FP FINANCIAL PARTNERS

September 2016

Asset Allocation Dashboard

Positive | Neutral | Negative

Asset class	View	Change	Comments		
Equities			**Positive**	**Negative**	**Our view**
Developed equities	Neutral	↔	Corporates continue to generate reasonable levels of profit and earnings per share have been quite robust, notwithstanding some sector dispersion. Valuations are slightly rich by historical standards but low yields warrant the higher multiple. Central Bank activity continues to provide a boost to markets.	The global macroeconomic environment is more uncertain than risk markets might suggest and risk looks under-priced in some sectors and regions. Markets have continued to perform strongly and there is a risk of momentum stalling and profits being taken in the absence of improving sales or profit margins to push stocks higher. Brexit risk is arguably now more of a domestic issue which will continue through the evolving political change and forthcoming negotiations.	At these valuation levels we view a broadly neutral allocation as appropriate. Valuations are not cheap but Central Bank policy remains supportive for risk assets and on a relative value basis equity returns remain attractive over the medium term, even if nominal expectations are quite low. Short term volatility should be expected with policy and politics central to risk pricing.
UK equities Relative to developed	Positive	↔	Valuations are fair and while the implications of Brexit are yet to be fully understood, UK corporates have so far weathered the short term volatility. The fall in sterling will support UK business, more so the exporters and those that earn their revenues overseas. This should boost earnings for the larger cap businesses. The recent BoE rate reduction and the re-firing of the asset purchase program should keep risk appetite buoyed in the near term.	Uncertainty remains in the UK economy at this time following the referendum result to leave the EU and data surprises to both the up and downside. In the smaller cap indexes where businesses are more domestically exposed, one might argue that this risk is under-priced today. The UK market remains disproportionately exposed to moves in commodity prices.	With Brexit behind us, attractive return expectations and a bias to a weaker sterling we remain favourable towards UK equities. Brexit risks have faded but remain. Prices in both small and large cap indexes are higher than pre-referendum is somewhat surprising. The risk to UK plc is a stalling of investment but equity earnings and prices should be supported by more accommodative policy in the short term. The market remains disproportionately sensitive to the commodity prices and we are cognisant of the recent offer pricing in oil markets.
European equities Relative to developed	Positive	↔	The Central Bank remains committed to its QE program which includes the purchase of corporate debt which they are currently buying at a pace of ~€8bn a month. Some businesses may stand to gain from Brexit fallout if capital flows to the region and investment moves to the continent. Recent underperformance may provide some support vs other DM markets. Business indicators and fundamentals continue to improve.	The intervention of the ECB has, on the whole, been well received, but the longer term efficacy remains to be seen and QE extension has been mostly priced in. Low rates in Europe and beyond puts pressure on the banking sector, notably in Italy where, coupled with souring non-performing loans, the sector is under intense pressure. We are mindful of political issues within Europe including the knock on effects of the UK Brexit vote, the upcoming referendum in Italy and elections in France and Germany next year.	European equity looks reasonably valued at current levels, especially when viewed against corporate and sovereign European bond markets. We continue to rate this market as a mild green relative to broader DM equities given the backdrop of continuing Central Bank stimulus which lowers corporate funding costs and the room for relative price improvement.
US equities Relative to developed	Negative	↔	The broad US economic outlook remains amongst the best of the major economies. Consumer confidence remains high and unemployment continues to edge lower, albeit at a slowing pace. Arguably the region warrants a premium at a time of uncertainty in Europe and Japan. Rates look increasingly likely to remain low through 2016 and beyond which will support valuations, although this can and has changed rapidly as macro data and market sentiment evolves.	The US remains one of the most expensive equity regions, with high investor expectations already priced in and Q2 earnings beating on lower revised estimates. With profit margins having peaked, US equity requires reasonable earnings growth to justify today's valuation and against a slow global backdrop this may prove hard to realise. The Fed's interest rate policy will remain a source of volatility and is increasingly becoming influenced by external factors. An inflation surprise could force policy action to be repriced which could introduce more volatility. ISM numbers out of the US are showing some signs of pressure. The US presidential election is looming and event risk around the outcome could pull US asset markets lower.	Still the most expensive regional equity market in our valuation framework. Despite decent US news flow, it warrants an underweight as investors can buy similar companies elsewhere for less. Monetary policy remains a key swing factor for the US. We will watch with interest as political trends evolve through the year.

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Equities			**Positive**	**Negative**	**Our view**
Japanese equities Relative to developed (continued)	Positive	↔	Negative rates should be constructive for equities despite creating bouts of volatility in the near term. Whilst yen strength has hurt performance, increasing currency rhetoric and potential intervention could boost returns. BoJ purchase of equity through ETF structures, as well as the continuing purchase of JGBs, should support prices. Investors expect additional accommodative measures from the BoJ. Following recent yen strength equity valuations remain attractive.	A strengthening yen will be a problem for exporters and recent action has seen this play out and hedged investments get hit twice. 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. Longer term Japan remains in a difficult position with an ageing population and little or no economic growth. Confidence seems to be stalling in the ability of the BoJ to deliver on its QE objectives.	The government's pro liquidity policies are welcome but inconsistent data readings, habitual disappointment and the yen's safe haven currency status warrant caution. We continue to rate this market as a green today in light of the recent underperformance, attractive valuations and a continuing program to increase equity allocations within pension portfolios. Yen strength remains a risk but conversely weakening rhetoric may provide a boost and any repricing higher in US rates should see benefits come through.
Emerging market equities	Positive	↑	Valuations remain attractive in emerging markets with much of the negative news surrounding commodity exporting countries having been priced in and the respective currencies having adjusted. We are starting to see a shift in leading indicators which, if sustained, may see the growth differential between emerging markets and DM markets start to widen. Early but promising. Policy action remains supportive towards riskier assets.	The asset class may face near term headwinds including the US dollar and the moderation in Chinese growth which heavily influences the EM asset class. Fundamentals in a number of countries including Brazil and Russia remain weak and considerable political risk abounds. Commodity falls have disproportionately hit the emerging markets equity index due to the large weight of the resources sector. Commodity prices have improved but will remain volatile and this is reflected in cheaper valuations.	Valuations are attractive and with slowly improving fundamentals and a noticeable repositioning in risk appetite among investors, we move to a positive view on the asset class today. Care should be taken to ensure the strong valuation bifurcation between high and low quality stocks does not impact returns. This remains a volatile section of the equity market: care is required on position sizing.

Asset class	View	Change	Comments		
Fixed income			**Positive**	**Negative**	**Our view**
Government	Negative	↔	DM policy remains accommodative and as inflation expectations continue to price well under policy targets, bond yields are under little near term upward pressure. High quality government paper remains the ultimate haven in times of elevated risk aversion.	Extraordinary monetary policy has brought about artificially low bond yields and long term government bonds remain expensive in our view. The real return available to investors in a variety of 10 year 'safe haven' government bonds will now be negative even in a modest inflationary environment as negative rates become more entrenched. With forward rate and bond markets priced for de minimis inflation, the asymmetric risk today looks more pronounced than ever. Further easing has already been priced in in the UK.	The Bank of England joins the ECB and BoJ in restarting their asset purchase program which lends some technical support to bond prices. On a medium term outlook however, government bond yields are not attractive and the asymmetry of potential returns from this asset class is stark. There are some relative value opportunities for the more sophisticated investors but today it is only the diversifying qualities of the asset class that warrants a holding.
Index-linked Relative to government	Positive	↔	Realised levels of inflation in the developed world are low and forward looking basis inflation expectations remain low and attractive in our view. Given the historical stickiness of inflation at levels above breakeven inflation rates, linkers look better value today than fixed rate government bonds. US inflation and inflation surprise across the G4 economies has started to edge higher.	Linkers 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.	Like their nominal counterparts, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond, at these levels they are likely to provide some protection against future inflation which is underpriced today. Core inflation remains relatively stable and headline appears to have turned a corner. Isolated US 'breakevens' have some value today.

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Positive Neutral Negative

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Fixed income			**Positive**	**Negative**	**Our view**
Investment grade Relative to government		↔	Investment grade spreads – a measure of relative value compared to government bonds – remain attractive despite having tightened from the post Brexit highs. At current levels we think investors are well paid for the fundamental risk. IG bonds also provide some diversification to riskier assets with their embedded rate risk. UK investment grade bonds have found price support ahead of the Bank of England commencing purchases of corporate bonds but retain some value. US bonds are preferred at the margin when considering regional valuations.	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 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. We are cognisant of debt issuance to support share buybacks, which has become more prevalent recently. We continue to rate this market as green today but recognise it has rallied quite sharply off the February spread lows.
High yield		↔	High yield spreads in both the US and Europe look reasonably attractive at current level vs what is on offer elsewhere but valuations have deteriorated as spreads have tightened. Default rates remain low in non-energy sectors. Recovery rates are below long term averages but this is a function of the market having become bifurcated between energy and non-energy sectors. Interest remains well covered. HY risk premia look reasonably attractive vs equity and IG.	The large proportion of energy related issuers will impact US index returns if the oil price continues to soften and default rates remain high in the sector. Furthermore, the credit cycle is now somewhat long in the tooth in the US with debt issued for LBOs and acquisitions on the increase and leverage higher. The asset class has rallied hard off its recent lows and we may see some profit taking.	The upside in allocating to high yield debt at present spread and yield levels is sufficient to continue to warrant a position to the asset class but we would pare some risk after the strong recent run. We prefer short duration to core high yield today as scenario analysis suggests a better risk return. We are mindful spreads could ‘overshoot’ before stabilising or tightening and valuations look fair today. On the basis of expected total returns we prefer US over Europe.
Loans		↔	Long term 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 is higher.	Loans sit in a less liquid part of the corporate debt market with wider bid/offer spreads. Fundamental risks are much the same as for high yield in the sense that a significant pickup in defaults may negatively impact the asset class. This is less liquid than high yield and this risk should be borne in mind when considering investments. 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 neutral view on the asset class. Hold exposure if appropriate to mandate. Similar to high yield, with the exception that investors need to consider the less liquid nature of this market and lack of an embedded rate component. The floating rate nature of the asset class will be accretive when interest rates do eventually rise above the embedded LIBOR floor, although we recognise that remains some way off.

Positive Neutral Negative

Asset class	View	Change	Comments		
Fixed income			Positive	Negative	Our view
Emerging market debt	Neutral	↔	Spreads today on hard currency denominated emerging markets remain reasonably attractive when considering duration and reinvestment risks. 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.	In the short term, EMD remains sensitive to disappointing growth, bad economic data, a stronger dollar and 'risk aversion' trades. 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 the slowing of the Chinese economy. The quality of the universe remains investment grade overall but has been deteriorating. We are more cautious today following the strong performance of the asset class, recognising that most of the return has come from the treasury rate component.	EMD is sensitive to global macro news, especially markets with current account deficits or a reliance on oil exports. Moderate allocations are justifiable, but we would pare back allocations following recent gains. Local EMD has optically attractive yields but dollar strength and currency risks may overwhelm the carry opportunity. Whilst we still see decent returns from the asset class over the medium term, the sharp repricing in recent months warrants some caution today and any further bouts of dollar strength will hurt FX returns. Hard currency looks more attractive at the margin.
Convertible bonds	Positive	↔	Convertible valuations remain reasonably attractive today following recent market weakness, continued cheapening of theoretical valuations and some underperformance versus straight equity.	Systemic risks remain. The call optionality embedded in converts ultimately only has real value if markets increase and the particular stocks in question participate in these moves.	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.

Positive   Neutral   Negative

Asset class	View	View	Comments		
Alternatives			**Positive**	**Negative**	**Our view**
Commodities		↔	Although global growth rates remain subdued commodity prices will continue to be influenced by broader risk appetite which remains buoyant at present. As inflation starts to surprise to the upside in some countries 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 newsflow.	Strength of final demand is still questionable especially with respect to China where it is clear commodity imports have slowed and growth continues to moderate. It is difficult to take a direct exposure to commodities and commodity curves will influence returns, often negatively. Commodity bears may view the recent bounce as short lived and the asset class more broadly is prone to bouts of dollar strength.	Commodities remain sensitive to negative news on growth. They could rally further from here but volatility and ongoing economic uncertainties suggest caution and the market still prices little inflation risk. The significant recent moves in the oil price demonstrate how volatile these prices can be, both to the downside and upside
Property (UK)		↔	Yields remain reasonably attractive in selective regional locations and will have improved as commercial valuations have come back. Reasonable vacancy rates still remain in certain areas. Active management remains key in this sector as is the avoidance of expensive 'legacy positions' in overly mature funds. The weakness in sterling post Brexit has revived some foreign flow into the asset class and any further weakness should see support for property from the overseas buyer.	The UK's economic outlook remains uncertain in light of the vote to leave the EU and ensuing political changes. The traditional British high street remains under pressure from the continuing growth of online retailing and high street chain closures are testament to this. We have warned in the past of the dangers of liquidity mismatch and this has been borne out in recent weeks as retail funds have gated or marked holdings down. Sentiment may remain softin the near term. As a longer duration asset class property remains susceptible to any repricing in long terms bond yields which have moved sharply lower in recent months.	Income is attractive versus gilts but there is limited room for capital growth and we have seen a number of funds reprice lower as Brexit concerns increase uncertainty over commercial terms, particularly in London. On the positive side, rental growth outside of London is likely to provide a positive impetus due to a lack of new supply. We also recognise the 'search for yield' lends support to the asset class and discounts in the sector should attract buyers.

Asset class	View	View	Comments
Currencies			
USDGBP		↔	With hikes priced out through 2018, and inflation starting to tick higher, we could be on the cusp of another leg higher for the Greenback if rates markets reprice higher. Against sterling the outlook is constructive and the Bank of England's aggressively accommodative stance is unlikely to give Sterling much of a near term boost.
EURGBP		↔	ECB policy remains accommodative and will continue to bias rates lower. Rate differentials across geographies provide little to no carry advantage. The recent bout of Euro strength may ebb away as policy looks set to remain on a divergent course. Following Brexit we have seen UK rates trading at new lows but more in tandem with Euro rates and that may see continued range bound trading.
JPYGBP		↔	The yen is bouncing off recent highs despite policy designed to see it weaker. If Asian currencies weaken and the Chinese renminbi comes under any renewed pressure the yen's only marginal value will be as a diversifier in a portfolio of risky assets. Any prolonged regional currency weakening will likely see the currency trade lower in sympathy. The BoJ has recently reinvigorated its programme of talking the currency down through talk of intervention and new stimulus measures are expected. This will prove a headwind to further yen strength but a weak sterling outlook is unlikely to see the JPYGBP cross move markedly higher.

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Important notes