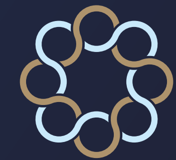


FINURA

PARTNERS

POINTS OF VIEW

MONTHLY COMMENTARY FROM PARMENION INVESTMENT MANAGEMENT

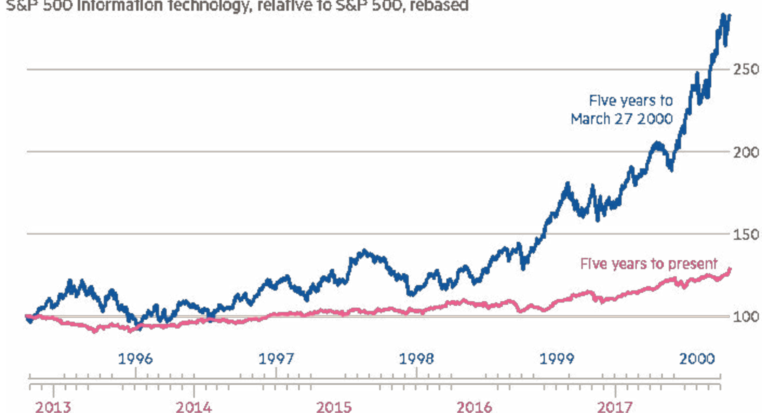
This month the IMF stated that the UK is a "notable exception" to an improving global growth outlook. Fundamentals appear to confirm this, with positive data points evident across most major economies outside the UK.

Index	October Return (£ base)
FTSE World Index	3.08%
FTSE USA TR GBP	3.33%
FTSE Europe ex UK TR GBP	1.40%
FTSE Japan TR GBP	5.81%
FTSE 100	1.82%
FTSE all share	1.86%
FTSE EM	3.62%

Economic fundamentals do not, however, have a direct translation to asset prices and the FTSE All Share continues to provide a positive return. As politics plays a quieter role, relatively, central bankers have filled the absent column inches. Expectations remain baked in for interest rate rises in both the UK and US this year, and this has hurt short term bond yields. The bond market is less certain on the sustainability of this rosy global picture, however, or at least an inflationary one, those with long duration positions left relatively unscathed.

The US

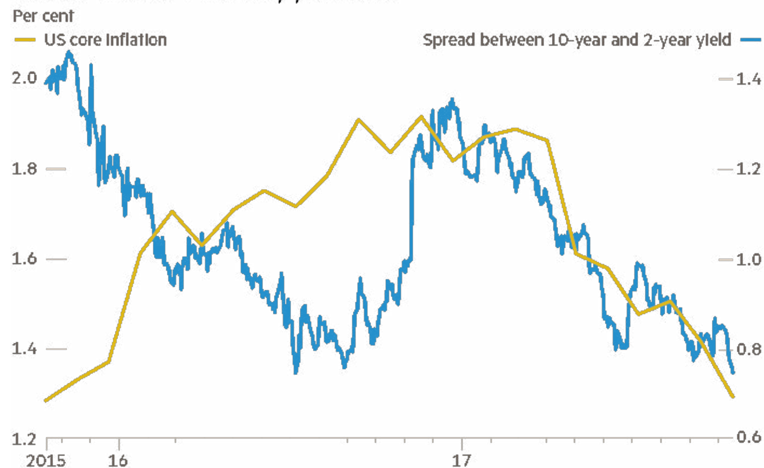
The US stock market ground higher, with positive contributions from the majority of sectors. Despite this broad based performance, the tech sector remains in the spotlight, once again the primary driver of returns for the period. In particular, strong results reported by Amazon, Alphabet (Google) and Microsoft as the month drew to a close, bumped these high performing stocks even higher. Amazon posted its fastest rise in sales for 5 years, assisted by the Whole Foods acquisition. Even excluding this bolt on, and currency impacts, sales were up 29%. By the end of the year, 44 cents in every dollar spent online are expected to pass through Amazon. Revenues of $43.7bn for Q3, however, hide the lack of operating profit, a mere $347M posted to accompany record sales. That hasn't deterred investors, however, the stock up 48% for the year.



Source: FT.com October 2017

Returning to the economy as a whole, fundamentals continue to provide a positive tailwind. Consumer confidence hit a 12 year high, while the bell weather ISM manufacturing statistic posted its strongest reading for over 6 years. Similarly the

ISM non-manufacturing remained positive as did core retail sales, unemployment and average hourly earnings growth. The only missing link is inflation, yet to fully emerge, CPI data disappointing again mid-month. This was picked up in the Federal Reserve's minutes, highlighting a level of concern surrounding the weak pick up in inflation. With the market pricing in an 80% probability of a further rate rise for December, this concern is deferred to next years rate rise journey, with the 10 year yield suffering as a result. As highlighted across prior commentary, the US yield curve continues to flatten, the spread between the 10yr and 2yr treasury following inflation lower. Traditionally this spread is an important barometer for the markets view on the prospects for the economy. Does that continue to ring true?



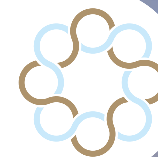
Source: FT.com October 2017

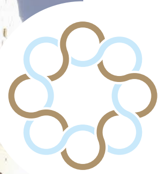
The UK

Fundamentals, for the most part, remain weak within the UK but it was the action of policy makers that dominated the trend in asset prices. Unspectacularly average movements for the FTSE were punctuated by some intraday volatility mid-month as Michel Barnier (chief negotiator for the Europeans), announced that talks on Brexit terms were at "deadlock". Reports from a German media outlet of 'some progress' quickly reversed the sterling depreciation with the suggestion of a 2 year transition deal erasing the 1% fall v the dollar.

Despite the negative press, there are some shards of light for the 'leavers' to cling to. In particular, UK manufacturing had its strongest quarter since the start of 2015, according to a British Chamber of Commerce Survey. Further, the UK economy eclipsed market expectation, growing at a slightly improved 0.4% for the quarter. Even so, inflation hit 3% in September, a five year high, further pressure on a stretched consumer. This coincided with an FCA survey that showed half of UK consumers exhibit characteristics of potential vulnerability in their financial circumstances. The strength seen in Sterling since Mark Carney (Bank of England governor) guided towards a November rate rise has been maintained, and the strong inflation print only confirmed to the market that a rise to 50bp was a near certainty for November.

Finally, on a separate note, analysis from the ONS uncovered that foreign-owned firms operating in the UK had far higher levels of productivity than the equivalent UK company. In fact, keeping industry, region and size of firm constant,





those businesses were 74% more productive in terms of value of output per worker per hour, than the UK firms. The conundrum of UK productivity continues!

Europe

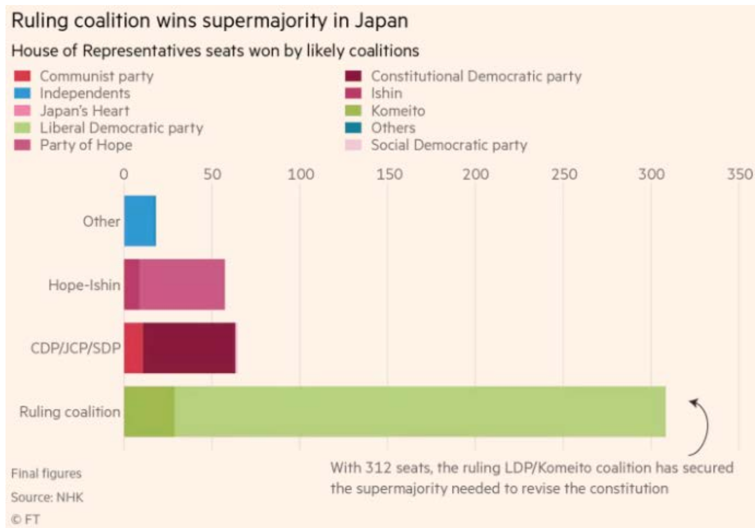
Having performed well this year, European stocks were equally sanguine last month. A reduction in the pace of the ECB's QE stimulus, announced on 26th October, triggered a weakening for the Euro. The addition of an extension to the programme was the driver for the weakness, tipping the markets reaction towards a dovish evaluation for the overall policy. In reaction to this the German Central Bank Chief, Jens Weidmann, questionned the logic of this extension when growth is robust. Europe indeed continues to post strong signals of recovery, Italian consumer and business confidence for example posting further improvements.

Equally, the GfK survey highlighted that the gap between downbeat economic sentiment in the UK and upbeat sentiment in the Euro area has never been wider. One beneficiary has been European High Yield, with yields on this high-risk credit now lower than the US 10 year Treasury. How much this yield compression is a result of the quantitative easing programme, and how much from Eurozone prosperity is unclear, but at these levels, we feel a degree of caution is warranted.

Source: Fred.stlouisfed.org, October 2017

Japan

The significant news out of Japan was the success for Shinzo Abe from a snap election decision. While Theresa May saw her majority dwindle, the early election gamble paid off for the Japanese prime minister and his ruling Liberal Democratic Party-led coalition, securing a two-thirds "super majority". This will give a fresh mandate for "Abenomics", allowing for potential fiscal stimulus accompanying reform. The market responded well to this result, gaining over 6% in local currency terms. Market reaction is perhaps unsurprising given the relative success Abe has had so far in stimulating an economy and labour market that has been subdued for so long.



Source: FT.com October 2017

Emerging Markets

Another region, another important political diary. This time we saw Xi Jinping confirmed as China's president for an additional term, many touting him as the most powerful ruler since Mao. Shortly after Zhou Ziaochaun, PBoC governor warned against complacency around risk from excessive debt and speculative investment. Was this a signal for tightening regulation and financial controls?

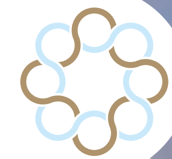
The bond market sold off and yields widened to near 3 year highs, but have since stabilised after the central bank reacted, injecting cash into the banking system. This eased concerns about a campaign to curb corporate debt. If we can learn anything from this episode it is that there remains fear of the excesses in the Chinese system, however, the central bank is cognisant of this and has the ability to act quickly and decisively.

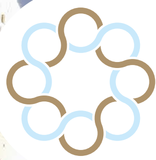
In other news...

India's government announced a $32bn plan to recapitalise the country's state-controlled banks. Generally, this was seen as growth positive with the action aimed at heading off a festering economic headache. The banks account for two-thirds of sector assets and concerns as to the extent of their bad loans had been growing.

*Past performance is not an indicator of future returns.

First published on 2nd November 2017 by Simon Brett of Parmenion Investment Management.





MIND THE PRODUCTIVITY GAP

Structural changes across the global economy are having unexpected consequences for the economy's recovery.

We have now seen nearly eight consecutive years of growth since the end of the 'great' recession. When the process of recovery began, we suggested that growth for the foreseeable future would be much duller than had been recorded during the 15 years prior to the recession, but it would be safer.

To date, that seems to have been true. What we did not foresee, however, was that job creation would be as strong as it has been in the countries that have topped the growth league, or that productivity growth would be so weak. So, the next challenge facing advanced economies is how to encourage stronger productivity growth.

The weakness in productivity has had meaningful consequences. In particular, it is necessarily reflected in weak real wage growth. As a result, there has been a growing feeling in advanced economies that working people are not sharing in the benefits of growth. The benefits of growth are more apparent in the sharp declines in unemployment in countries such as the US, Germany and the UK. This feeling that working people are not experiencing the income growth that might have been anticipated has had effects not just on the economic arena but also in election results on both sides of the Atlantic – the rise in votes going to anti-establishment politicians and parties.

Over the past 40 years, there have been many economic cycles, each with its own characteristics. What is becoming more evident in the current cycle is the distinct lack of cyclicality in most advanced economies. This has led to problems for the economics profession, which is paid to analyse and anticipate developments in the economic cycle. As a result, most current economic commentaries attempt to superimpose cyclical analysis on a world that is more beholden to longer-term structural trends such as the disruption from technology, demographics and globalisation.

Different speeds

That is not to say that all economies are showing the same pace of growth – but the differences are proving more nuanced. In the UK, slower real income growth and Brexit uncertainty have caused a modest loss of momentum, although not to the extent that was initially predicted. The US has gained momentum during 2017, although not to the extent some anticipated at the start of the year. Meanwhile, the eurozone, having lagged the rest of the developed world, has seen a notable improvement during 2017 and looks set to record the best annual gain in GDP since 2010 – but still only just over 2%. Japan, also, looks set to beat forecasts, while lagging in the growth rankings for advanced economies.

Unsurprisingly, the structural trends alluded to previously, have been reflected in subdued inflationary pressure across the world, although there are still cyclical influences that can see inflation pick-up. In the UK, post-referendum weakness in the pound and a recovery in commodity prices have

put upward pressure on prices. The continuing low wage inflation in the UK, US and Germany, where labour markets have tightened to a degree that would normally lead to higher labour costs, with labour demand remaining strong, and employment rates at high levels, remains a conundrum. Why this is not feeding through more directly to wages is not immediately obvious. In Germany and the UK, migration may have had an influence as would greater participation in the US labour force by those who dropped out during the recession. Even so, wage inflation should have become a more obvious problem by now!

Low wage inflation has taken pressure off policymakers. The tone of global policy debate seems, however, to have changed, particularly in the US, where a gentle process of normalising interest rates is under way. Whereas in the past, the US Federal Reserve (The Fed) had been looking for excuses not to raise interest rates, it now appears that rates will edge higher unless there are conspicuous reasons not to. In the UK, it is expected that rates will start rising by the end of this year, and in the eurozone, the ECB is expected to tone down the extent of its quantitative easing over the coming year. The approach is still softly-softly, but there does appear to have been a mood change.

We believe that by maintaining a near-zero interest rate policy over a prolonged period, central banks have inhibited productivity growth. By forcing down the risk-free rate, central banks have taken away the challenge to grow profits at a rate faster than GDP growth.

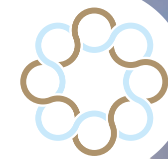
Looking ahead

If we are correct in our views about the impact of low interest rates on productivity, then rising rates should be associated with stronger output per person, first in the US and then elsewhere. This will prove the next and potentially more exciting chapter of the recovery and normalisation story.

If productivity growth does not respond, however, even the current dull growth rates will prove impossible to sustain.It is important to also consider valuation, sentiment and risk when building your portfolios, as economics alone will not provide the answer!

There are very few equity markets that can currently be described as cheap on traditional long-term measures such as price/earnings or price/book, although the strong earnings growth we are currently seeing gives an element of comfort. Bond markets are not offering compellingly attractive returns at current yields, especially when inflation is taken into account.

It is always a concern when sentiment and consensus is as unanimous as it is today, with commentators and investors both universally positive on equities and negative on government bonds. This 'chorus of consensus' does temper our enthusiasm for being overweight in equities – our positioning is more neutral. We do, however, concur with the negative view on bonds, where we maintain our long-held underweight position.



There are a number of potential risks that could upset the current calm and low volatility in investment markets; the biggest risk currently would be an unexpected downturn in developed economies, something that we watch for very closely. There is a risk as central banks try to 'normalise' monetary policy through higher interest rates and reversing quantitative easing, that asset markets are adversely impacted, but the respective central banks have been working very hard to communicate clearly the measures well in advance of implementation. Closer to home, a disorderly and hard Brexit would have an impact on all UK asset prices in the short term, as would a Corbyn government, and we watch very closely the level of foreign currency exposure in portfolios.

Overall, we remain comfortable with our positioning given the supportive environment of dull but synchronised global growth and subdued inflation, but are vigilant for the risks we have identified.

First published on 12th October by Caspar Rock, Chief Investment Officer, and Richard Jeffrey, Chief Economist, at Cazenove Capital Management.

MARKET IMPLICATIONS OF THE BANK OF ENGLAND INTEREST RATE RISE

As widely expected, the Bank of England (BoE) raised its benchmark interest rate by 0.25% to 0.5% in the November meeting, with a majority of 7-2 voting in favour. This is the first rate increase in the UK for over a decade.

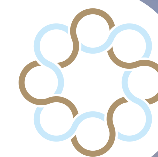
The Monetary Policy Committee (MPC) voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases at £10 billion and UK government bond purchases at £435 billion. With regards to forward guidance, all members agreed that future increases in Bank Rate would be 'limited' and at a 'gradual pace'.

With Consumer Price Index (CPI) inflation hitting 3% in September, UK economic activity remaining resilient and a continuing erosion of spare capacity, the inflation tolerance of the BoE has clearly declined. Indeed, the MPC judged that inflation is unlikely to return to 2%, at least until 2021, without some further adjustment in monetary policy. In our view, with the unemployment rate at a 42-year low (and generally strong labour market data), resilient household consumption, real earnings likely past its worst and a strengthening external backdrop, reversing the 0.25% rate cut last July is wholly justified and ought to be reinforced by further rate rises in the coming year. That said, the outcome of Brexit negotiations remains an important determinant of policy outlook and the BoE will remain highly data dependent.

The BoE's GDP growth forecasts are little changed but the unemployment rate projection has been revised down meaningfully. The expected path for CPI inflation has been revised marginally lower, although the expected Q4 2017 peak has been revised up to 3.0% from 2.8%. As noted above, without further policy action, inflation is expected to remain above the 2% target at least until 2021. Our view is that, although the rise in UK inflation is largely attributable to sterling weakness, there is a risk that second-round effects could be greater than expected. Moreover, there could be a weakening in inflation anchoring if households and companies begin to incorporate higher prevailing inflation rates into expectations – with those expectations then feeding through into wage demands and price-setting decisions.

The 0.25% increase in interest rates is unlikely to have a significant impact on economic activity. The economy is still generating growth in employment, household debt as a percentage of GDP has come down and many households will still be refinancing at lower mortgage rates. Also, the banking system and company balance sheets are generally in solid shape. The markets reacted to the MPC removing the line "monetary policy could need to be tightened by a somewhat greater extent over the forecast period than current market expectations" from the previous minutes. 10-year gilt yields fell by more than 8 basis points and sterling weakened by around 1.5%, as the markets perceived this as a dovish interest rate hike.

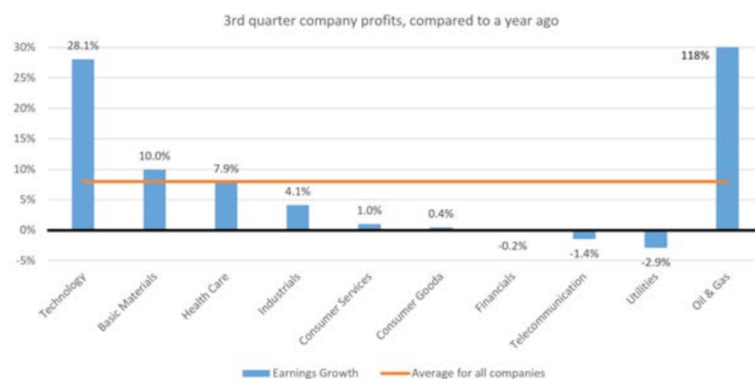
First published on 3rd November 2017 by Richard Jeffrey, Chief Economist, and Alex Smitten, Head of Fixed Income, at Cazenove Capital Management.



MARKET CONFIDENCE FUELLED BY GOOD COMPANY EARNINGS GROWTH

As publicly traded companies announce strong earnings growth for the last three months, markets have had a relatively muted reaction, meaning good results were expected. As the global economy heads into 2018 on a reasonably sure footing, it's tough to keep perspective when things are looking so positive.

This time last year we were concerned that earnings growth was largely driven by cost containment rather than businesses growing their revenue. But third quarter earnings reports in the US show that the revenue growth momentum we saw earlier in the year continues to hold up. So far sales growth is at 6.2%, contributing to an increase in earnings growth of 8.0% (as at 01.11.17), going some way to justify stock market highs.



Sectors performing particularly strongly include technology, as well as oil and gas. It's no surprise to see technology deliver the fastest growth, but it's impressive nonetheless given that 7 of the 10 largest businesses in the world are tech companies. The success of the oil and gas sector is largely attributable to a terrible 2016, so the growth is really just a return to profitability.

Meanwhile, the financial sector is not faring so well. Financial services firms make money when there is volatility, and so they have not done particularly well in their trading divisions. Businesses listed in the UK do not have to report quarterly earnings so there are fewer companies reporting here.

So far though, the outlook is positive for those that have. Sales growth is up 6%, and earnings growth is up 4%, although we should be careful not to take this at face value as a few outliers are disproportionately affecting this reading. Good performance is largely attributable to the fact that most UK-based businesses earn a significant proportion of their revenue outside of the UK. With the weakness of the pound after Brexit, and the euro showing increasing strength, it's no surprise that sterling profits are higher.

"Market confidence remains high, as do equity valuations. While this is positive news for investors, we must remain disciplined and not let short-term optimism take us away from a robust valuation orientated framework. After all, it's when valuations are reflecting the most optimistic outcome that the risk of a surprise is highest." - Philip Smeaton, Chief Investment Officer.

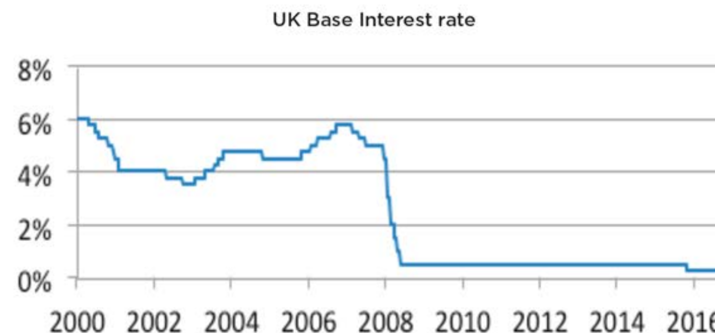
Positioning for growth, whilst protecting from downside risk

As markets continue to ride the crest of a wave, and global growth remains strong, it feels slightly negative to be talking about downside risk. But we wouldn't be doing our job if we didn't feel concerned about inflated asset prices, and what a market correction could mean for our clients. In previous months, we've reported an underweight position in equities – especially in the US where prices are particularly high. Of course, being underweight in an asset class doesn't meanwe're not invested and able to reap the rewards that are out there. But, as markets rise, it's important to be mindful of the increasing level of risk for investors, as a negative economic surprise would lead to a larger fall in asset prices.

To express a moderately cautious outlook whilst still being 'in play', we're looking at moving cash into a defensive structured product called an Autocall. This is a complex product that trades some of the upside for protection against the first part of a market's fall. For example, it promises to return roughly 7% per annum whether or not markets continue to rally. In fact, if equity markets fall by up to 40% by the time the product matures in six years' time, the product still delivers 7% per annum. It's not risk free, however. If equity markets fall more than 40% at maturity, then this product will underperform. However, history suggests that this outcome is unlikely, and we have selected equities where we think the risk is even further reduced. We certainly feel it complements other holdings, particularly in an environment where there are few opportunities.

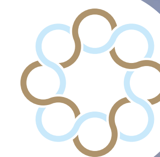
Bank of England increases interest rates

The UK has not seen an increase in its base rate for over 10 years, so this month's announcement marks a significant moment, even if markets saw it coming. The graph below reminds us how quickly, and by how far, the rate of interest fell in the wake of the 2008 financial crisis, and for how long it has remained close to zero.



Source: Bloomberg

The Monetary Policy Committee (MPC) has a clear mandate to keep inflation at 2%. This maintains price stability, and gives people confidence that the currency will maintain most of its purchasing power. With the Consumer Prices Index (CPI) rising to 3% in September, its highest level since April 2012, the MPC has taken preventative action to head off the possibility of further inflation increases, and the need for aggressive rate hikes in the future. We don't think this is the start of a series of rate increases. Indeed, we believe inflation will return to target levels of its own volition, as the effects of a weak Sterling dissipate.

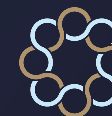


“The UK economic environment remains challenging, with consumer and government spending expected to be flatl whilst the Brexit negotiations delay business investment. We expect the inflation outlook to stabilise, and consequently for this to be the first, and last, interest rate hike we will see for a while. Hopefully a continued low interest rate environment can offset some of the reasons to be cautious.” - Matthew Brittain, Investment Analyst.

First published on 7th November by Sanlam UK.

The contents of Points of View is for general information only and is not intended to be advice.

No individual should act on it without consulting a regulated professional Financial Adviser for a full review of their circumstances. Investments can go down as well as up.



FINURA

PARTNERS

Level 2, Juxon House, 100 St Paul's Churchyard, London, EC4M 8BU

T: +44 (0)20 3102 7730 **E:** enquiries@finurapartners.com **W:** finurapartners.com

Finura Partners Limited is an appointed representative of CAERUS Financial Limited. CAERUS Financial Limited is part of the CAERUS Capital Group, which is wholly owned by Intrinsic Financial Services Limited. Old Mutual Wealth Holdings Limited owns 100% of the share capital of Intrinsic Financial Services Limited.

CAERUS Financial Limited is authorised and regulated by the Financial Conduct Authority. FCA number 497604.
Caerus Financial Limited is a limited company registered in England & Wales, registered number 06784783, registered office, Wiltshire Court, Farnsby Street, Swindon SN1 5AH

Finura Partners Limited: Registered in England. Registered Number 09560937. Registered Address: 30 City Road, London, EC1Y 2AB.