trend may continue Against that, Sterling makes for a rather uncompelling pairing as the UK faces its own challenges, most notably with ongoing Brexit headwinds. Sterling remains at the low end of valuations, but with recent gains due mostly to the hawkish tone coming from the MPC, Sterling may on balance struggle to maintain its rally.
EURGBP	Neutral	⟷	Rate differentials continue to provide little to no carry advantage for the Eurobut . any additional and unexpected QE tapering will see the common currency push higher. In real terms the currency still has some upside potential but on balance is probably due something of a pause after a strong rally year to date. Versus Sterling the view remains more neutral today.
JPYGBP	Neutral	⟷	With the BoJ maintaining a yield target on its QE bond program and no change in policy rates it is hard to see a fundamental reason for the Yen to under or outperform meaningfully. In real terms however the currency looks somewhat undervalued. This currency cross remains sensitive to risk news but with both currencies looking somewhat cheap on a long term real basis, and no imminent rate events likely to upset the cross, it is difficult to take a strong directional view on this pair today.

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