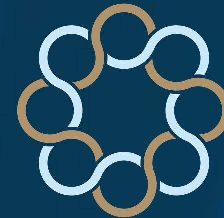

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Q1 Market Recap

2016

Market Commentary from Parmenion Investment Management

The year has begun with a volatile quarter. Take for example the US stock market. In the first six weeks of 2016 it fell 10% (local currency) amid concern that economic growth was less robust than forecast and manufacturing weaker than expected.

However, employment data showed that the US is continuing to create jobs at a healthy pace. The market was also helped by hints from Janet Yellen (Head of the Federal Reserve) that interest rate rises would be more subdued than initially thought at the time of the first increase in December last year. The stock market managed to claw back the losses and ended up by 1.3% (local currency) by the end of the quarter. The UK followed a similar path with a rise of just 0.1%. (Source: JP Morgan)

Oil and gold both had an interesting quarter. The oil price rebounded by 40% from a low of $28 in February (Source: FE Analytics) encouraged by the possibility of a deal between Saudi Arabia and Russia to control output. The oil price fall was caused by a combination of the US output doubling over the past 10 years and Saudi Arabia increasing its output.

Looking ahead, the comeback of Iranian production will not help prices, and it remains to be seen whether uneconomic projects can be closed quickly enough to restore equilibrium between demand and supply.

Bizarrely although a fillip for consumers via lower petrol prices, a low oil price does not help central banks trying to generate an inflation rate of 2% or more. Uncertainty helped gold to gain 16%, mostly during the first half of the quarter owing to the stock market turmoil and geopolitical concerns, with investors viewing the metal as a safe haven investment.

The hunt for yield has become even more acute in a "negative" interest rate environment. The European Central Bank (ECB), Switzerland and Japan all have a negative interest rate policy. The mechanics are as follows; commercial banks often deposit monies with their respective central banks on which they earn a rate of interest. However, now the central bank charges them for such deposits i.e. the commercial banks have to pay to deposit these monies with the central bank. The hope is that the commercial banks instead of earing a negative return, will lend the monies to companies /individuals and encourage investment and /or consumption by the latter and hence increase economic growth. In this environment of negative rates, low inflation and low yields from short dated investments, returns from long dated government debt often exceeded that of stock markets as investors scrambled for income. UK government bonds returned 5.2% in the first quarter. (Source: JP Morgan)

After a diabolical 2015, emerging markets were one of the bright spots for stock markets, up nearly 10% in sterling terms. The good news is that China does not appear to be experiencing a "hard landing". Slowly its economy is moving away from one based upon manufacturing to services and consumption.

Although investors cannot expect the double digit growth of yesteryear, it is important to remember it is still growing at a healthy 5-6%. Emerging markets have also benefitted from a weakening dollar. With expected interest rate rises to be more subdued in the US, the dollar may not strengthen as much as has been feared, which makes it less expensive for emerging market companies to repay their dollar borrowings.

Over the next few months there is some political risk in both the UK and US. Looking ahead one cannot ignore the forthcoming BREXIT referendum in the UK. The uncertainty over the outcome is already causing volatility in the sterling currency market, which may increase as the date approaches.

And in the US, the rise of Donald Trump as the prospective Republican candidate may cause some uncertainty as November comes closer. By the time of writing the next market commentary, the result of the BREXIT referendum will be known and hopefully at least UK investors can plan ahead with greater clarity.

Commentary by Simon Brett, Director & Chief Investment Officer, Parmenion Investment Management.

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Market Commentary from Parmenion Investment Management

If there was ever a good time to use the analogy 'a game of two halves' then Q1 2016 is it. Barring brief rallies in October and December last year, markets suffered a prolonged downward trend for a large part of 2015 and this didn't look to be letting up leading into 2016.

In fact some markets recorded their worst start to a year since records began which led to fears of a potential global recession. Since early February though, equity markets have turned and bounced back.

The most noticeable turn around has been within Emerging Markets however all equity asset classes have recovered well since early February. The Emerging Markets performance has coincided with a bounce in the oil price which would be expected and also comments from the Fed have dampened rate rise expectations this year which in turn provides further relief for Emerging Market economies that have borrowed heavily in US dollars. Emerging Markets is an enormously broad and diversified region so while many economies still face head winds, others have reasons to be optimistic as we move forward and we have full confidence in our active managers to find these pockets of opportunity.

Fixed interest performance is worth highlighting given the outperformance of passive over active managers. Our Fixed Interest allocations are diversified across numerous sub asset classes, Gilts, Index Linked Gilts, Corporate Bonds and Global (Strategic) Bonds. The major drawback has really been one of duration. As we all know, the US raised rates towards the end of 2015 and many expected the UK to be close behind. This has not turned out to be the case however with rate rises being a risk within fixed interest over an extended period of time most active managers have held a short duration position to help prevent capital losses in the event of a this occurring. Passive funds simply 'buy the market' and therefore its duration which has benefited them. Will it continue to do so? Is a difficult question. Given the defensive nature of Fixed Interest and the role that it plays within a diversified portfolio we are comfortable with the short duration position and if rates were to rise then the divergence in active and passive performance could close very quickly.

It's pleasing to say that asset classes such as Fixed Interest have performed as we would expect and offered the capital protection that's necessary for our lower risk investors. The asset class data highlights the importance of a diversified portfolio with different asset classes outperforming others through different cycles.

First published on Friday 1st April 2016 by Harry Garrett, Parmenion Investment Management.

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Brexit, Sterling and Market Impact

Brexit is a term which has worked its way into British language over the past year or so and is now commonplace, particularly in the financial press.

One could argue that the term coined in reference to the referendum to be held on the 23 June implies that Britain is certain to leave the European Union (EU) and is, therefore, overly negative (a view supported by Bank of America who have apparently banned the use of the term).

The outcome is far from certain with the "don't knows" making up a good proportion of the vote. According to the FT poll of polls, the remain camp represents 45% of the vote, leave 42% and undecided the remaining 13% as of the 3rd April. Clearly the outcome is finely balanced if we are to trust this data but, as the General Election highlighted, polling agencies are far from infallible.

The economic impact of Britain leaving the EU has been well debated and so I would like to focus on the potential impact on financial markets. As we all know, markets despise uncertainty which has already been felt in the currency markets. The chart opposite shows that sterling has fallen significantly versus the US Dollar since the middle of June and also against the Euro more recently.

There is a distinct possibility that the volatility in sterling will continue until the outcome of the referendum is known.

But what is the impact on other financial assets? Well, the UK equity market has a large proportion of exporting companies with circa 70% of FTSE 100 earnings coming from overseas. These exporting companies all of a sudden start to look more attractive as their goods effectively become cheaper for overseas buyers. This should be supportive of equities. However, investor sentiment towards the UK could sour in the run up to the referendum and the UK market is fully valued at around 26 x price to earnings (source; FT 5th April 2016). These factors could provide significant headwind to any progress in the equity market.

The gilt market is influenced by low interest rates, which look set to stay low, helping to keep gilt yields supressed. However, as the 10 year gilt yield is a mere 1.40% at the time or writing, there is plenty of room for an increase in yields should we leave the EU and the UK is perceived as a riskier place in which to invest. This would feed through into the corporate bond markets where uncertainty over future trade with Europe could cause credit spreads to widen causing capital losses for bond holders. The counter argument is that the bond markets may see inflows in the face of volatility in other asset classes as investors seek safer assets to protect capital and diversify their portfolios serving to keep yields contained.

Commercial property ought to be fairly well insulated although there is a key risk that the market slows as corporate leaders hold off investing in their businesses. According to the Deloitte CFO survey brexit, worries are having a major impact on the perception of financial and economic uncertainty despite 53% of responding CFOs saying that they have made no contingency plans for a possible exit from the EU.

Whilst some professional investors are relatively sanguine over the impact of the referendum, others are less so and the effect on financial securities are numerous and varied. The referendum may affect UK assets far more that European holdings although the potential effects on Europe are also unclear. As ever, this all serves to highlight the importance of diversification and professional investment management.

Sterling and Euros versus US Dollars

Source: FE Analytics. Returns are shown bid to bid, with income reinvested, excluding charges and tax over the period 22/06/2015 to 06/04/2016.

First published by Stephen Lennon, Investment Manager, Parmenion Investment Management.

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Registered Address: 30 City Road, London, EC1Y 2AB.

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