Discretionary Portfolio Service

Market Commentary for the Period 1st January 2017 – 31st March 2017

Global equity markets were strong over the period with emerging markets outperforming on a relative basis. In the World Economic Outlook the IMF raised its US growth forecast by 0.1% to 2.3% in 2017 and by 0.4% to 2.5% in 2018 while maintaining its outlook on global growth. The organisation cited Trump's plans for fiscal stimulus including increased infrastructure spending and tax cuts as the key reasons. They outlined that risks to the global growth outlook were skewed to the downside over the medium term picking up on increased restrictions on global trade, impaired balance sheets, emerging market economic vulnerabilities and geopolitical risks. Higher inflation was a continued theme over the quarter which was driven primarily by higher fuel costs. Bond markets delivered marginally positive returns with conflicting pressures impacting prices.

US equity markets posted attractive returns leading the country's largest 500 companies (S&P500 index) to be valued at $20 trillion in aggregate in mid-February. Following his inauguration as President, Donald Trump withdrew the US from the Trans-Pacific Partnership (TPP), pulling out from trade deals with 11 countries in the Pacific Rim. He later directed a review of the Dodd-Frank act adopting the view that financial regulation was too onerous on businesses due to the inability to borrow funds. The Federal Reserve raised interest rates by 0.25% in March following strength in economic activity and the labour market. The central bank maintained their original forecast of 3 interest rate hikes over 2017 which remain dependent on the economic outlook as informed by incoming data. US fourth quarter GDP fell to 2.1% q/q (annualised). This was below the previous quarter driven in part by lower investment and net trade subtracting from growth. US inflation rose to 2.7% y/y in February, reaching the highest rate since March 2012, driven predominately by higher fuel prices. Unemployment fell to 4.7% in February, lower than 4.8% the previous month.

UK equity markets performed well noting that the FTSE 100 index recorded its longest ever run of positive daily returns since the index was created in 1984. Early in the quarter the UK's representative to the EU Sir Ivan Rogers quit months before initiating Brexit negotiations. He expressed to his colleagues that they should 'challenge ill-founded arguments and muddled thinking'. Britain later initiated its exit from the EU after invoking Article 50 of the Lisbon Treaty. The Bank of England left interest rates and stimulus levels unchanged in their most recent meeting. The Monetary Policy Committee stated that they were balancing the trade-off between the speed at which inflation returns to target with the support that policy provides to jobs and activity.

UK fourth quarter GDP rose to 0.7% q/q with net trade and consumer spending both contributing positively and business investment having a negative impact on the overall growth figure. Inflation rose to 2.3% y/y in February, marking the highest rate since September 2013, with rising fuel prices having a significant impact. Unemployment fell to 4.7% in January marking the lowest rate since September 2005. Despite the low unemployment rate, wage growth was reported lower than expected at 2.2% y/y (inc bonuses) which was also lower than inflation. In addition, there was a substantial rise in the number of people on zero hour contracts which rose to a total of 905,000 people in December.

European equity markets delivered strong returns despite uncertainty over looming elections in both France and Germany. The European Central Bank made no changes over the period, but reiterated that monthly asset purchases would reduce by €20bn per month to €60bn from April in an attempt to reduce stimulus measures. ECB President Mario Draghi however mentioned that this could quickly reverse should the outlook become less favourable. The IMF and EU initially failed to reach an agreement on lending €7bn that Greece required to avoid bankruptcy. With the debt due in July, Eurozone ministers were keen to reach an agreement to prevent issues of confidence over European elections. Mark Rutte of the centre-right VVD party won the Dutch election giving him a third successive term as Prime Minister. He surpassed Geert Wilders of the anti-immigration Freedom Party playing down fears of a rise in nationalism across Europe. The VVD will now have to form a coalition with 3 other parties, which they have expressed will not include the Freedom Party.

Eurozone fourth quarter GDP remained at 0.4% q/q, unchanged from the previous quarter. Eastern European countries such as Estonia and Lithuania posted the highest levels of growth, whilst the Greek economy continued to contract. Inflation rose to 2% y/y in February marking the highest rate since January 2013 driven by increasing fuel prices. Unemployment remained at 9.6% in January, the lowest rate since May 2009.

Japanese equity markets ended the quarter marginally negative amid a period of fairly lacklustre data. The Bank of Japan maintained interest rates and the stimulus program at their most recent meeting. The central bank expressed their expectations of an uptrend in domestic demand driven by spending in both the household and corporate sectors following highly accommodative financial conditions and fiscal spending. Japanese fourth quarter GDP remained at 0.3% q/q in line with the previous quarter. The overall growth rate was boosted in part by exports and government spending while household consumption was flat. Inflation fell to 0.3% y/y in February with easing food prices and falling cost of housing. Unemployment fell to 2.8% in February marking the lowest unemployment rate since June 1994.

Emerging markets experienced a strong quarter amid a period of stability in the US dollar, taking away some of the adverse pressure on returns. Chinese fourth quarter GDP rose to 6.8% y/y, remaining within the government's target range and supported by strong consumer spending, higher government expenditure and robust bank lending. Interest rates were cut in Brazil by 0.75% to 12.25% with the future path of interest rates to be dependent on expectations for inflation. Conversely, Mexico raised interest rates by 0.50% to 6.25% over concerns of a weakening currency leading to higher inflation. In China, financial regulators drafted a consultation paper directed to lower financial leverage and risk in asset management products. India's budget was taken positively easing concerns over the introduction of a capital gains tax and policy aimed at boosting consumption. The oil price suffered a sharp fall in March as data from the Department of Energy showed US inventories at a record high. This, combined with growth in US shale oil production, has led to higher levels of supply putting downward pressure on oil prices.

In fixed income markets, yields remained largely unchanged on a broad basis leading to marginally positive gains for investors. An interest rate rise in the US, reduced monetary stimulus in Europe and rising inflation all put pressure on returns, whereas continued structural demand stabilised bond prices. Yields on the UK, US and German 10 year bond ended the quarter at 1.14%, 2.39% and 0.33% respectively.

Past performance is not a guide to future performance. The value of investments and any income from them can fall as well as rise and is not guaranteed. The comments in this Market Commentary are based on our views at 4th April 2017. These views are subject to change. They are for information only and do not contain any forecasts or recommendations.

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