Investment Solutions

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Investment Solutions – Market Commentary – February 2017

January 2017 - An eventful month

£30 Million - this is the amount bookmakers have said a £10 bet could have returned, on Leicester City winning the Premier League, Britain Voting Out of the EU and Donald Trump winning the United States Presidential Election in 2016.

Following the big surprises in 2016, January 2017 has been eventful – Donald Trump has now been sworn in as President of the United States and the internet has been flooded with Donald Trump memes.

Who saw that coming? Well, apparently the TV show *'The Simpsons'* did, back in 2000, when they featured Donald Trump as the out-going President, making way for the new President - Lisa Simpson!

Trump's speech on 20th January, confirms that Trump does indeed plan to pursue the protectionist policies he has spoken about:

"We will follow two simple rules – buy American and hire American".

As always, January each year is full of predictions, with some headlines suggesting we are heading for a fall. You may recall a year ago, economists at Royal Bank of Scotland advised clients to sell everything ahead of a Stock Market crash, forecasting a 20% slump in shares. Rather than crashing by 20%, the Market jumped by 24%. It is all too easy to get caught up in the excitement of rising markets, just because the FTSE 100 has reached new all-time highs, does not mean that a crash is imminent.

So far in 2017, we have seen a nominal growth surge and commodity prices increasing. America is likely to raise interest rates in response to the surge in growth, however we also believe that they will remain relatively low, as the Dollar is likely to be strong, limiting the need for the US to further raise interest rates.

UK

The FTSE 100 climbed to an all-time high in January, with the fall in the price of Sterling playing a significant part: over 70% of FTSE 100 Companies' earnings are made overseas and therefore benefit from any fall in the pound.

Following The Prime Minister, Theresa May's Brexit speech, she travelled to the US to strengthen the 'special relationship' and talk trade deals. Brexit Secretary, David Davies, informed us that the ruling of the Supreme Court for a Parliamentary vote will not delay the 31st March deadline set by the PM last year.

The Article 50 Enactment could weaken Sterling further, resulting in boosting overseas returns.

According to the figures just announced by the Office of National Statistics, the UK economy grew by 0.6% between October and December 2016, beating analysts' expectations and bringing the total growth figure for the year to 2%. Strong consumer spending in the services sector led the expansion.

Uncertainty over the UK growth outlook has split financial markets, with investors pricing in a 50% chance of one interest rate increase by the end of 2017.

Inflation

Inflation figures published in January, show that consumer prices in the UK rose 1.6% year on year in December 2016, above Market expectations of 1.4%. This is the highest inflation rate since July 2014, boosted by rising costs of transport, housing and utilities amid a weaker pound. Inflation has averaged 2.58% from 1989 until 2016, with the all-time high of 8.5% in April of 1991 and record low of 0.10% in April 2015.

Low, stable and predictable inflation improves public wellbeing, by helping real wages to adjust more smoothly. In the coming months, UK inflation will be largely dependent upon the UK economy's supply potential, domestic demand and the value of Sterling. This is uncertain whilst the UK redefines its openness to the movement of goods, services, people and capital.

Although question marks remain over the outlook for domestic growth, investment clarity for UK investors is slowly beginning to improve following the Prime minister's Brexit speech.

For UK investors, we continue to favour UK large cap stocks. The pound is likely to remain weak for the foreseeable future and a stronger global economic backdrop, together with the FTSE 100's 25% weighting towards the materials and energy sectors, will continue to advance UK-based large cap stocks.

US

The majority of US analysts believe that the impact of Trump's presidency will be positive for companies over the next two years. Tax reforms for businesses as well as income tax rate cuts are expected, together with infrastructure spending. Trump's pro-fossil fuel stance, deregulation, and a clean sweep Republican control of Congress are also highlighted as positive for businesses. This will also mean some increased wage costs, more expensive imports, deteriorating export opportunities, due to poorer trade relations and protectionism - causing disruption in the Healthcare Sector.

Sectors such as Materials, Telecoms, Industrials and Financials are expected to benefit. Infrastructure demand would support material producers in the US, while foreign producers thrive on dollar strength as they often have costs in local currencies and sell their products in dollars. Financial companies would benefit from the expected reflationary policies, leading to stronger demand and steeper yield curves, as well as infrastructure

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financing in the US. However, the Global IT Sector is expected to face some headwinds, as its highly international production and value chains are vulnerable to increased protectionism. Nevertheless, IT is still the strongest Sector, benefiting from increased IT spending in other sectors, continuing innovation and a pick-up in cyclical demand.

As a result of the Election, the S&P 500 Index has experienced its longest streak of positive annual returns for the Index since the 1980s. The Dow Jones broke through 20,000 for the first time ever and Global stocks hit a 19-month high.

Changes in Government policy in the US are certain, with potentially significant ramifications for the economy and equity markets. We will simply have to wait and see what policies are pushed forward, however tax cuts and infrastructure spending are likely to come to fruition in 2017.

Europe

Europe will continue to be a story of politics, with the next European General Election being in Holland in March. Populism is growing stronger, across Europe. Markets have realised this to a certain extent and priced much of this uncertainty in. The recent rally in European banks, drew wider investor attention back to the potential returns available.

Other World Markets

Japan is currently benefiting from the rise in the US Dollar, the weaker Yen is feeding though into upwardly revised growth forecasts, coupled with positive equity market performance. Further stimulus may be unnecessary in the first half of 2017. Across Asia and Emerging Market companies, fundamentals remain healthy and whilst it is tough to decide the potential impact on markets, Trump will be making the US-China relationship a central part of his presidency. Who knows in years to come, this may prove to be successful for both parties. In the short term some volatility may be expected.

Notwithstanding the elevated level of Stock Market valuations, opportunities for the long-term investor have started to emerge, as a result of the substantial sector rotations that have occurred since the EU Referendum. Fund Managers will continue to seek out companies who can demonstrate sustainable top line growth and translate that into profit, free cash flow and dividends without excessive financial leverage. Analysists' surveys suggest an upbeat outlook for the Global Corporate Sector, which is less weighed down by political risk than the media reports may suggest. It is of course impossible for companies or investors to plan for all potential risks; it is never clear in advance as to what extent they will materialise.

Commodities

The World Bank is forecasting strong gains for industrial commodities such as Energy and Metals in 2017, due to tightening supply and strengthening demand. Prices for raw materials have been improving gradually, since the second half of 2016, on the back of a steady recovery in most markets, resulting in stronger global demand. Energy prices continued to rally in January, mainly due to crude oil prices.

In our January update, we highlighted Oil companies to be key contributors to the FTSE 100 profits and dividends in 2017. Prices have increased solidly in the wake of OPEC's first production cut agreement in 10 years. The cuts, which started in January will amount to 1.2 million barrels per day, with a further cut of 0.6 million barrels per day coming from non-OPEC producers – mainly Russia.

The outlook for industrial metals remains positive. It is supported by fiscal spending and an infrastructure-led boom in investment in China, and also on the back of investors' views that Donald Trump's infrastructure spending programme will boost demand.

What lies ahead?

It is impossible to know the future, however, that doesn't mean you can't identify themes that are likely to have a major bearing on the world of investing over the current year and beyond. We see the value in fund managers' rigorous macro-analysis.

Into 2017, we continue to recommend balanced,diversified portfolios, which means a spread across different asset classes, geographies and securities, in addition to incorporating a broad range of strategies and styles.

This helps to cushion the occasional shocks investors experience with investing in single asset classes.