Investment Solutions

tel. 01903 214640 • fax. 01903 214656 • email. ifa@investment-solutions.co.uk • web. www.investment-solutions.co.uk

Investment Solutions – Market Commentary – January 2017

2016 – What a year!

Now that we are in mid-winter and the temperature is more seasonal, we reflect on the year gone by, taking stock of progress (or otherwise) that has been made in Global economics and the investing environment more broadly. We also look towards the year ahead for major events and how we can best steer your funds through these "interesting" times!

From a very negative state of sentiment early in 2016, the Markets returned to a more upbeat state of mind as spring turned to early summer. Heading towards the EU Referendum vote, we saw a sideways trending market as headlines were dominated by all kinds of comments on the risks and benefits of a largely unknown event – the UK leaving the European Union.

Post-Referendum vote, after an initial fall the UK Stock Market rallied strongly, powered not least by weakness in the £ (making UK assets look attractive to overseas investors). A sense of rationality returned too, as investors realised that immediate effects are rather limited, life goes on, companies still trade, and dividends are still paid.

The next major event for investors' focus was the US Election. In a year that was defined by surprises, the US was no exception, with the unlikely victory of Donald Trump - seemingly supported by a much wider base that was initially thought by the mass media. In another surprise turn, the Stock Markets' negative reaction to the Election result lasted literally hours before the Markets powered on ahead, citing the positive impact of tax cuts and infrastructure spending.

Turning to 2017

Our best case is for continued economic growth, defined as "the bright side of muddling through". Whilst economic growth may not be stellar, it has been remarkably consistent. We are in different times- this recovery (and, arguably, the whole economic cycle) is not the same as before. Peak interest rates will likely be lower than previously, and arguably the cycle may go on for longer than previous boom and bust cycles. All of that is okay from an investment point of view – whilst not ideal, we are confident that our clients can still make money in this environment. However, in order to do this, one must be more open-minded and must embrace new ideas, new technology and know when to make changes and when to see things through.

We therefore remain broadly positive on Equities and there is no shortage of stock and strategy ideas for us to explore. That said, it would be foolish to believe that a fall back to recession is only a remote possibility, so we remain in favour of a diversified approach, both in terms of asset allocation and diversification, preferring a mixture of investments from fixed income, alternative assets and property, in addition to equities – for most of our client portfolios.

World Markets

In regard to the main Markets outside the UK, the US economy has not managed a year with annualised GDP growth in excess of 3% for more than a decade. Anti-Police protests and civil unrest have brought the issues of race and justice to the forefront during 2016 and President Obama failed to get approval for his cherished Trans-Atlantic Trade and Investment Partnership (TTIP) trade deal with Europe before he left centre-stage, while the Asian equivalent, the Trans-Pacific Partnership (TPP) remains a source of angst in the USA. Yet it rarely pays to be too down on America for too long. The US rebounded far quicker than anyone else from the 2007 – 2009 financial crisis and its entrepreneurial spirit is hard to deny, especially as it is already throwing up the next generation of disruptive technology firms, like Uber, Airbnb and Dropbox.

As for Europe, the European Union continues to ponder a future without the United Kingdom as Theresa May prepares to invoke Article 50 and begin negotiations to withdraw from the economic bloc. It must not be forgotten amid the macro-economic and political uncertainty how Europe offers many high-quality dividend-paying stocks at valuations which look cheap, relative to their international peers. As for Japan, its Nikkei 225 still trades at less than half its 1989 all-time high, some 27 years after its debt-fuelled Property and Equity bubble popped. It also trades at nearly twice the level reached just before Prime Minister Shinzo Abe became Prime Minister in late 2012. However, relative to its British, American and European equivalents, Japan's Stock Market does not look expensive and a move by corporations to engage with shareholders more fully and also start to return surplus cash more generously provides a respectable dividend yield – at least by local standards.

As for Asia, scheduled elections in South Korea, Thailand and New Zealand will keep the political pot boiling, as will the 19th Communist Party Congress in China, which is likely to help a few rising stars in their quest for the top jobs, come the 2022 event. Asia looks capable of providing stronger structural growth narratives than the West, equity valuations look low, at least compared to developed markets and Corporate Governments' improvements to allow us and our clients to access funds which could benefit from improved dividend pay-outs and share buy-back schemes.

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Other Investment Markets

In Africa and the Middle East, political and military strife did not stop the region performing well in 2016. Further continued commodity price strength and financial and political reform will be needed to maintain this momentum in 2017 and beyond. Open cross-border warfare and civil unrest characterise too much of Africa and the Middle East for comfort, even if America's Nuclear Agreement with Iran and decision to start lifting economic sanctions suggest religious, political and military tensions could at least start to ease in this potential tinder box.

Even if weak oil prices have helped some countries' economies, they have badly hurt others, as evidenced by just how many nations currently find themselves going to the International Monetary Fund, the African Development Bank, World Bank or the Global Bond Markets for much-needed liquidity – Iraq, Nigeria and Saudi Arabia are just 3 examples.

As for the Arab Spring of 2011, this seems a long time ago and it is not just because former colleagues of the UK's ex-Prime Minister, David Cameron, are now queuing up to criticise his decision to sanction military involvement in Libya as ill-conceived and unsuccessful. For all of the Western efforts over the past century (and more) to forge a solution, the complexities of a region which is neither wholly Arab, nor wholly Muslim and has substantial Jewish, Christian, Druze and other diverse communities, means peace looks further away now than ever - especially as the Arabs are split between Sunnis and Shiites. This ethnic tension explains why relations between Iran and Saudi Arabia are ice-cold and also why the Kurdish issue is proving too intractable for Turkey as the Kurds are Sunni Muslims, hostile to Arab Sunnis and Shiites alike.

Alternative Investment Classes

Oil

A series of drops in US oil inventories and the announcement that OPEC's late-September Algerian Summit could lead to production cuts are boosting the oil price, which is back above $50 a barrel. This is certainly good news for our clients with oil exposure in their portfolios, either directly, or indirectly and may even benefit the whole UK Equity market. Certainly we envisage that major oil companies such as BP and Shell are forecast to be two of the biggest contributors to FTSE 100 profits and dividends in 2017.

Property

Following the Referendum, buyers and sellers paused to see whether job security and / or access to competitively-priced mortgages (in the UK) were likely to change. There is no doubt most are taking longer to commit and negotiating harder and some property prices have softened. The short-term effects of the Brexit vote were probably over-estimated, but the long-term impact may have been under-estimated. The Bank of England showed its determination to reduce the risk of recession by cutting already rock-bottom interest rates, although the fall in Sterling and almost certain rise in inflation mean a further reduction is unlikely in Quarter 1, 2017.

From The Team, may I thank you for your continued support over 2016. We look forward to continuing to navigate these markets on your behalf with prudence, pragmatism and diligence in 2017 and hopefully for many years to come. May we also take this opportunity to wish you a healthy and prosperous 2017.