



Weekly Digest

Week ending **11 December 2016**

Between Belief and Incredulity: How 2016 has shaped the Outlook for 2017

As 2016 comes to a close, the portfolio managers felt it an apt time to look back on the year and to look forward to some key issues for 2017. 2016 was a year of mixed fortunes for investors, a very weak start set precedence for what looks likely to be a decent year for equity markets. 2016 will be best remembered for its twin political surprises of Brexit and Trump, or Brump, if you will. Whilst both being seismic-scale political events, the fact that their respective domestic markets brushed them off underscores the fact that a macro or political story is not the same as an investment case. To put it another way - even if you had called both elections correctly, would you have positioned your portfolio to benefit from an equity rally in either case? Probably not.

A post Brump observation to be gleaned from the performance of markets is that, firstly, people like certainty. The build-up to these votes caused more market jitters than the surprise outcome itself. The UK certainly stuttered for a few days post Brexit but once the initial sting of surprise had subsided, the markets rallied. Many are predicting the election of Trump to likely usher in a period of higher inflation in the US which could spill over into the rest of the developed markets. But modest inflation increases would be welcome in developed markets. This is not least because it simply reduces the risk of consumption sapping deflation. A corollary of this would be interest rate rises which has already been seen to some extent. The impact of substantial interest rate gains would be painful in the fixed income markets, particularly in the high quality sovereign space, but these assets are, in the manager's view, already too expensive. A readjustment back towards pre-financial crisis norms would be extremely painful for large holders of these assets, such as insurance companies and defined benefit (DB) pensions (although their liabilities would also reduce). However, to have prevailing yields back into healthy single digits would be positive for sentiment and savers. The managers do not expect interest rates to go all the way back to 2007 levels. 'Lower for longer' seems likely to remain the mantra even in an increasing interest rate world.

For interest rates to go up on a concerted basis global growth needs to be on a firmer footing. It remains a conundrum why the walls of money placed toward shoring up markets have not translated into better levels of growth. Productivity weakness is often cited as a reason for sluggish growth in the

developed markets and as a result increases in productivity would be welcome. Trump is clearly more hawkish than his predecessors and so it is possible that he will also try to end extraordinary monetary policies. Even a gentle unwind of QE seems unlikely in the foreseeable future – the market rallies following Mario Draghi's alteration to the ECB's buying pattern last week underlines how important QE remains to sentiment.

Many are expressing surprise at the size of returns out of regions such as the US over the year, which is up close to 13% at the time of writing. Given that we are now nearly eight years past the markets' post financial crisis bottom, there are inevitably some questions over the sustainability of recent market performance. Ultimately the portfolio managers look to valuations to provide a guide as to whether markets are an attractive investment prospect. They still see sufficient opportunity out there, albeit their enthusiasm is not as firm as it was at the start of the year as earnings are not keeping up with price movements. Nevertheless underneath the headline numbers there are still good opportunities for judicious investors, especially those with the nimbleness to search for opportunities on a sub asset class, sectoral or stylistic basis - as the managers can as part of their outcomes based investment process.

The Marketplace

- Markets climb on 'Santa Claus rally'
- ECB extends quantitative easing programme
- Volatile week for Italian banks following referendum
- Encouraging trade data out of China
- Oil surges after more countries agree to cut production

Market Focus

Europe

- Moves in global equity markets gave investors plenty of reason to be jolly last week. Continental European stock markets broadly shrugged off any worries following the Italian referendum vote and rose 5.2% for their strongest weekly performance since January 2015, whilst UK equities similarly rose an impressive 3.3%.
- Most pivotal was the European Central Bank's Policy Maker's decision in their monthly meeting on Wednesday to extend their quantitative easing programme until December 2017, albeit reducing monthly purchases of bonds from EUR 80 billion to EUR 60 billion. The euro depreciated 1.3% against the US dollar following the decision.
- In Italy, markets were buoyed as Paolo Gentiloni, the former Foreign Minister, was promptly appointed as the new Prime Minister, and given a mandate to form a new government.
- Italian equities rose 7.1% last week, with the Italian banks index gaining 12.8%, despite a 2.3% fall on Friday after the ECB rejected a timeline extension for a proposed recapitalization of the sector.

US

- Positive sentiment carried over to US equity markets, which rose 3.1% for the week. The S&P 500, Dow Jones Industrial Average, Nasdaq Composite, and Russell 200 indices once again all hit record highs during the week.
- With the highly anticipated Federal Open Markets Committee meeting this week, any economic data was closely followed. Notable releases included November's non-manufacturing ISM reading which came in at 57.3 versus 55.5 expected, as well as trade data showing that, month-on-month, exports decreased 1.8% while imports increased 1.3%.

China

- Trade data surprised to the upside as exports and imports both rose in November. Exports rose 0.1% year-on-year after a worrying 7.3% decline in October, while imports rose 6.7%, the fastest pace since 2014.
- However, less encouraging were China's foreign currency reserve levels, which fell for the fifth month in a row in November, by USD 69 billion.

Commodities

- Oil prices, after falling by 0.2% last week, have surged by 4.0% on Monday after news reporting that Russia, along with ten other non-OPEC countries, have agreed to cut production by 558,000 barrels per day in the new year. This is on top of the 1.2 million barrel-per-day cut announced by OPEC members in late November. Since that initial announcement Brent crude oil prices have risen by 21.9% to USD 56.50 per barrel.

James Klempster (CFA) & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 09 December 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	3.1%	2.8%	12.2%	12.1%
United Kingdom	GBP	3.3%	2.6%	16.1%	18.2%
Continental Europe	EUR	5.2%	4.1%	0.3%	0.9%
Japan	JPY	3.2%	3.8%	0.6%	0.2%
Asia Pacific (ex Japan)	USD	1.9%	1.4%	9.5%	11.8%
Australia	AUD	2.2%	2.2%	9.5%	14.4%
Global	USD	3.0%	2.8%	8.0%	8.0%
Emerging Market Equities					
Emerging Europe	USD	4.7%	5.3%	21.0%	19.6%
Emerging Asia	USD	2.2%	1.3%	9.1%	10.7%
Emerging Latin America	USD	4.3%	0.7%	30.9%	24.1%
BRICs	USD	1.9%	0.3%	13.8%	13.1%
MENA countries	USD	1.3%	2.4%	6.7%	7.5%
South Africa	USD	6.0%	4.1%	16.5%	11.1%
India	USD	2.9%	2.0%	3.4%	8.9%
Global emerging markets	USD	2.9%	1.8%	12.9%	13.0%
Bonds					
US Treasuries	USD	-0.4%	-0.5%	0.7%	0.4%
US Treasuries (inflation protected)	USD	-0.2%	-0.5%	4.5%	4.0%
US Corporate (investment grade)	USD	-0.3%	-0.4%	5.0%	4.2%
US High Yield	USD	1.2%	1.3%	16.5%	15.1%
UK Gilts	GBP	-0.7%	-0.4%	8.1%	7.1%
UK Corporate (investment grade)	GBP	-0.2%	0.0%	8.4%	7.8%
Euro Government Bonds	EUR	-0.5%	-0.5%	2.0%	1.7%
Euro Corporate (investment grade)	EUR	0.1%	-0.1%	4.0%	3.8%
Euro High Yield	EUR	0.9%	0.9%	8.0%	6.6%
Japanese Government	JPY	-0.6%	-0.8%	3.5%	4.1%
Australian Government	AUD	0.3%	-0.5%	2.3%	2.5%
Global Government Bonds	USD	-1.1%	-0.9%	1.3%	1.0%
Global Bonds	USD	-0.8%	-0.7%	1.6%	1.1%
Global Convertible Bonds	USD	1.1%	0.7%	0.2%	0.0%
Emerging Market Bonds	USD	1.3%	0.5%	8.8%	7.6%

Asset Class/Region	Currency	Currency returns			
		Week ending 09 December 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	3.9%	3.4%	6.0%	9.2%
Australian Property Securities	AUD	3.7%	0.8%	3.5%	4.5%
Asia Property Securities	USD	1.2%	0.8%	7.0%	7.8%
Global Property Securities	USD	2.7%	2.2%	4.7%	6.6%
Currencies					
Euro	USD	-1.0%	-0.3%	-2.7%	-4.2%
UK Pound Sterling	USD	-1.2%	0.5%	-14.7%	-17.2%
Japanese Yen	USD	-1.6%	-0.7%	4.3%	5.3%
Australian Dollar	USD	0.0%	0.9%	2.2%	3.0%
South African Rand	USD	0.1%	2.0%	12.2%	8.5%
Swiss Franc	USD	-0.6%	0.1%	-1.4%	-3.3%
Chinese Yuan	USD	-0.6%	-0.2%	-6.0%	-6.9%
Commodities & Alternatives					
Commodities	USD	0.7%	2.4%	13.3%	11.3%
Agricultural Commodities	USD	1.0%	0.7%	2.6%	0.5%
Oil	USD	-0.2%	7.6%	45.7%	35.5%
Gold	USD	-1.5%	-1.1%	9.3%	8.1%
Hedge funds	USD	1.1%	0.9%	2.4%	2.2%

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