Investment Commentary

THOMAS MILLER INVESTMENT

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Recent economic developments

From a global perspective, economic reports over the past month have painted a picture of stable growth momentum and the evidence suggests that following a slower than expected pace of growth in some key regions during the first few months of the year, the next six months should see a modest acceleration in the growth rate of economic activity.

In line with these broad expectations, a key message of the OECD's latest Global Economic Outlook is that global growth is expected to pick-up modestly over the next 12-18 months. The OECD also noted that productivity and wage growth remain subdued and financial stability risks persist. The chart below outlines the organisation's latest projections.

The forecast of 3.5% growth rate for the world economy in 2017 represents an uplift from the 3.3% estimate published in March 2017 and, if correct, would mark the fastest pace of global economic growth in six years. However, the OECD warned that the improving outlook could be undermined by protectionism.

Important regional changes to growth expectations include a downgrade to the US outlook and an upgrade to the German outlook. The downgrade to the US outlook was driven by concerns about further delays to planned tax cuts and infrastructure spending by the new US administration. The outlook for the UK was left unchanged, with the organisation continuing to expect a slowdown on the back of Brexit uncertainty and weaker consumer spending.

Chart 1: OECD Forecasts of Real GDP Growth (year-on-year, %)

	2015	2016	2017	2018
World[1]	3.1	3.0	3.5	3.6
United States	2.6	1.6	2.1	2.4
Euro Area[1]	1.5	1.7	1.8	1.8
Germany	1.5	1.8	2.0	2.0
France	1.2	1.1	1.3	1.5
Italy	0.7	1.0	1.0	0.8
Japan	1.1	1.0	1.4	1.0
Canada	0.9	1.4	2.8	2.3
United Kingdom	2.2	1.8	1.6	1.0
China	6.9	6.7	6.6	6.4
India[2]	7.9	7.1	7.3	7.7
Brazil	-3.8	-3.6	0.7	1.6

NOTE: Difference in percentage points based on rounded figures.

1. With growth in Ireland in 2015 computed using gross value added at constant prices excluding foreign-owned multinational enterprise dominated sectors.
2. Fiscal years startiung in April.

UK Election Result: Does Brexit still mean Brexit?

In the UK, the revised estimate for Q1 GDP showed that the pace of economic growth during the quarter dropped to less than a third of the growth rate recorded in the previous quarter. The GDP report showed broad weakness across the economy led by the services sector. Consumer spending weakened, imports declined and production was weaker than previously reported. It is also notable that the UK's first quarter GDP growth rate was the lowest seen across all 28 members of the European Union, according to data released by Eurostat.

In light of the uncertainty surrounding the nature of any UK-EU trade agreement, economists have rightly regarded Brexit as a prominent source of downside risk to the medium-longer term outlook for the UK economy. Following the largely unexpected outcome of the June general election, it now seems probable that the country will avoid a so-called 'hard-Brexit' and thus reduce the anticipated negative impact on growth. If that turns out to be the case, then from a purely economic perspective the short term political uncertainty that the election delivered is arguably a price worth paying for such an outcome.

Financial markets and investment strategy

Despite occasional short-lived spikes in risk aversion, global equity markets have remained buoyant in recent weeks. Over the past month, US equities have led with gains of about 2% on the S&P 500 index. The FTSE 100 index has gained about 1% while the Euro Stoxx 50 index has lost about 2% over the same period (all in local currency terms). The gains have been driven by a combination of improving economic sentiment and an upturn in corporate earnings. For instance, according to data from Thomson Reuters, in the US about 63% of S&P 500 companies have reported Q1 2017 revenue above analyst expectations. This is above the long-term average of 59% and above the prior four quarter average of 53%. Likewise, just over 75% have reported earnings above analyst expectations, exceeding the long-term average of 64% and the prior four quarter average of 71%.

In the fixed income markets, yields have generally trended lower over the past month, with 10-year US Treasury yields having fallen to 2.11% by mid-June from about 2.40% a month earlier. Similarly, the equivalent 10-year UK Gilt yield has fallen to 0.96% from a previous level of 1.21%. As at the time of writing, the 2-year UK Gilt stands at 0.09%, reflecting investors' expectations that the Bank of England is unlikely to hike again for 18-24 months.

In the currency markets, the key development in recent weeks has been the renewed downtrend in sterling following the UK general election result. While sterling responded with a sharp decline as the exit polls came out, the reality is that GBP continues to trade within the tight range between $1.25 and $1.30. The eventual direction of travel is likely to be determined by the outlook for the Brexit negotiations. Expectations of a hard (soft) Brexit will likely result in sterling weakness (strength).

To summarise our asset allocation positions, we retain a cautious stance on equities, based on lingering concerns about stretched valuations and the rising risk of disappointment on the policy and, or growth front. We retain a neutral position on fixed income investments and continue to favour a carefully selected range of alternative investments, including infrastructure and listed private equity.

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Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 9th June 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	-
Bonds (overall)	0					
Agency/ Supra	0	0	0	0	0	0
Corporate bonds	0	0	0	0	0	0
High Yield bonds	0	0	0	0	0	0
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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