Spring

Market outlook.

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The UK Economy

Nine months after the EU Referendum, the UK finally invoked Article 50 on 29 March 2017 officially starting the process of leaving the EU. Confidence is high that a Brexit deal will be reached by October 2018. However, Theresa May's letter to Donald Tusk, EU President, highlighted the complex and contentious negotiations ahead which will demand considerable horse trading and arm twisting before the UK's new relationship with the EU can be redefined. In order to strengthen her Brexit negotiations, Theresa May announced an early election scheduled for 8 June 2017 and if she is able to capitalise on her lead in the opinion polls, the Tories should be able to extend their current tiny 17 seat majority, potentially resulting in a softer exit.

With UK inflation currently running at the highest level in over three years and with wage growth remaining weak, UK consumers are starting to come under increased pressure. UK retail sales fell 1.5% in March (the largest decline in seven years) and as consumer spending accounts for around 60% of the UK economy, it was unsurprising, UK GDP growth slowed to 0.3% in the first quarter of 2017.

The Japanese Economy

2017 has been a quiet period for Japanese markets and indeed Japanese policy and stimulus, seeing the Japanese market being one of the poorest performing equity markets in sterling terms. This lull in activity from the Bank of Japan (BoJ) governor Haruhiko Kuroda and Prime Minister Shinzo Abe was anything but unexpected. With an extremely protectionist US president (Donald Trump), any further monetary stimulus could have them labelled as currency manipulators, potentially damaging relations with one of their biggest trading partners. Hand in hand with this, we have seen the US back out of the Transatlantic Trade Partnership (TPP), a trade agreement between 12 countries that included Japan and the US, delaying its introduction. With the BoJ having its hands tied, and the TPP agreement appearing at least partially crippled, when coupled with the apparent ineffectiveness of BoJ stimulus to date, 2017 looks to be a difficult economic environment for President Abe to manoeuvre in. In addition to this, GDP (Gross Domestic Product) for the fourth quarter of 2016 has missed expectation and inflation continues to disappoint despite excessive stimulus!

The Emerging Markets & Asia Economy

2017 has been an extremely strong period for the Asian and Emerging Market asset classes in sterling terms. Valuations remain some of the most compelling out of all of the asset classes. The political backdrop appears arguably more stable than that of the West, and with US president, Donald Trump, now tempering his tone on trade with many countries in these regions, any US related worries have subsided. Trump's meeting with the Chinese President Xi Jinping was extremely positive, seeing him take a step back from accusing the Chinese of stealing US manufacturing jobs and then u-turning on labelling them as 'currency manipulators'… instead we have heard positive tones and talk of a strengthening trade relationship between the two countries. We have also seen a leap in progress in India, seeing the removal of higher valued paper money from the economy (demonetisation) reduce corruption in the region. India also announced their budget which consisted of (amongst other things) the promise to electrify all villages by 2018, increase rural subsidies, generate more jobs outside of the major cities, and reduce taxation… all with a view to increasing the quality of life and ultimately consumption levels. So, with valuations remaining attractive compared to many other asset classes, and with the political backdrop remaining arguably more stable than that of the Western world, it appears the opportune environment for countries in the Asian and Emerging Market regions to thrive!

The US Economy

From the first few months of the 'Donald Trump era', it has become apparent that the ability for him to pass some of the extremist policies that he 'toed' during his campaign trail is becoming less likely. Trump's new found tempered approach to dealing with trade partnerships has been taken well by markets, including the US. So, with this in mind, whilst valuations remain high compared to historical averages, opportunities for domestic company growth/expansion remains high. As, despite Trump not being able to get a number of his policies through (such as his healthcare bill, and immigration ban imposed on Muslim countries), the policies he is able to pass, being US centric, are geared to benefit US small to medium sized businesses. So, whilst Trump has made it clear that he feels the US Dollar needs to weaken slightly to enable the US to remain competitive, the acceptance that the US would not be able to 'onshore' all of its manufacturing has made this less pressing. The market expectation of a further 2 small rate rises from the US Federal Reserve Bank (Fed) this year would support a slight depreciation of the dollar, but given the levels of monetary stimulus in other regions such as Japan/Europe, significant relative weakening appears unlikely.

The European Economy

The European markets have been one of the strongest performing equity markets year to date, despite the uncertainty around the multiple election hurdles it needs to clear. The worry of 'polling data accuracy' has subsided, partially quashing investor worry of a raft of extremist right parties taking control. March 2017 saw Mark Rutte's centre-right Liberal party claiming victory in the Dutch elections, with Geert Wilders' far right party gaining little more traction than in previous. Likewise, the French election primaries were held in the second half of April seeing the polling data accurately predicting a Marine Le Pen and Emmanuel Macron runoff. The French second round is set to be on 7 May with polls suggesting a landslide victory for Macron, which would see another far right extremist party fail to gain traction. With all of this in mind, and whilst one must be conscious of the up and coming UK snap election, and more importantly for continental Europe the German elections later this year, recent results have introduced an air of rationalism back to the market. With little by way of further action from the European Central Bank and positive noises from its president Mario Draghi, it is this rationalism, alongside further perceived 'positive' election results in the months to come, that could be the catalyst to further release the attractive valuations that many European companies have relative to those of other regions.

Fixed Interest

2017 has been a difficult period for the broader bond market. As, whilst we have seen pockets of normalised correlations return between bonds and equities in recent months (equities decrease and bond markets increase, and vice versa), this relationship is still unstable. It is this instability of correlations that makes an asset class, typically known for its protection in falling markets, difficult to invest in, particularly in an environment that is more supportive of equities. In addition to this, credit markets remain tight with the only flicker of light coming from central bank policies in the major economies refraining from significantly strengthening monetary stimulus… that being said, Quantitative Easing (QE - central bank bond buying) is still at high levels, and rates are likely to remain low for some time ahead. Corporate credit still appears more attractive than that of government bonds, both on a risk return basis and a correlation basis.

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