Autumn

Market outlook.

Brought to you by the Investment Management team at my wealth WEALTH at work

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The UK Economy

In August, the Bank of England cut interest rates for the first time in seven years to an all-time low of 0.25% and announced a new bond buying programme. Monetary policy is expected to remain accommodative for the foreseeable future and so all eyes will be on what the government will deliver in the Autumn Statement.

Sterling has now declined more than 17% versus the US dollar since the Brexit vote and whilst there is currently "no explicit evidence" that inflation has yet to fully reflect the recent weakness in sterling (a weaker pound makes our imports more expensive), the recent spat between Tesco and Unilever ('Marmite-gate') suggests that we can expect higher prices to start coming through in the coming months. The FTSE 100 hit an all-time intraday high in October, benefiting from the pounds decline given the majority of FTSE-100 companies sales originate offshore.

The Japanese Economy

Financial Markets in Japan have had a volatile year, underperforming other global markets in sterling terms up until the third quarter. A recent rally in Japan looks somewhat unfounded, and appears to be based on an expectation of central bank intervention (more quantitative easing - QE). However, with the head of the Bank of Japan (Haruhiko Kuroda) recently announcing that further policy adjustments will be based on the direction and level of the yield curve, the move away from a firm monetary policy, lack of domestic reform, and the real potential for them not to publish QE levels in the months to come, the recent rally makes Japan look unstable on a valuation basis as well as on a policy basis. This is all coupled with inflation data looking continually weak, with -0.5% an age away from the 2% target, particularly with the job to applicant ratio continuing to increase (1.27 to 1.38 this year)!

The Emerging Markets & Asia Economy

The sell-off in the first quarter of 2016 seems like an age away, with the Asian and Emerging Markets being the strongest performing asset classes year to date, in sterling terms. Whilst there have been some policy moves by the Peoples Bank of China (PBOC), predominantly altering the currency peg when compared to a basket of other major currencies, and some policy announcements from Narendra Modi's government in India (principally a new tax regime to make a more stable environment for investors and businesses), the broader Asia and Emerging Market asset class has been relatively sanguine when it has come to major policy intervention. Aside from the relatively overvalued Latin American markets, principally driven by the uncertainty in Brazil following the impeachment of its President Dilma Rouseff, this asset class continues to look attractive on a valuation basis, with only the prospect of a raise in the U.S. interest rates that could cause a major short term hurdle.

The US Economy

This year global markets have pivoted on the monthly meeting of the Federal Reserve Bank (Fed) Federal Reserve Bank and the expectation of whether it would raise interest rates. This quarter has been no different. Even with the headline unemployment rate rising to 5% (from 4.9%), the participation rate also rose by 0.1% leaving the economy arguably still drifting at or around full employment, giving little reason for a labour market economist such as Janet Yellen (head of the Fed) to keep rates static. Whilst it is unlikely that the Fed will look to raise rates in November, an election month, the broader market expectation is that rates could move up 0.25% in December. With this in mind, there are two things worth noting:

- Whilst the election is dominating headlines, it is the expectant movement in US interest rates that will likely move markets. However, in reality a decision to move rates up by 0.25% is insignificant, as rates will likely remain lower for longer.
- Volatility around the election is probable. However, markets will likely settle and focus on central bank policy and fundamentals come the inauguration in January, if not sooner.

The European Economy

Dominated by the 'Brexit' referendum, it could be argued that European markets have been unfairly treated throughout 2016. Broader domestic valuations continue to look far more attractive than many other western world countries, and with the Brexit vote preventing European Central Bank (ECB) policy from gaining traction, the head of the ECB, Mario Draghi, has done very little in recent months, merely allowing time for current policy measures to take effect. With QE sitting at €80bln, split between broader government bond purchases, regional bond purchases, and now corporate bond purchases, and with interest rate cuts seemingly flooring at -0.4%, relatively modest market growth this year in Europe leaves potential upside strong. There are of course the hurdles of the French and German elections in Q2 and Q4 of 2017 respectively, and the Italian constitutional referendum in December of this year. However, with valuations looking attractive, inflation and Gross Domestic Product (GDP) stabilising, and unemployment too remaining stable across the region (even decreasing in the hardest hit areas such as Spain), the growth potential for European markets remains strong... even when the UK does decide to invoke 'Article 50', a scenario that is likely more detrimental to UK stability than European.

Fixed Interest

With UK interest rates decreasing following the October meeting of the Bank of England and gilt yields spiking, the UK government debt market is looking decisively uncertain… particularly ahead of the exercising of Article 50 and Britain's vote to exit the EU. The uncertainty around the rate rise cycle in the US and broader intervention of global central banks is not only impacting global government debt, but also global corporate debt. This, married with atypical positive correlations between bonds and equities, and attractive equity valuations in many areas, makes bonds a difficult area to invest in over the short to medium term. However, with that in mind, the corporate debt space continues to look more consistent and attractive than its government counterpart, but do bear in mind that with central banks such as the ECB now purchasing corporate bonds as well as government bonds, valuations are becoming increasingly distorted in many regions.

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