



FINURA
PARTNERS

MARKET
REPORT
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MARKET COMMENTARY FROM PARMENION INVESTMENT MANAGEMENT

Trumponomics, Trumpflation or the Trump trade or whatever you want to call it has been the oft quoted explanation for the good returns enjoyed by the US stock market. Wall Street made numerous all-time highs during the first quarter of 2017 as 'animal spirits' held sway.

The election of President Trump and his inauguration in January have led to a number of expectations; namely that the new administration will deliver on a number of bold promises to cut personal and corporate taxes, review trade deals that benefit the US and spend more on infrastructure and defence.

What is there not to like? Markets did not err on the side of caution and instead adopted an optimistic outlook.

However, more recently there have been a few question marks over whether all of the above is achievable. A Republican controlled Congress failed to repeal and replace Obamacare. This raises the question if Trump can garner enough support from politicians to push through other items on his extensive agenda.

Putting to one side the expected benefits of the above, the US economy was already in good shape. So much so that the Federal Reserve raised interest rates by 0.25% to 1%. Reasons given were that unemployment is falling and thus wages may rise pushing up inflation. There was also an indication that there may be two more rate hikes later in the year.

Closer to home, politics have dominated and will continue to intrigue Europe in the coming months.

The theme in Europe (as was the case in the US and UK) is the rise of populist movements that are upsetting the established political parties. Although the Dutch elections returned the incumbent government, the upcoming French election is looking to be a contest between Marine Le Pen and Emmanuel Macron. Should the former win, what then for the European Union?

It will perhaps only take one populist to win to upset the European project as per the Brexit vote in the UK.

Now that Article 50 to leave the European Union has been triggered by the UK, there are two years in which to negotiate a beneficial withdrawal. Hopefully both sides will be pragmatic and find a workable solution, and that the rhetoric from some will become more measured.

Post the June vote, the depreciation of sterling has been both good and bad for the UK economy. Good for exporters who became more competitive, but bad for imported inflation. In February the inflation rate jumped to 2.3% from 1.8% in January, pushed up by rising fuel and food prices. Interestingly the figure is the same for average readings, meaning flat living standards at best. Combined with a fall in the savings rate (the lowest rate since records began in 1963) it appears that the consumer is dipping into savings to finance their expenditure. Given that the UK economy has relied upon

the consumer since the financial crisis to maintain growth, then the above may presage a slow-down in the economy. It should, therefore, come as no surprise that the next interest rate rise is forecast for the first quarter of 2019.

An old stock market adage is that 'markets climb a wall of worry'. That has certainly been the case for the past year, generated by unexpected political upheavals.

Investors should perhaps expect more of the same for the rest of 2017, and should remain aware of how much risk they are prepared and comfortable to tolerate.

In this time of change, it appears more important than ever to ensure your Clients' portfolios are well diversified to mitigate any external shocks or change in sentiment which may follow.

The risk-graded framework, around which all our portfolios are based at Parmenion, is also essential for ensuring Clients' Investment portfolios are aligned with their Attitude to Risk and Capacity for Loss, to ensure there are no surprises.

First published on 5th May 2017 by Simon Brett, Director & Chief Investment Officer of Parmenion Investment Management.





A STRONG START TO 2017, BUT IS IT SUSTAINABLE?

Equity markets made a robust start to 2017, with the US performing particularly strongly. Investors are buoyed by the prospect of increased government spending and potentially lower taxes, while unemployment rates continue to decline and worldwide deflationary fears have started to abate. This is leading investors to believe that the global economy is no longer as fragile as it was, and some are even talking of an economic boom.



Optimism abounds

There's a lot of optimism out there, which has already been priced into global equity markets. So far, much of that optimism is built on belief rather than reality which in itself can act as an important driver of growth. Until now, companies and households have been hoarding cash, and this positive sentiment could be the catalyst that convinces them to invest, with powerful ramifications.

That said, we must exercise caution. Valuations and margins across most geographies remain elevated, making further gains in stock prices incrementally tougher to justify. The US is particularly expensive and the recent surge in business optimism needs to be translated into higher levels of investment, supported by the proposed tax cuts and infrastructure expenditure, before these valuations can be justified.

Pressure on bonds

Meanwhile, government bonds remain expensive relative to their own history, even in markets that have experienced the greatest fall in prices. The combination of low growth, low inflation and central-bank activity pushed bonds to record low yield.

While these pressures have not fully reversed, the direction of travel is towards higher inflation, higher growth and less central-bank intervention. That direction vindicates the very cautious outlook we have had, and continue to have, on core government bonds as they remain vulnerable to higher inflation and growth surprises. On the other hand, the improving economic situation means that corporates should be in a strong position to pay their debts. As a result, we're favouring exposure to corporate bonds that offer a reasonable yield without being as sensitive to interest rates.

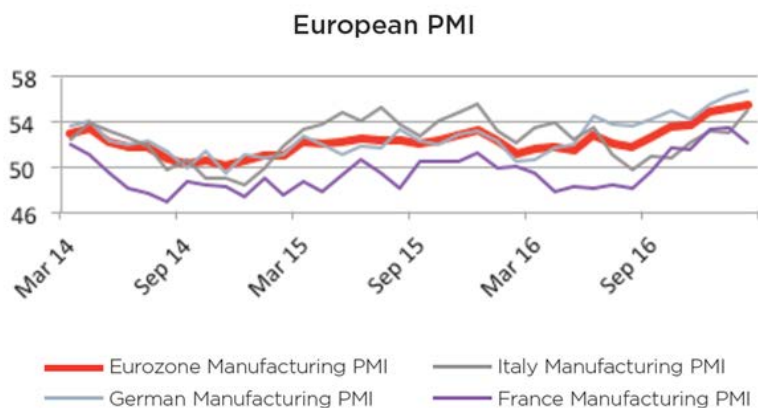
A word on inflation

Global inflation is on the increase, largely caused by higher input prices, such as for commodities, and increased Chinese factory prices. We would like to see higher core inflation, driven by tighter labour markets and supply constraints, as this would lend more weight to the improving macroeconomic outlook that has everyone so excited. Inflation in the UK is likely to pick up more than other markets as weakness in the currency is now starting to feed through to the economy, although this too is not the demand-driven inflation that we want to see.

Could this be the year for Europe?

In spite of the well publicised political issues, Europe appears to be showing signs of life:

- For the first time since 2013, inflation has surprised to the upside
- Company earnings for the fourth quarter of 2016 were surprisingly strong and continue to grow
- The Purchasing Managers' Index (PMI), which is an indicator of the economic health of the manufacturing sector, is firmly in expansionary territory (see graph below) – even in countries like Italy.



Source: Bloomberg

Of course, the political uncertainty looms over the region – particularly with upcoming elections in France and the Netherlands.

But this is only one element of the European investment case, and the improving fundamentals cannot be ignored.

Where do emerging markets stand under Trump?

When Donald Trump was elected president, there was concern that the recovery in emerging markets may stall. Both the strengthening US dollar and the protectionist policies of the Trump administration could negatively impact economic growth in the developing world.

However, after a sharp selloff, emerging markets have steadily recovered and we think they will remain resilient. The valuations continue to be broadly attractive, supported by reasonable levels of growth. In many ways, improved economic performance in the US is likely to be supportive for emerging markets, not destructive.

5%

The amount the MSCI Emerging Markets index has risen since the US election.

(9.5% year to date)

£418m

Inflows into emerging market exchange traded funds since the start of 2017.

Source: Bloomberg

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