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Newsflash

A new month and the 125th issue of Viewpoint from **Financial Partners**.

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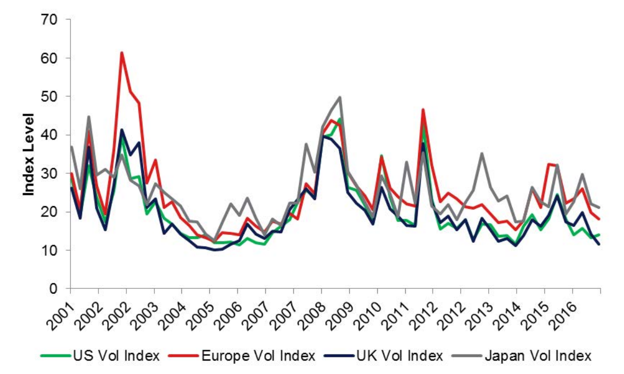
Market Commentary

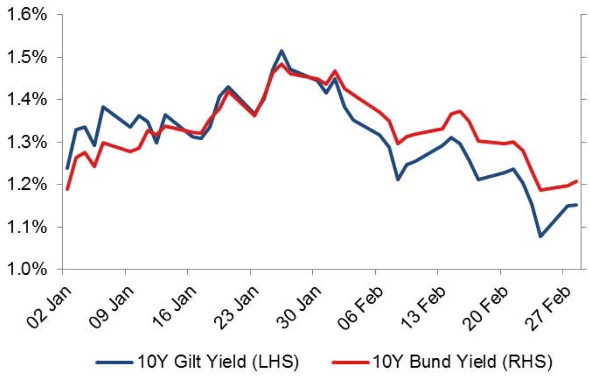
The broad pattern of market performance since Trump's election victory continued in February in a period notable for its particularly low volatility, with the Vix 'fear' index now at its lowest levels since the financial crisis. Equities, led by the US, significantly outperformed bonds again; global developed equities returned 2.8% in February compared with a return of 0.4% from global bonds, taking the year-to-date outperformance of equities to 3.9%. With global growth continuing to show clear signs of acceleration, emerging markets, led by Asia and Latin America, again outperformed developed markets. So far this year they have returned 8.7%, which is 3.4% ahead of developed markets.

Figure 1: Historically low volatility in developed equity markets



The two most notable features of markets in February was the return to strength of the US dollar, which erased much of its weakness in January, and the falls in bond market yields, despite the evidence of strengthening economic growth and higher inflation. The USD rose 1.6% on a trade weighted basis, with the euro falling 2.1% and sterling declining by 1.6%; in contrast the yen was stable and some developing world currencies strengthened. Bond yields generally fell back after the rises of recent months. There was, however, a notable difference in performance between the US, which only saw modest declines in yields in longer maturities, and yields in European markets, which fell much more significantly, with 10-year gilt yields in the UK experiencing a monthly drop of 25 basis points to 1.15% and German bund yields seeing similar sized moves to fall to 0.2%.

Figure 2: Gilt & bund yields fall from January highs

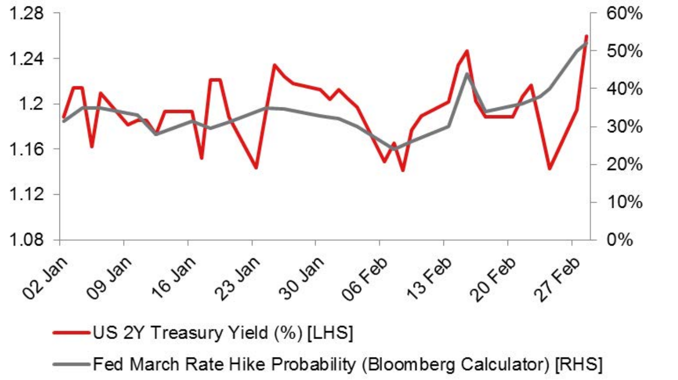


Such moves were somewhat perplexing given the broad evidence of a pick-up in both growth and inflation globally. However, within the euro area, huge scale ECB bond purchases and increasing fears surrounding the French Presidential election in May, with Marine le Pen seemingly benefitting from disarray within the traditional mainstream parties, helped support valuations of safe-haven German bunds, with investors avoiding peripheral European markets.

Depressed gilt yields in the UK were for different reasons: investors began to worry that the widely forecast, but to date non-existent post EU referendum economic slowdown, was beginning to emerge. Such concerns followed marginally weaker trends in consumer spending and other leading indicators, combined with forecasts that rising inflation following sterling's sharp falls, and uncertainty over the terms of Brexit, will dampen confidence and growth in the UK.

In contrast yields on short-dated US bonds moved up. With most data on the economy continuing to improve, the labour market remaining strong and all measures of inflation moving up (both headline and core CPI are above the US Federal Reserve's 2% inflation target) the market has re-priced expectations for impending rate rises. Hawkish noises from members of the Federal Open Markets Committee have pushed yields on two-year bonds to 1.3%, their highest levels since mid-2009, and the market is now almost fully discounting a 25 basis point increase in rates at the mid-March meeting of the US Federal Reserve, with expectations of between one and two further rises this year. There is now a yield differential of 220 basis points between US and German government bonds, a very wide gap by historical standards, which is likely to keep the US dollar well supported.

Figure 3: Correlation between short term US yields and hike expectations



President Trump's first, much anticipated address to Congress proved to deliver nothing new in terms of policy substance. Tax cuts and reforms, one trillion dollars of infrastructure spending, a 10% increase in defence spending, the repeal of Obamacare, and the 'hire American, buy American' initiative, had all been well flagged previously. However, markets were encouraged by a more presidential approach, sticking to a well-crafted script that was noticeably less antagonistic and gloomy than his inauguration speech. His intent is clear and if successfully implemented his moves would undoubtedly be reflationary, but the address did nothing to allay concerns about how policies would be funded. Additionally, nothing was said to reduce the apparent risk of rising trade tensions, and the focus will now shift to more detailed policy announcements and the ability to steer these through Congress.

Markets have performed well this year and have risen sharply since the US election. The evidence of higher growth has been encouraging and many of Trump's policies are market friendly. However, we are now at the stage where the detail of policy will be subject to higher scrutiny. Political uncertainties remain high at a time when the status quo in Europe also faces several key challenges. Worst case outcomes which would cast doubt over the future of the euro and EU, while unlikely, don't appear in any way priced into markets. With valuations high, markets are vulnerable to a correction and the long period of subdued volatility that we have enjoyed over the past few months will surely be tested before too long.

However, this cycle is particularly long and it will be important to stay invested, anything less is likely to lead to disappointment. Opportunities for returns outweigh the risks and we expect equities to continue to outperform bonds through 2017, so periodic bouts of weakness in equity markets will present buying opportunities.

Source: Bloomberg. Returns in US dollars unless otherwise stated. February 2017.

Market Performance

Asset Class/Region	Index	To 28 February 2017		
		Currency	1 Month	Year to date
Developed markets equities				
United States	S&P 500 NR	**USD**	3.9%	5.8%
United Kingdom	MSCI UK NR	**GBP**	3.1%	2.6%
Continental Europe	MSCI Europe ex UK NR	**EUR**	2.6%	2.5%
Japan	Topix TR	**JPY**	0.9%	1.2%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	3.4%	9.4%
Global	MSCI World NR	**USD**	2.8%	5.3%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-2.0%	-0.3%
Emerging Asia	MSCI EM Asia NR	**USD**	3.6%	9.7%
Emerging Latin America	MSCI EM Latin America NR	**USD**	3.6%	11.4%
BRICs	MSCI BRIC NR	**USD**	3.2%	9.7%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	**USD**	3.1%	8.7%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	0.5%	0.8%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Lin ed TR	**USD**	0.5%	1.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	1.1%	1.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	1.5%	2.9%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	3.2%	1.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	2.5%	1.6%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	1.2%	-0.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	1.2%	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	1.1%	1.8%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	0.3%	-0.3%
Australian Government	JP Morgan Australia GBI TR	**AUD**	0.1%	0.7%
Global Government Bonds	JP Morgan Global GBI	**USD**	0.4%	1.3%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	0.4%	1.2%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	0.9%	3.0%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	1.9%	3.4%

Source: Bloomberg ** estimate*

Market Performance

Asset Class/Region	Index	To 28 February 2017		
		Currency	1 Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	**USD**	3.4%	3.3%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	3.3%	-1.7%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	2.6%	8.3%
Global Property Securities	S&P Global Property USD TR	**USD**	3.3%	4.5%
Currencies				
Euro		**USD**	-2.0%	0.5%
UK Pound Sterling		**USD**	-1.6%	0.2%
Japanese Yen		**USD**	0.0%	3.8%
Australian Dollar		**USD**	0.9%	6.4%
South African Rand		**USD**	2.6%	4.3%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	0.3%	1.2%
Agricultural Commodities	RICI Agriculture TR	**USD**	-0.1%	3.0%
Oil	Brent Crude Oil	**USD**	-0.2%	-2.2%
Gold	Gold Spot	**USD**	3.1%	8.3%
Hedge funds	HFRX Global Hedge Fund	**USD**	1.1%	1.6%
Interest rates				
United States			0.75%	
United Kingdom			0.25%	
Eurozone			0.00%	
Japan			0.00%	
Australia			1.50%	
South Africa			7.00%	

Source: Bloomberg ** estimate*

Asset Allocation Dashboard

Positive Neutral Negative

Asset class	View
Equities	
Developed equities	
UK equities (relative to developed)	
European equities (relative to developed)	
US equities (relative to developed)	
Japan equities (relative to developed)	
Emerging market equities	
Fixed Income	
Government	
Index-linked (relative to government)	
Investment grade (relative to government)	
High yield	
Loans	
Emerging market debt	
Convertible bonds	
Alternatives	
Commodities	
Property (UK)	
Currencies	
GBP	
Euro	
Yen	

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