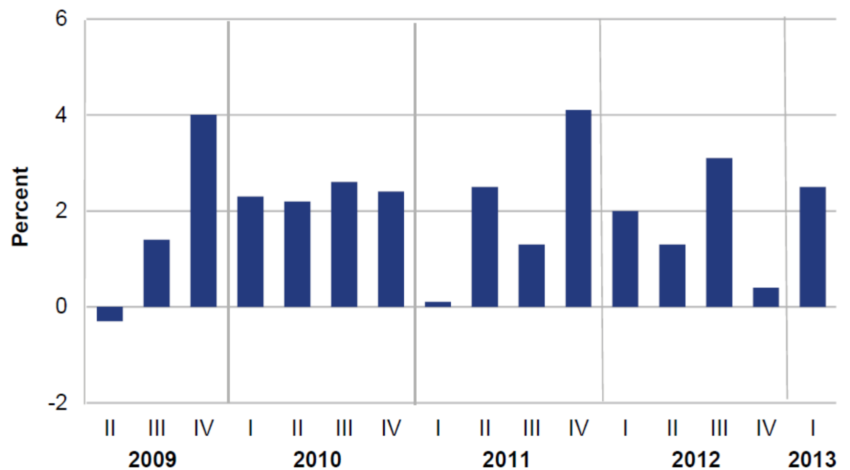
THOMAS MILLER INVESTMENT

TMI Investment Commentary

May 2013

Macroeconomic Assessment

In a continuation of recent trends the bulk of reports on the global economy over the past month have been weaker than consensus forecasts. For the US, weak manufacturing data reinforced evidence from several other sources including retail sales, labour market and ISM business condition indices that the pace of US economic growth has slowed in recent weeks. A key report released in recent weeks was the advance reading on first quarter GDP. The data showed that the US economy grew at an annualised pace of 2.5% in Q1 versus consensus forecasts of 3.0%.



Real GDP growth is measured at seasonally adjusted anual rates

Source: Bureau of Economic Analysis

While the 2.5% growth rate was weaker than expected, it represented a strong rebound from the 0.4% pace of growth recorded in the last quarter of 2012. The gains were driven by a recovery in inventory investment, acceleration in consumer spending and ongoing recovery in residential construction. On the downside, contraction in government spending was a drag on growth. Notably, the acceleration in consumer spending was fuelled by a decline in the saving rate which fell to 2.6% from a previous rate of 4.7%. Real disposable incomes declined by 5.3% over the quarter. Looking ahead to the rest of the year, leading economic indicators continue to suggest ongoing growth. However, weaker incoming monthly economic data and forward looking survey evidence point to a slower pace of growth in the second quarter. Further contraction in government spending (perhaps driven by sequestration spending cuts) is likely to reinforce the slowdown.

Economic conditions in the Euro-zone deteriorated in the first quarter and early indications are that the region's economy contracted in Q1 2013. In response to the weakness in the incoming data and the sharp decline in underlying inflation, the ECB cut the main refinancing rate by 25 basis points in early May. In our view, while the rate cut is welcome, its impact on the real economy is likely to be limited. Growth in the Euro zone is expected to remain weak for some time and the ECB would need to provide stronger stimulus in the months ahead.

In the UK, Q1 GDP grew at a pace of 0.3%, exceeding market forecasts of a growth rate of 0.1%. The services sector led the recovery, with an expansion of 0.6% over the period. There was also a positive contribution from production industries while construction industries detracted from growth. The report from the ONS also showed that UK GDP has been broadly flat over the past 18 months and remains about 3% below the pre-recession peak.

The better than expected Q1 GDP report was welcome if only because it helped to avoid another series of negative headlines that could have undermined consumer and business confidence further. However, the issue of whether or not the UK suffered a triple dip recession misses the point. Recessions are more than mere statistical events! Households continue to feel the squeeze from falling real incomes and weakening labour market, bank lending remains weak despite the efforts of policymakers and fiscal consolidation is set to remain a drag on growth for some time yet. Overall, while the recent string of more positive data on the UK economy has generated a lot of excitement and renewed optimism, the evidence on the outlook for the next few quarters remain mixed and significant headwinds persist. Nevertheless, the positive change in direction is encouraging.

Financial market & Investment strategy

Equity markets experienced higher volatility during the last month but still delivered strong returns. In line with the pattern observed in the first quarter, Japanese equities led global equities higher in April with total returns of just under 12% for the month (in local currency terms). The Nikkei index has now returned about 43% for the first four months of 2013. The S&P 500 index and the FTSE All Share index returned about 1.9% and 0.6% in local currency terms respectively for the month. European equities outperformed their US and UK counterparts with gains of about 4.2% on the Euro STOXX index.

In the fixed income markets, yields generally declined in April. The yield on 10-year US government bonds fell from 1.85% to 1.67%. Likewise, yields on 10-year UK Gilts and 10-year German government Bunds declined by about 8 basis points over the month. Periphery

bonds continued to see strong demand too. For the year to date, yields on 10-year Greek government bonds have fallen by about 230 basis points. Likewise, equivalent yields for Portugal, Spain and Italy have declined by about 135, 85 and 45 basis points respectively.

In the currency markets the US Dollar weakened against the Euro and sterling in April but strengthened against the Japanese Yen. Sterling rallied following the Q1 GDP report on the back of a combination of short covering and investors' expectations that the better-than-expected data would delay any further quantitative easing that the BOE might have been considering. While we agree with that assessment, the reality remains that the UK economy continues to face a number of headwinds which warrant further policy support. In light of the government's choice regarding the speed of fiscal adjustment, the onus remains on the Bank of England to do more to support the economy. On that basis, the bounce in sterling is likely to be temporary, and GBP is likely to come under renewed selling pressure in the weeks ahead. Likewise, deteriorating regional growth and falling inflation should continue to weigh on the euro.

As we noted last month, the different messages from coincident and leading economic indicators present something of a dilemma for asset allocators. On one hand, market experience over the past two years would suggest that a Spring slowdown could coincide with a short term corrective selloff in risk assets. On the other hand, the combination of an upswing in leading indicators and substantial pool of liquidity should continue to provide strong support for equities despite the magnitude of the rally that we have seen so far this year.

We are mindful that equities face a number of notable sources of downside risks. However, on balance, we continue to believe that the backdrop of steady, albeit slow, global economic growth; moderate inflation; resilient corporate earnings; and loose monetary policy favour risk assets. Consequently, our current investment strategy is to be overweight equities, underweight cash and neutral on fixed interest. Within the fixed interest asset class, we continue to favour corporate bonds over government bonds.

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