Winter

Market outlook.

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

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The UK Economy

The fall in the pound during 2016 following the result of the EU referendum will start to make its impact in 2017 with higher inflation, which will eat into wages and sap UK consumer confidence (the consumer accounts for over 60% of the UK economy). Furthermore, UK economic growth may be sluggish thanks to uncertainty over the triggering of Article 50 and the subsequent exit negotiations, especially if this results in higher UK unemployment. Consequently, whilst 2017 could prove to be a challenging year for the UK economy, it should be remembered the equity market is somewhat detached from the domestic economy as it is dominated by global businesses.

The Japanese Economy

Following on from a volatile 2016, Japanese markets have started 2017 slowly on a risk adjusted basis. Following last year's policy adjustment from the Bank of Japan to move away from their previous stimulus policies of interest rate manipulation and Quantitative Easing, they are now focused on the yield curve (income from bonds with different maturities) in order to dictate policy. As such, their appears to be an air of uncertainty around what constitutes a 'solid plan' from Prime Minister Abe in order to aid in healing the Japanese economy following decades of deflation. With inflation targets continuing to be pushed out further and further (hitting its 2% target has now been pushed out to 2018), it appears the mass of stimulus imposed over recent years has not been as effective as intended. This, when coupled with the potential collapse of the intended 'Transpacific Trade Partnership' trade pact (an intended source of increased global trade), and the new US President Donald Trump appearing to target 'currency manipulating' countries of which Japan's stimulus in recent years potentially makes them a prime target, suggests Japan's economic stability is marred. As such, other equity asset classes appear to have an arguably more stable outlook for their markets on a risk adjusted basis.

The Emerging Markets & Asia Economy

Market expectation of a Donald Trump victory in the US election was suggestive that this would cause a trade and currency collapse in the Asia & Emerging Market regions, primarily due to Trump's vocal hard line on Mexico and China, and his intention to 'onshore' manufacturing processes. However, despite broader market expectation the Asian and Emerging Markets have continued to perform strongly. Growth data out of the likes of China and India continues to be stronger than expected, as does policy support from the respective governments. We saw President Xi of China address world leaders for the first time at a conference in

Switzerland earlier this year, which suggests an appetite to grow relations globally. In addition to which with China being arguably as important to the US economy as the US is to it, and with limitations to Trump's ability to onshore many manufacturing processes due to availability of skills/resources, a Chinese 'hard landing' is increasingly less likely. Whilst the Chinese currency (the renminbi) continues to slowly depreciate, this is a controlled depreciation, and with the government still having many policy levers to pull, a controlled depreciating currency can be seen as a less concerning prospect! India continues to reform, and with the recent February budget announcing rural reform and development, as well as large infrastructure spending and tax cuts to stimulate consumption, Prime Minister Modi looks to have positioned the economy well for external investment and growth throughout both the shorter and longer terms. Whilst there are still inevitable concerns within certain regions within the Emerging Markets, such as Brazilian valuations/politics, and the uncertainty around Mexican/US relations, valuations on many metrics look strong relative to other asset classes… and the political backdrop in many of these countries looks arguably more stable than those of the western world.

The US Economy

Donald Trump's presidency and the US Federal Reserve (Fed) raising interest rates in December have been 'the only two stories in town' over the past couple of months in the US, but for very different reasons. Janet Yellen, the head of the Fed announced a rate rise in December of last year, suggesting that they believe growth, inflation, and employment data is robust enough to accommodate it. As with last year, whilst there is general expectation that there will be further rate rises in the US this year, it will likely be dependent on economic data and the Fed's assessment strength of the US economy. With that in mind, and with Donald Trump winning the election and his policies being 'pro US business', whether we see an aggressive stance by the President or not, any policy is likely to benefit US domestic companies. So, whilst there is still uncertainty around US policy, it could be considered to be arguably a more stable backdrop than it was last year. In addition to this, the dollar is likely going to be a more stable currency than most which again stands to benefit US domestics. Despite the uncertainty around policy detail and timing, many indicators suggest that the US economy is in much better shape than many other regions.

The European Economy

In light of nervousness around Brexit, and the markets anticipation of successful 'anti-European' regime campaigns in up and coming European elections in Holland, France and Germany (amongst others), the European markets have been arguably robust and slowly gaining traction! However, it could be thought that European politics and the European economy had been unfairly treated over the past few months and throughout 2016, as polling data suggests the extremist right wing parties, whilst polling well, are still a significant margin away from winning the majority. In addition, due to the extremist nature of these outfits, forming coalitions in order to seize power would be difficult. With that in mind, valuations continue to look attractive relative to other asset classes, and economic data such as inflation, unemployment and economic confidence all strengthening, the opportunity and growth potential in European markets remains strong relative to other regions. Brexit and the invoking of article 50 does remain an uncertainty, but one that will likely be more of a concern for UK businesses than that of Continental Europe. So with that in mind, no extreme policy moves from the European Central Bank (ECB) and with a less than controversial result from the up and coming Dutch and French elections, this could aid in releasing some of the pent up valuations in the asset class.

Fixed Interest

With differing economic policies imposed from country to country, and a disparity in their respective economic impact, one of the only constants seems to be uncertainty and increased volatility in the broader bond market... an asset class that is intended to be a downside protector in most portfolios. Credit continues to tighten, and with inflation beginning to put pressure on bond returns, the outlook for the bond market is sanguine at best over the short to medium term. It should also be considered that with central bank policy rife, particularly in the UK and Europe, artificial support of the bond market through Quantitative Easing (QE - central bank bond buying) will likely continue. All of this being said, and given QE, particularly in Europe, also purchasing corporate bonds as well as government bonds, good quality corporate debt appears the most solid asset within this asset class on a risk adjusted basis... however, with liquidity in some bond markets becoming more of a concern, equities continue to look better value than bonds as we continue to plough into 2017!

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