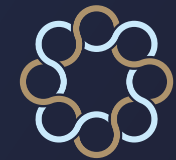

FINURA

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POINTS OF VIEW

MONTHLY COMMENTARY FROM PARMENION INVESTMENT MANAGEMENT

Politics take centre stage, once again. Global equity markets (ex-UK) were relative sanguine in April, gaining between 1% and 3% in local currency once sterling volatility was removed.

As can be seen below, the strength of sterling post the election announcement has detracted from that performance for UK investors, while the market has repriced large cap UK companies for the reverse currency translation that saw them perform so well post-Brexit. Despite a variety of fundamental data points both good and bad reported last month, politics remains an attention grabber and is likely to continue to focus the attention until it doesn't!

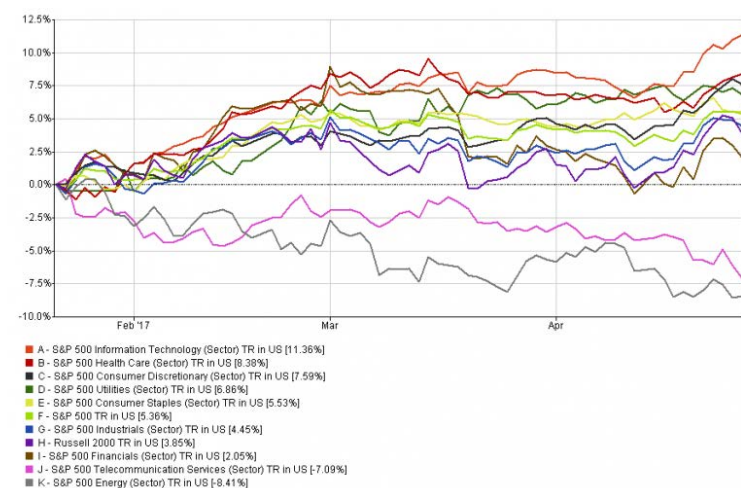
Index

Index	April Return (£ base)	April Return (Local ccy)
FTSE World Index	-1.78%	1.31%
FTSE USA TR GBP	-2.32%	1.06%
FTSE Europe ex UK TR GBP	0.85%	2.84%
FTSE Japan TR GBP	-2.15%	1.28%
FTSE 100	-1.33%	-1.33%
FTSE all share	-0.37%	-0.37%
FTSE EM	-1.48%	1.72%

*Past performance is not an indication of future returns. The value of investments and any income from them is not guaranteed and can go down as well as up.

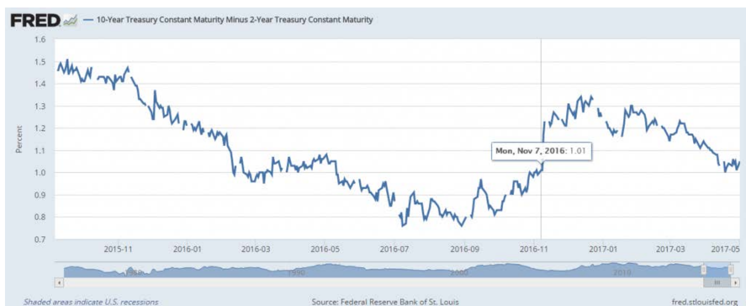
United States

As we pass the self-imposed 100 day point for reflection on the success of Trumps change agenda it's fair to say the market is viewing his potential with far less blinkered 'animal spirits'. The middle of March was the reflection point for the stock market and April continued with this mild exhalation of confidence, the S&P and Russell 2000 similarly up a mere 1% in local currency (down 2.5% in GBP).



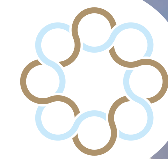
What may be of greater interest is the sector returns which in the most part continue the theme observed since the inauguration, that faith in Trumps reflationary trade seemed to be waning far sooner than his failure to appeal Obamacare. Since Trump took seat in the White house, the worst performing sectors of the S&P 500 in local currency terms have been Energy (-8.4%), Telecom's (7.1%), Financials (2.1%) and industrials (4.5%). These are predominantly the sectors

that would most obviously benefit from 'Trumpflation'. Equally the domestically orientated Russell 2000 is up comparatively less at 3.9%. On the flip side we have seen the bond proxy Utilities up 6.9%, healthcare up 8.4% with IT driving returns, up 11.4%.



This is mirrored more acutely in the bond market where the spread between the 10yr and 2yr Treasury yield has completely reversed all the gains accumulated post the election. Specifically this graph implies that the medium term growth and inflation expectations that the election result encouraged have been fully unwound, with the inauguration date a mere 6bp off the high for this spread at 1.28% and the end of April matching the pre-election rate of 1.01%.

Looking at fundamentals for a change, we saw a disappointing Q1 GDP estimate, implying a mere 0.7% growth, well short of the 1.3% consensus and 2.1% seen in Q416. This was exacerbated by some disappointing retail sales and CPI data. Having said that, while consumer confidence dipped slightly, the April release continues to show that confidence remains high and this coincides with positive employment data and an improving employment cost index. Taken together it suggests there is still some momentum behind the consumer but that we need to be aware of potential trap doors such and personal debt levels.



United Kingdom

Surprise as politics takes centre stage once again! A snap election from Theresa May caught us all unaware given her prior rhetoric, allowing the pollsters another chance to embarrass themselves. The opportunistic timing with her approval rating nicely up since her elevation to PM, leads markets to tilt towards the delivery of a strong mandate from the election result. This manifests itself to a stronger sterling under the premise that Theresa will have less need for a hard Brexit to appease hard line backbenchers. Markets have subsequently been driven by this currency reaction with the FTSE 100 down on currency translation and the FTSE 250 up on domestic prosperity improvements.

Politics largely overshadowed a less than positive April on the economic front. Q1 forecast GDP came in at a lower than expected 0.3% as spending in retail and hospitality was hurt by rising inflation. UK consumer confidence in disposable incomes has fallen to its lowest level in 3 years as the imported inflation from a weak currency has acted to erase any real wage growth. While one time hits to inflation from revaluations like that seen to the pound last June eventually roll out of the data, the danger of the impact on the consumers ability to spend at a point when debt is high and savings are falling, could be quite detrimental to the minimal growth currently existing in the economy.

Europe

Despite a wobble prior to the first round of the French election, the FTSE Europe index maintained a positive return for the month while other developed markets struggled. Fundamentals have been strong with persistent business confidence, continued purchasing manager's strength (both manufacturing and services) and signs that inflation will finally make an appearance.

On the 23rd the electorate determined that the final leg of the presidency race would be fought between the far-right Marine le Pen and the more centralist Macron. At one point there was a strong possibility that Melenchon might join Le Pen leaving a choice between far-right and far-left but as sense prevailed equities rallied adding almost 4% to the index, turning a deficit on the month into a 3% gain. If Europe can negotiate the coming month's elections without deteriorating the Union's status further, then the positive economic momentum should continue to benefit underlying companies.

Japan

Japans labour market reached its tightest in 26 years last month, however weakness in wages and consumer spending led to a continuation of stagnant prices. The ratio of open jobs to applicants rose to 1.45x, the highest since 1990 and within a fraction of the peak hit during Japan's bubble economy of the 1980's. The BOJ's target of 2% inflation appears far off, however, as consumer prices ex-fresh food were up a modest 0.2% yoy. The central bank will continue its massive stimulus programme, buying $720bn worth of government bonds annually while capping the 10yr yield at 0% under the hope of inspiring inflation. Equities reacted with a gentle slide upwards over the month in local currency, in line with many other developed indexes.

Emerging Markets

Emerging markets added to gains they accumulated YTD as a gentle rise in local currency equity performance permeated across most major equity markets. Last month The FTCR Asean Economic Sentiment Index showed a tick upward for Q1 indicating increasing optimism among Asean consumers about the economic outlook. Mexico also had some good news with an unexpected uptick in growth for Q1 coming in at 0.6%, confirming the market overreaction to the weakness expected. On the flip side an independent survey of China's manufacturing sector indicated business activity grew at the slowest pace since September as sluggish demand dragged on production.

*All performance data quoted in this article is derived from FE Analytics.

Any figures quoted are for illustrative purposes and should not be taken as a forecast or guarantee. Past performance should not be seen as an indication of future returns and clients may get back less than they have invested.

First published on 4th May 2017 by Parmenion Investment Management.

BIG SOCIETIES CHALLENGE BIG GOVERNMENTS

Cazenove Capital Management's Chief Economist, Richard Jeffrey, considers the causes of the shock EU referendum and US election results.

What seems to connect the UK referendum and the US presidential election is the apparent willingness of electorates to reject the established order and take a step into the unknown. There have been similar moments of rejection in the past. The landslide vote for Labour in 1945 was one, though its cause was more obvious. And in 1970, the left-wing Labour politician Richard Crossman wrote: "There is a cracking sound in the political atmosphere: the sound of the consensus breaking up," although this fracturing did not manifest until almost a decade later, with the election of Margaret Thatcher.

Disconnected politicians

What appears to have come together with so much force over the past year is a potent combination of political and economic influences on elector attitudes. These have brought about a distinct feeling of social ennui and disassociation from Westminster and Washington. Rightly or wrongly, the political classes have been judged to have become increasingly disconnected from the man and woman on the street. This, in itself, is nothing new – indeed, you could argue that it has been the case for most of history. What is new is the confidence that electors have shown in challenging the established order.

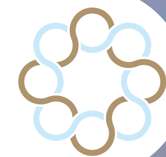
To a certain extent, modern media and communications may be responsible. The deficiencies of politicians are now continually exposed. Yet this still does not explain the risk that electorates took in 2016. Is it just that the disconnect between the common people and their political masters has become too extreme? In the referendum campaign, Nigel Farage addressed directly the concerns of many about the overarching influence of the EU. Likewise, Mr Trump developed a style that appealed to at least a proportion of the population. In both cases, the outcomes reflected the feeling of many people that their interests had been ignored for too long.

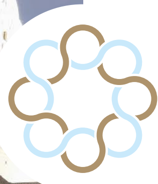
Workers aren't benefiting

In themselves, these influences may have been enough for voters to reject the status quo. But there has been another source of dissatisfaction. Statistics tell us that the UK and US have enjoyed seven consecutive years of decent growth. UK households have seen an average annual gain of 1% in total real disposable income.

However, this is not the whole story. Over the period, the numbers of people in employment and the number of households have both risen. So, whereas total wages and salaries have increased by 2.75% per annum in cash terms, the increase per employee has been about 1.75% – less than the inflation rate.

Weak productivity is not peculiar to the UK or US – it is more or less pervasive in advanced economies. It is my strong





belief that the consequences for employee incomes have had a much greater impact on electoral mood than might have been realised. The inescapable conclusion is that most employees have not seen the benefits of growth slip into their pay packets. And it may not just be in the UK and US that the dissatisfaction of voters is starting to manifest.

First published on 7th April 2017 by Richard Jeffrey, Chief Economist at Cazenove Capital Management..

ECONOMIC OPTIMISM THROUGH A GLOBAL LENS

The International Monetary Fund (IMF) has revised up its 2017 world GDP growth projection from 3.4% to 3.5%, on the back of better than expected data from Europe, China and Japan, driven by broad-based recovery in trade and industrial activity. The encouraging feature is that growth in developing and advanced economies will both improve in 2017, for the first time since 2010.

US

Survey evidence relating to the performance of the US economy has been surprising to the upside since the presidential election last November. A distinguishing feature has been the rise in consumer and business confidence to the highest levels in a decade, which may be attributable to a revival of 'animal spirits' triggered by President Trump's proposed expansionary policies. However, it is noteworthy that that sentiment and survey-based information has been considerably stronger than actual activity data.

On the consumer side, retail sales values remain solid but no better than this, failing to breakthrough the 4% year-on-year trend.

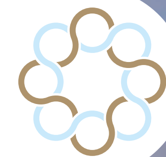
In addition, the trend in real personal expenditure is flat-lining due to higher prices. It suggests consumers, while being optimistic, are still waiting for more clarification before loosening their purse strings. The testing issue for US consumers this year will be higher inflation and policy disappointment.

Overall, fundamentals remain moderately supportive vis-à-vis household consumption. The labour market tightened further in March, with the unemployment rate dipping to 4.5% from 4.7%, the lowest since April 2007. The unemployment rate has already fallen to the US Federal Reserve's projection for the fourth quarter of 2017 and is running below the neutral rate estimate of 4.7% – implying that faster wage growth should now be expected. Backing this view, the National Federation of Independent Businesses (NFIB) survey has suggested employers have been finding it increasingly difficult to fill job openings and are preparing to pay higher wages.

On the business side, the CEO confidence survey has picked-up and pointed to potentially stronger capital spending. The catalysts are the stronger growth outlook and President Trump's proposal to cut the main corporate tax rate from 35% to 15%. Although the tax reform proposals may not be passed in its full form, the combination of a pro-business White House and the Republican-controlled Congress will likely achieve some form of tax cut.

Eurozone

A major political risk for 2017 has now receded following the result of the first round of the French presidential election. Emmanuel Macron and Marine Le Pen are the finalists of the French presidential election, and polls (which have proven



to be accurate) suggest the centrist candidate Macron will comfortably win the second-round vote on 7th May. With the tail-risk of an extremist French leader now receding, investors can finally move their focus from politics to growth.

Improved economic momentum in the Eurozone has continued into the second quarter, with the Eurozone composite Purchasing Manager Index rising to its highest level in nearly six years. The pick-up in activity has been broad-based across key economies and sectors, with the weak euro and faster global growth supporting export activity. Germany, whose economy is highly export-oriented, enjoyed a strong first quarter, with industrial production, net trade and factory orders all exceeding expectations.

The European Central Bank lending survey for the first quarter of 2017 was largely positive. The survey showed easing lending conditions and increasing demand across all loan categories, pointing to a sustained pickup in credit growth. The conjunction of improving economic activity and a growing appetite to lend suggests that credit growth will continue to strengthen. This should help support a productivity enhancing recovery in capital spending.

UK

Following the announcement of a general election on June 8th, the UK will be the next to feature in the European political merry-go-round. The Conservative Party hopes to exploit its current 20-point opinion-poll lead over Labour to increase its majority in the House of Commons and strengthen its Brexit mandate. In addition, moving the date of the following general election, potentially to mid-2022, relieves some of the time pressure to complete a Brexit deal.

While the near-term growth impact of the approaching election is likely to be limited, momentum in the UK economy appears to have subsided. Official retail sales data for the first quarter disappointed markedly, confirming a slowdown in consumption growth as higher inflation depressed households' spending power. A spike in inflation and slower pay growth meant that regular real wage growth dipped to -0.1% YoY in March, and will possibly weaken further over the course of 2017. Slower real wage growth, less scope to deploy savings and a weak first quarter all point to lower contribution to overall GDP growth from household consumption in 2017. On a more positive note, there is little sign of a significant deterioration in UK consumer confidence, which suggests consumption is unlikely to fall precipitously.

Despite the slowdown in household consumption, we expect the UK's growth mix to be more balanced in 2017, with more positive contributions coming from net trade and capital investment. There is evidence that exporters have benefited from previous weakness in sterling, as nominal export of goods and services rose 12.9% YoY in February, the best monthly increase since 2011.

Emerging markets

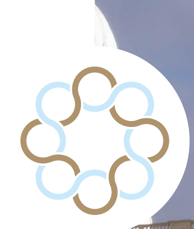
World trade volumes have recovered since mid-2016, expanding at about a 4% annual pace in first quarter of

2017, the best performance since late 2011. This has had a particularly positive impact on emerging economies, whose growth models are more geared toward exports and hence global trade.

The pick up in EM exports was helped by higher commodity prices, improved purchasing power for commodity producers and better demand from advanced economies. The double-digit rise in Chinese imports undeniably had a major role to play in generating the improvement, especially in relation to exports from other Asian economies. This was attributable to the stimulus measures introduced in China and the subsequent construction boom which increased demand for imported materials and investment goods.

On the flipside, the momentum in China construction may now slow due to tighter monetary and macro-prudential policy. Going forward, if we do see a pick-up in capital spending within advanced economies in 2017, the upturn in the trade cycle may be prolonged due to the trade-intensive nature of investment goods.

First published on 5th May 2017 by Janet Mui, Global Economist at Cazenove Capital Management..



THE DIVERGENCE BETWEEN SENTIMENT AND REALITY GIVING CAUSE FOR CONCERN

In March we talked about optimism, and the fact that it can become a self-fulfilling prophecy for growth. But what happens if reality doesn't catch up with this positive sentiment? At what point do markets stop believing, and react to the fact that this confidence was, in fact, misplaced?

It's this scenario that is continuing to give us cause for concern. At the beginning of 2017, investors were buoyed by the prospect of tax cuts in the US, and what that would mean for the global economy. Yet nearly half way through the year, we're seeing an increasing divergence between the positivity of the "softer" forward-looking economic indicators (such as consumer purchasing, manufacturing and small business sentiment indices), and the more concrete backward-looking data (such as payrolls, vehicle sales and corporate loans), which are showing signs of weakness.

Here is Sanlam UK's view on what they think this means for global markets, and how it's affecting their investment thinking.

"Despite generally improving global economic data, our view remains that we are in a low return environment, as current valuations already discount a benign interest rate environment and significantly higher company earnings." - Philip Smeaton, Sanlam UK Chief Investment Officer.

The US – awaiting clarity on tax cut

To achieve the highly anticipated economic expansion in the US, the Trump administration needs to turn the promise of tax and government infrastructure reform into reality. If it can do this, it will deliver immediate results for company bottom lines, helping to justify current stock prices. But if the tax cuts are not realised, there could be dramatic falls. We have limited our US exposure for now, and we expect there to be further clarity on these changes in August.

The UK – disappointing economic performance and a general election

The UK's economic performance has been disappointing, given that the weakness of sterling should have supported export-oriented manufacturers and those that compete with imports. Despite low interest rates, businesses continue to be reluctant to invest in growth (which is understandable, given Brexit uncertainty), and the government is holding back on infrastructure spending. An impending election may provide a boost to sterling and sterling-denominated assets, perhaps providing an opportunity to reduce our exposure to the region.

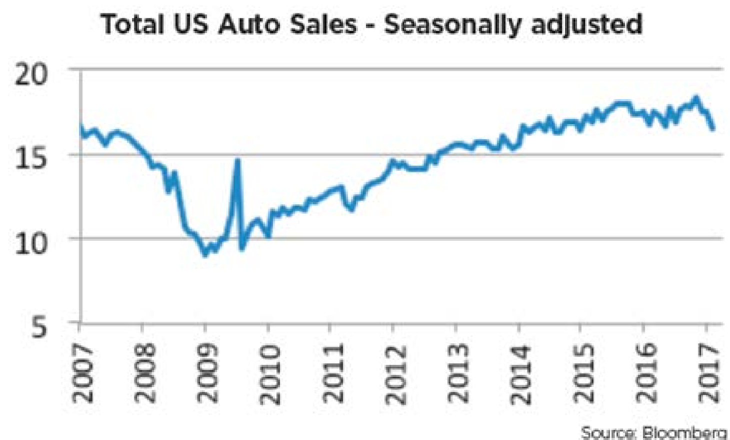
Europe: improving fundamentals, but concern over viability of the euro

Improvements in company earnings and the outlook for inflation are positive indicators for Europe. There remains concern for the future viability of the euro, but this is mostly counter-balanced by the relatively attractive valuations and improving fundamentals in the region.

Valuations in the emerging markets appear cheap enough to compensate for the additional risk. Stabilisation within commodity prices, less uncertainty surrounding China and improvements in the political outlook for other major emerging market economies, such as Brazil and India, also make us more comfortable with this risk. Ultimately there are some excellent companies in these regions, experiencing better growth and trading at more attractive prices than their developed-market peers. As a result, we are looking to allocate some capital to this region.

The significance (or not) of weakening car sales in the US

We've recently seen a dramatic decrease in car sales in the US, which fell to their lowest level in two years. Traditionally, car sales are seen as an early indicator of changes in economic health, so how significant is this? As yet, it's too early to tell, and we shouldn't read too much into a single data point. It is a worrying shift in consumer behaviour, but one that will need to play out over the longer term to tell us anything meaningful. Watch this space.



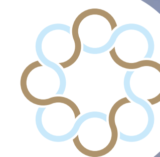
Five reasons why we should be concerned about stagflation in the UK

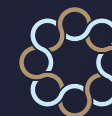
A recent report by the Office for National Statistics (ONS) showed that UK manufacturing production fell by 0.1% in February versus an expected increase of 0.2%. Meanwhile, inflation is on the increase, giving rise to the term 'stagflation'.

Here are five reasons why we should be concerned:

1. Despite Brexit worries, we would expect manufacturing to be stronger. This is because many UK manufacturers are competing against more expensive imports, or are exporters themselves – in both cases benefiting from the weakness of sterling.
2. UK companies are still operating under the existing EU rules, so are currently in the sweet spot of trade rules. They should be able to perform better in these conditions.
3. The Government is in the middle of a deficit-reducing agenda, which means it is not going to be a major source of growth spending. Growth must come from the private sector.
4. UK inflation is higher on the basis of higher global prices and a weak currency – not economic growth. So the economy is going nowhere.
5. Wages are not increasing in line with inflation, and there is weaker consumer confidence.

First published on 3rd May 2017 by Sanlam UK.





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