Investment Solutions

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

Investment Solutions – Market Commentary – June 2017

Global Overview

The global economy now appears healthier than at the same time last year. Reflation is now global, rather than US led, with global manufacturing and services posting stronger readings so far this year. Europe, in particular is now showing positive signs.

With Global stocks reaching record highs, many investors are questioning if this can last. We see further, albeit more muted, gains ahead as an increasingly broad-based rally is backed by strong earnings and global reflation. We may be more concerned if the global economy goes into overdrive, but for now it's only just getting out of second gear.

It looks like the world's banking system (with some exceptions), is finally returning to reasonable health, and credit is beginning to flow again.

President Trump still has at least another four years to serve in the normal course of events and, Brexit negotiations look likely to extend beyond the formal two-year deadline. No doubt, therefore, there are more twists and turns to come, but the good news is that the global economy continues to prosper. We are enjoying the first concerted global recovery since 2010, something which markets deemed highly improbable not much more than twelve months ago.

It is accepted that as economies normalise, interest rates must rise, but there is a very delicate balance due to enormous debts in the global economy. US interest rates are especially influential because of the dollar's global reserve currency status and the fact that many countries and companies, especially in the emerging world, have substantial dollar-denominated liabilities.

Unfortunately, outright optimism is tempered by a number of factors. After such a long bull market, it is a struggle to describe most financial assets as being especially cheap. That doesn't necessarily make us pessimistic, but it means fund managers have to be more selective. It also means that there is no safety net for equities in the event that growth disappoints.

UK

The UK economy has remained resilient, despite the uncertainty over Brexit.

The market approved of the UK General Election announcement, believing that it gives the Prime Minister a stronger hand in negotiating the terms of Brexit. This was reflected in the recovery of the pound at the time of the announcement.

In May, the FTSE 100 and FTSE 250 both climbed to all-time highs and sterling suffered its worst falls since January. This was due to the YouGov opinion poll showing the Conservatives' lead over the Labour Party had narrowed sharply, ahead of the general election on June 8.

The UK's falling unemployment rate has been one of the major economic success stories of the past year. Initially led by part-timers and the self-employed, however, the pace of improvement has slowed notably. Real wages, which dropped about 8 per cent since the financial crisis began, are recovering slowly.

Inflation has been rising in recent months due to energy price inflation dynamics, as well as the fall in sterling, which is raising the price of imported goods and services. Inflation figures provided in May showed inflation CPI at 2.7% and RPI at 3.5% for the year to April. According to the latest Producer Price Index data, input prices are still rising by 16.6% year-on-year, although this is down from the peak in recent months.

The data suggests that producers have seen the peak in cost inflation, however, over the coming months; most of these costs will most likely be passed on to consumers. This will of course drive inflation higher still. Inflation continues to outpace wage growth and this could persist for some time.

US

Despite the markets suffering a fall on the threat of potential impeachment of the US President in mid-May, US equities have continued to move higher. At one point racking up 110 consecutive days without experiencing a daily fall of 1%.

The market is now fully discounting a reflationary outcome, which could lead to disappointment if it fails to materialise. However, as home to an impressive selection of world-leading businesses, especially in the technology sector, the US market will continue to attract support. There is also cautious optimism that Trump can make some progress with his proposed tax reforms.

Europe

Whilst there has been a lot of noise around politics and elections across Europe, the Eurozone economy has been quietly recovering, and European equity markets continue to offer good value.

With the exception of Italy, electoral risks have mostly diminished and, the change in corporate fundamentals now has the scope to be appreciated. With improving manufacturing and the Q1 2017 earnings' reports being their strongest in 10 years, investor confidence in the region has picked up. Market's Eurozone manufacturing Productivity Manufacturing Index (PMI) hit a 6-year peak in Q1, reaching 56.4; service sector PMIs for Germany, France, and Spain were all above 55 for the quarter.

The German ZEW business sentiment survey showed an increase in both current and forecast conditions, while French unemployment fell to its lowest level in five years (9.3%). The European Central Bank noted that some of its members considered risks to growth and inflation to be broadly balanced in its own assessment of conditions.

Japan

In Japan, there was a strong Q1 GDP report. Inflation, however, is nowhere to be seen and annual wage growth is now the weakest in over 18 months.

Japan's stock market remains beholden to shifts in the value of the yen: as the yen rises the market falls, and vice versa. This is down to the high export content of quoted companies. Behind this, though, lies an encouraging story of improving corporate governance against a background of an economy that is slowly inching forward.

The domestic economy, which is performing well on its own terms, is home to companies offering attractive returns to international investors, regardless of how the currency performs.

Japan has suffered from two decades of stagnant growth and yet it remains the world's third largest economy. It has one of the fastest ageing populations of any developed country, but remains a sounding ground for world-beating technology and robotics.

The Prime Minister 'Abe' appears to be making progress on economic reform and is delivering on at least some of his promises. Even if growth targets are not met, the government appears to be doing whatever it can to prevent GDP declining again.

Emerging Markets/Asia

Emerging Market equities have endured a rollercoaster ride over the last six months, falling immediately after the election of Donald Trump, owing to concerns about his trade policies and a strong dollar. However they have since rallied strongly, as Trump's rhetoric has softened and sentiment in emerging market stocks has improved.

Commodity producers have also enjoyed higher commodity prices. The move has closed some of the value gap that had opened up between emerging and developed economy markets, but we remain of the opinion that emerging economies will enjoy, over the long term, superior growth. Emerging market equities are still trading on valuations that appear attractive relative to developed markets.

In counties such as Taiwan, companies have managed to carve out particular niches in certain sectors, which have embedded them as crucial players in global supply chains.

While we still monitor risks, such as the recent credit tightening within the Chinese economy or geo-political risks in relation to North Korea, we are certainly more optimistic than at the start of Donald Trump's presidency.

China

Q1 2017 saw the news in Asia mainly focused on China and the US dollar. In China, the current account has become less of a concern, as both headline exports and imports are rising strongly.

During Q1, the nation's economy grew at a 6.9% pace – the best pace seen in six quarters. This surpassed the 6.5% target set by its government. Real estate investment increased 9.1% and fixed-asset investment 9.2% from a year earlier, but the real boost came from a 21.0% year-over-year gain in local and central government spending. Disposable income grew at a yearly rate of 7.0%, a high unmatched since late 2015. Chinese factory growth did fall short of expectations in April, with the nation's official PMI hitting a 6-month trough of 51.2.