THOMAS
MILLER
INVESTMENT

Investment Commentary

December 2017

Recent economic developments

■ The global economy has maintained strong momentum going into the year end. In the US, GDP growth in the third quarter was revised higher to 3.3%, the fastest pace of growth in three years, from an initial estimate of 3%. The upward revision was largely a result of stronger than estimated business investment and higher government spending. Furthermore, the strong economy is boosting consumer confidence which rose to a 17-year high in November. This may result in higher consumer spending and further reinforce the ongoing economic expansion.

■ The pace of growth has also led the Federal Reserve Bank (Fed) to reaffirm its plan to raise interest rates again in December. However, the recently-released minutes of the Fed's last meeting also flagged ongoing debate within the central bank about the outlook for inflation, with several members seemingly unconvinced that the bank would be able to hike rates three times in 2018 as it currently expects.

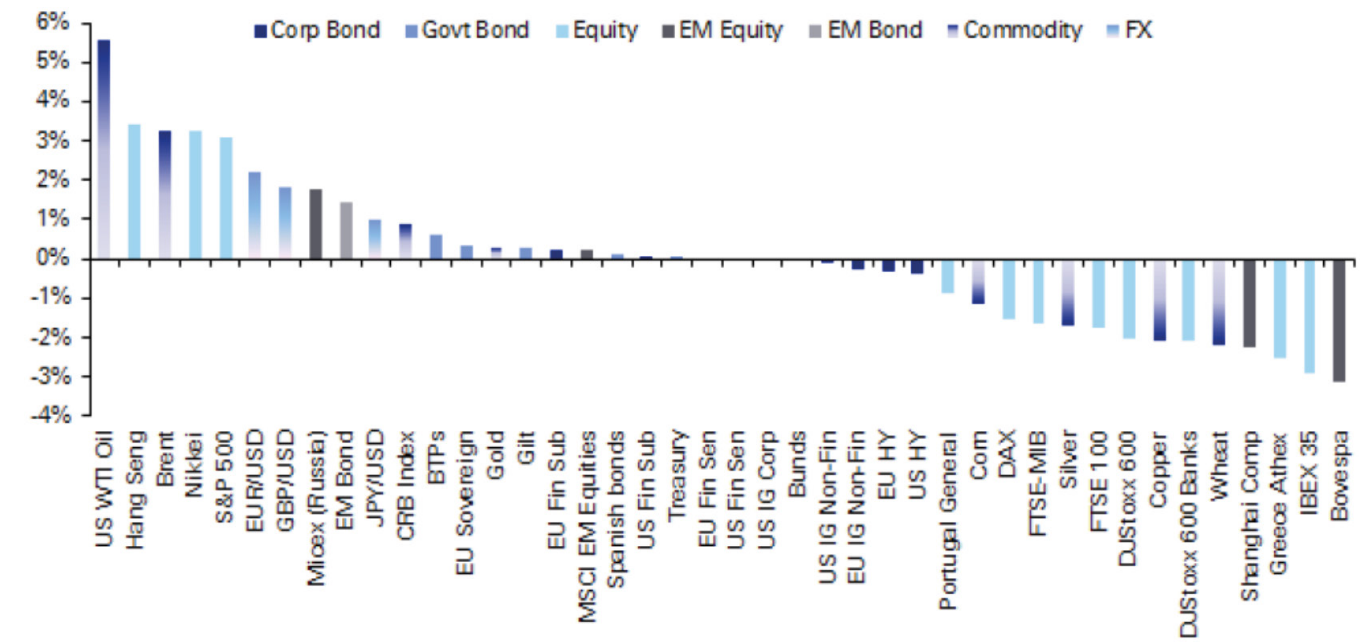
"Across the Euro-zone, economic activity is at its strongest pace in a decade. The strength of business and consumer confidence indices and various leading indicators of economic activity suggest that the positive growth momentum should carry through into the New Year."

■ Notable developments in the UK over the past month have included the publication of the 2017 budget by the Chancellor of the Exchequer and revisions to economic forecasts by the Office for Budget Responsibility (OBR). The budget itself was a mixed bag and direct market impact has been muted. Arguably, of greater significance was the fact that the OBR downgraded the outlook for the UK's productivity growth, business investment and GDP growth over the next five years. The OBR now expects the UK's GDP growth rate to decline progressively for the next few years, reaching a low of 1.3% in 2019 and 2020 before rising again to 1.5% in 2021. The OBR's view on the labour market is also worth flagging. Essentially, it sees the current unemployment rate of 4.3% as the trough.

■ If the OBR's latest estimates on GDP growth rate and the labour market are correct, then the next few years could bring a combination of weakening economic growth and rising unemployment. The government may find itself with a lot less room for manoeuvre.

■ Elsewhere in the developed markets, the Euro-zone continues to enjoy a strong period of economic performance. Across the region, economic activity is at its strongest pace in a decade. The strength of business and consumer confidence indices and various leading indicators of economic activity suggest that the positive growth momentum should carry through into the New Year.

Chart 1: Total return performance of major global financial assets (Local currency)



Source: DB, Bloomberg, Markit

Financial markets and investment strategy

■ In recent weeks, the financial markets have been boosted by growing optimism about the proposed tax cut package that is currently being finalised in Washington. In contrast, bond yields have risen (and capital values fallen) as a raft of economic data releases have pointed to stronger growth and reinforced the case for further tightening in monetary policy in the US and less accommodative policy stance elsewhere.

■ While there has been a broad-based rally across global equity markets, financial stocks and small capitalisation stocks have performed particularly well on the back of the news. The financial sector has also benefited from investors' expectation of a looser regulatory regime under the Trump administration. Technology stocks experienced a more volatile month on the back of profit taking and sector rotation following what has been a strong year for the sector.

■ Across global equity markets, in November, the Asian markets led the way, with the Hang Seng and Nikkei up about 3.4% and 3.2% respectively. The US S&P 500 index was not far behind with a gain of about 3.1%. European equity markets lagged, with losses of -2.0% and -1.6% on the DJ Stoxx 600 and the German DAX indices respectively. The UK stock market followed the rest of Europe lower, with a decline of -1.8% on the FTSE 100 index. [All in local currency terms].

■ In the developed markets, small losses on corporate bonds were balanced by small gains on government bonds. The pattern was similar for emerging market bonds although the magnitude of the gains on EM sovereign debt was larger.

■ As the year winds down and trading volumes decline, we favour a neutral asset allocation stance with portfolio positioning broadly in line with longer term strategic weightings across the major asset classes.

■ We expect equity markets to approach 2018 in buoyant mood. However, we remain cognisant of risks that lie ahead. For instance, the debate surrounding the debt ceiling in the US, the possibility of another flare up in geo-political risks and uncertainties around Fed policy under a new Chair are just some of the challenges that investors will have to contend with in the New Year.

Abi Oladimeji
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ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 4th December 2017)

	United States	United Kingdom	Euro-Zone ex UK	Asia ex Japan	Japan	Emerging Markets
Equities (overall)	0					
Equity allocation by Region	0	0	+	0	0	0/+
Bonds (overall)	0					
Agency/ Supra	0	0	0	0	0	0
Corporate bonds	0/-	0/-	0/-	0/-	0/-	0/-
High Yield bonds	-	-	-	-	-	-
Govt guaranteed bonds	+	+	0	0	0	0
Index-linked bonds	0	0	0	0	0	0
Alternatives	+					
Cash	0/-					

The scorecard above represents our current tactical asset allocation position relative to portfolio benchmark. 0 = neutral, + = overweight, - = underweight.

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