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

# Investment Solutions – Market Commentary – October 2017

## Global Overview

Generally conditions in markets have changed little over the year, and September has been no exception, apart from a small pull back in most markets. Overall though risk assets (equities) are at, or close to near all-time highs and volatility levels continue to remain highly compressed by any historical measures. There is no obvious signal in the market that this volatile position is likely to change anytime soon.

Putting Brexit to one side and President Trump's ongoing trouble with implementing his promised tax cuts and reform agenda, the global outlook for growth remains one of modest expansion. However, growing geopolitical tensions in the Far East, the prospect of rising inflationary pressures and growing signals from global central banks that the end of the ultra-loose monetary conditions is drawing ever closer, all suggest that a degree of caution is in order.

Over the last three months we detail below the best and the worst sectors from across the world

**Top Performing Sectors over 3 months**

| | |
|---|---|
| China/Greater China | 7.3% |
| Global Emerging Markets | 3.99% |
| UK Smaller Companies | 3.66% |

**Bottom sectors over 3 months**

| | |
|---|---|
| North America | -3% |
| UK Index Linked Gilts | -3.13% |
| North American Smaller Co's | -4.38% |

## UK

The UK economy continues to splutter along, with the performance of the FTSE 100 seemingly influenced more by the movements in the value of the pound than corporate earnings.

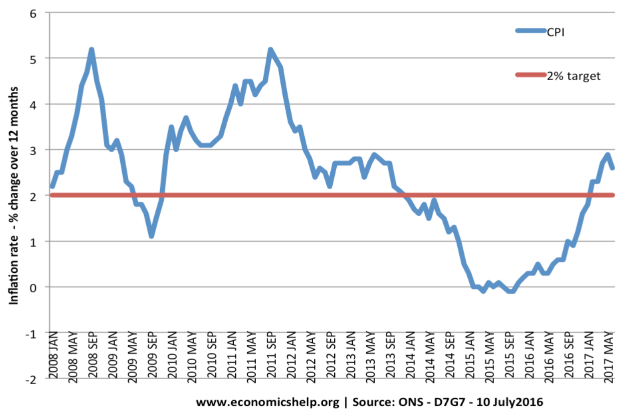
In comparison, the Eurozone has grown twice as fast. The former grew by a tepid 0.3% in the three months to June, while the latter expanded at a much healthier 0.6%. The pound has fallen to its lowest level in eight years, down 16% since the referendum but it's also falling because the euro is gaining ground - part of a broad recovery under way since 2014.

It's at home, however, that sterling's fall in value has affected the economy. The slump, boosted inflation to 2.9% in September and the Bank of England expects the cost of living to rise further, feeding through to higher prices in the shops, as imported goods cost more, putting pressure on household spending, a key driver in the UK economy.

Consumers are tightening their belts as costs increase while real wages aren't going up anywhere near as fast. The recent decision to lift the pay cap on some public workers was more a gesture than an answer to the pay crisis. ONS data shows average earnings only rose by 2.1% in May to July, meaning real wages actually shrank by 0.4%

The BoE inflation target is 2%, the graph below shows movement in the CPI in comparison:

**UK Inflation (CPI)**




Unemployment is now at its lowest levels since the 1970's, although more people are now in unstable zero hours contracts.

The drop in sterling should make Britain's manufacturing sector more competitive as our products become cheaper for foreign buyers, but manufacturing only accounts for 10% of the UK economy and so far the impact has been negligible.

## US

Investors are growing concerned with the ever increasing valuations in North America. The S&P 500 index's forward price to earnings ratio is more than 18 times, well above its global counterparts. A further uncertainty concerns volatility - Insomuch as there is none. Markets are experiencing the lowest levels of volatility in its history, indicating on the surface at least, almost total calm.

However managers who have been invested in the big 5 tech stocks have done well, the Faang stocks (Facebook, Amazon, Apple, Netflix and Google) account for 12% of the S&P 500, and the leading funds in the US that have returned 22% this year all hold the big 5. Over the month we have seen a number of managers reducing their exposure to North America, and positioning themselves

with more cash in their portfolio's ready to buy back in if markets fall.

We don't believe clients should be selling out of the region, but perhaps not adding further monies. As an exception, the US Smaller Companies sector was one of only three sectors to enjoy positive returns in the month, of 0.9%.

Investment Solutions

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

# Investment Solutions – Market Commentary – October 2017

**Europe**

Europe continues to show signs of a sustained recovery. GDP figures show the European economy gathering more pace in the second quarter. Eurozone GDP growth stood at 0.6% in quarter two, up from 0.5% in the first quarter.

What is encouraging is that other European countries within the 19 nation region, aside from Germany which has been the catalyst for growth, are also making a notable contribution. GDP data from the second quarter of 2017 showed Spain growing at its strongest pace in almost two years.

Exports and investment have led France to its strongest continuous GDP expansion since 2011, while the Netherlands posted the fastest GDP growth since the end of 2007. Moreover, Italy, a country that has lagged the pickup of its peers, is now showing encouraging signs and is expected to grow GDP by over 1% this year for the first time since 2010.

At client reviews we are looking to position portfolio's to over weight in Europe given the supportive ECB policies, low interest rates and growing corporate earnings.

**Japan**

Japan's equity market ended the month marginally lower following regional tensions. These issues overseas, detracted from solid corporate earnings momentum and a strong domestic economy.

Overall, the number of companies reporting greater-than-expected earnings outweighed those that reported disappointing figures. GDP was reported at 4% quarter-on-quarter annualised, representing strong growth, well above the market consensus forecast of 2.5%. The government is still committed to growing the economy by whatever means, and currently based on domestic figures their policies are working.

**Emerging Markets/Asia**

Emerging Market (EM) equities underperformed in the month, along with most regions. This on the back of successive gains for previous months based on continued economic expansion, and strong retail sales and exports.

The long term outlook for EM's remains strong. The difference now to 18 months ago when EM's had a dire time is that then commodity prices were low, corporate profitability was lousy and the dollar was strong. All those factors have turned around, but there is plenty to be wary of, and high volatility is a constant issue within EM's.

Valuations in EM's are ok, but they are dependent on profitability, which is dependent on capital discipline, which in turn is dependent on investing wisely - which has not always been a strong feature in some EM's. One of the biggest threats to EM's is US policy due to their reliance on trading and borrowing. It's very difficult to know what Donald Trump will do next. Exposure to EM remains a key part of any investors portfolio with an above average risk appetite and investing for over 10 years.

**China**

China continues to show progress, having been the top performing sector over 3 months, thanks to generally better than expected corporate earnings and further signs of resilience in the underlying economy, a weaker US dollar and higher commodity prices provided tailwinds. In October, the 19th National Congress of the Communist Party of China will be held in Beijing. Policy makers across the world will be keeping an eye on whether China adopts more outward looking policies or seeks to tighten the central control of its economy.

**Points of interest**

The budget takes place on 22nd November and a couple of important changes may come out of it.

Cutting of Pensions tax relief. Phillip Hammond could announce the current system of 20% or 40% tax relief is replaced with a flat rate system at nearer to 30%, meaning a loss of 10% in tax relief for higher rate clients. Our advice is to use it, or potentially lose it.

VCT's are also under the spotlight as the government is concerned that they are focussing their investment strategies on capital preservation rather than investing in more risky start-up ventures, which is the reasons that the attractive tax reliefs are available for investors.