Summer

Market outlook.

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The UK Economy

The polls got it wrong again and June's snap election did not play out as expected for the Conservative Party, although they just managed to maintain their majority (by forming a coalition with the DUP), allowing Brexit negations to finally start.

Whilst UK interest rates were held in June, there was dissention with three members of the Bank of England's (BoE) monetary policy committee (MPC) voting for an increase. Following the split decision, during his Mansion House speech, Mark Carney, the Governor of the BoE, said that there was no rush to increase UK interest rates and reiterated the impact and risks of Brexit on the UK economy (in terms of consumer spending, business investment, the current-account deficit and the financial-services industry), in addition, he highlighted that domestic inflation pressures remain subdued and that wage growth was anaemic.

On the subject of UK inflation, it fell for the first time since last October from 2.9% in May to 2.6% in June. Although this is still above the BoE 2% target, it does help to alleviate some pressure on the MPC. Furthermore, it won't be too long before the effect of sterling's weakness starts to fall out of the year-on-year inflation data. Consequently, I continue to believe that an interest rate increase this year is very unlikely, especially as the long-awaited and long-feared Brexit consumer crunch appears to be finally here, with several companies having recently warned of spending declines (DFS, AO World and Visa Europe). Although, official data has held up owing to warmer weather encouraging clothing purchases and the timing of the Muslim festival EID versus prior years.

The Japanese Economy

The past few months have been difficult for Japanese economy, driven by a blend of political instability and volatile data. Following a recent scandal insinuating that Prime Minister Shinzo Abe was using his 'political influence' to favour a friend's business expansion, his credibility has been called in to question. As a result, despite Abe refuting the claim, his approval rating dropped considerably with a recent survey seeing 56% of his cabinet stating they did not support him, and support for Abe's cabinet dropping to an all-time low of 36%. Let's not forget that Abe stepped down as Prime Minister in 2007 after a short tenure due to corruption allegations. With the 2018 elections pending and Abe's approval ratings low (and dropping), the outlook is uncertain for not only Japanese politics, but both policy and the stock market. Coupled with all of this, the head of the Bank of Japan (BoJ) Haruhiko Kuroda's term is also up in 2018, and given his age and the potential for his close friend Shinzo Abe to be superseded as Prime Minister, it is uncertain whether he will stay on for another term. With all of this in mind, a volatile currency, GDP (Gross Domestic Product) continuing to be low and inflation struggling to hit targets, the outlook for Japan for the remainder of 2017 is one of uncertainty if nothing else.

The Emerging Markets & Asia Economy

Year to date, the Asian and Emerging Markets have been the strongest performing equity markets in sterling terms. Strong valuations and arguably more stable governments in the core, such as India and China, have seen policy rife and domestic businesses thrive. India is a prime example, as under its Prime Minister, Narendra Modi, we have seen a raft of changes. July saw India undergo the biggest overhaul of its tax system in history with the introduction of the Goods and Services Tax (Indian equivalent of VAT). This tax has been put in place to aid in reducing corruption, streamline taxation, and to be a reliable revenue generator for the government to fund infrastructure change. Its introduction is seen as a massive step towards growth in the region and has gone a long way towards increasing investor confidence. China has too seen a boost from policy with its shift towards a service driven economy gaining traction, seeing Q2 GDP beat expectation at 6.9%. This commitment to growth saw its president, Xi Jinping, dedicate a further $100 billion to the 'one belt, one road' project aimed at increasing trade throughout Europe and Asia. In addition, there was also a commitment from President Xi to reduce the debt pile from state owned business at the 'National Financial Work Conference' at the end of July. This commitment to growth and development across countries in the asset class, despite pockets of uncertainty such as political instability in Brazil, sees investment opportunities look amongst the strongest globally.

The US Economy

The US President, Donald Trump, has dominated headlines for most of the year, arguably overshadowing any comments or policy shifts by the Federal Reserve Bank (Fed). Despite Trump's rhetoric to drive through domestically beneficial policies to 'make America great again', so far this year he has struggled to get his healthcare act and indeed his immigration policy approved by the Senate. All of this noise, when coupled with the corruption scandal regarding Russia's involvement with the US election, has made it extremely difficult for Trump to gain traction with any of his policy amendments, and whilst he will get some policy measures through, likely lead by tax reform, it may be 2018 before anything meaningful occurs. However, whilst it is sensible to be mindful of this, it is mainly noise, so let's not lose sight of what is important. In a recent testimony by the head of the Fed, Janet Yellen, she was increasingly dovish, stating that it will be difficult for the US to meet its 3% growth target. In addition, inflation data was weaker than expected, and when coupled with unemployment data that is on brittle ground at its current low level, it seems unlikely that the rate rise cycle will steepen (lower for longer), or that any 'meaningful' unwind of the quantitative easing programme will occur any time soon. With all of the above in mind and valuations looking stretched, it is difficult to be bullish on the US stock market, yet with the currency arguably one of the most stable and prospects for domestically focussed policy it is dangerous to be too negative...

The European Economy

With a number of political hurdles already cleared this year, including the avoidance of 'far right' victories in the Dutch and French elections, June saw the newly appointed French President, Emmanuel Macron, succeed in gaining a significant majority in the parliamentary elections despite a meagre turnout of sub 45%. This allows Macron to push ahead with policy implementation, facing little resistance occupying 350 seats of the 577 in parliament. This was a relief for the European stock markets, especially when coupled with Italy's 'far right' 5 Star 'populist party' failing to gain any traction in the local elections (also in June) ahead of the Italian general election in 2018. The next major political hurdle is the German elections in September of this year, and with incumbent Chancellor Angela Merkel polling well and the German public seemingly receptive to the additional funding of the Greek bailout, it is looking likely that the 'anti-establishment' movement throughout Europe is waning. In addition to the political backdrop, the European Central Bank has been relatively muted in terms of policy over the past quarter, with verbal rhetoric from its head, Mario Draghi, suggesting that he is comfortable with the current recovery and data. With deflation avoided, and broader growth and employment dynamics improving, in recent press conferences Draghi has

insinuated that depending on improving data, a potential tapering of the current quantitative easing policy (bond purchasing) is currently under consideration. This improving political and economic backdrop has the potential to release the relative suppressed value in European companies, as we have seen year to date.

Fixed Interest

Other than some narrative from central banks flickering between hawkish and dovish comments, not much has changed in the asset class with the backdrop for the bond market appearing muted at best… certainly in the run up to 2018. The Bank of England and ECB continue to support their current monetary stimulus levels despite talk of 'rate rises' and 'tapering' of quantitative easing policies, as in truth all economies are still at a stage where they are assessing if current stimulus has been successful and if a tapering of stimulus would derail any progress made… as in the UK in particular, with wage growth looking unlikely, inflation becoming a threat, and the economy broadly weakening, a rate rise has the potential to drive the economy into recession. As such, despite the odd spike in yields, the only strong returns are being generated in the subordinated arena which comes with much higher risk, and with correlations between bonds and equities still positive and equities performing well, corporate bonds appear to offer the strongest risk adjusted returns at present.

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