THOMAS MILLER INVESTMENT

Investment Commentary

March 2017

Improvement in economic sentiment across the globe

Recent economic developments

In March, the publication of the OECD's latest Interim Economic Outlook provided investors with another confirmation of the ongoing improvement in economic sentiment across the globe. The OECD outlined its forecasts for global economic growth to pick up modestly next year to around 3.6% from a projected 3.3% in 2017.

In the US, a second estimate of Q4 2016 GDP growth was left unrevised at 1.9% annualised, as an upward revision to consumption growth offset a downward revision to business investment growth. The wider picture is that US GDP growth accelerated markedly between the first and second halves of 2016 and the ongoing strength in survey data suggests that growth could continue at a brisk pace in the first half of this year too.

In a further sign of the improving sentiment on the UK economy, the OECD followed the recent lead of the Bank of England and the Office for Budget Responsibility by raising its forecast for growth in 2017. The OECD upgraded its forecast for UK GDP growth in 2017 to 1.6% from 1.2% in November. However, like the BOE and OBR, it warned of a weaker outlook for the UK in 2018 as rising inflation is expected to dampen consumption while uncertainty over Brexit could undermine business investment. For now though, key indicators continue to point to a decent pace of growth in the UK, albeit at a slower rate than in recent months.

Looking across the major emerging economies, it is worth noting that China recently lowered its 2017 economic growth forecast to 6.5% which is a 25-year low. The world's second largest economy had targeted growth of 6.5%–7.0% last year and achieved a reported 6.7% growth rate. Premier Li Keqiang's assertion that the government will continue implementing proactive fiscal measures while maintaining a prudent monetary policy was well received by investors. He also reiterated the Chinese government's commitment to supply-side reforms.

Divergence in global monetary policy

As widely expected, the Fed raised US interest rates by 0.25%. What appeared to catch a lot of investors off guard was the Fed's refusal to rise to the hawkish expectations of market participants, many of whom were seeking signs that the central bank might be considering a more aggressive response to increasing optimism on growth and rising inflation expectations.

As afore-mentioned, the pace of US economic growth picked up strongly in the second half of 2016 and key leading economic indicators continue to flag that barring any unforeseen negative shocks that positive trend should persist during the first half of 2017. Viewed in that context, the Fed's decision to move early in the year can be seen as prudent risk management. While there may be upside risks to inflation, there remain notable downside risks to growth projections.

Much of the optimism about the growth outlook in the US centres on the policy proposals of the new administration. Clearly, well-designed policies that cut taxes, boost infrastructure spending and reduce regulatory burden will stimulate growth and spur inflation. However, the delivery of these policy proposals entails significant implementation risks. The Fed is right to adopt a 'wait-and-see' approach. Should the growth momentum turn lower in the second half of the year, the Fed may yet find itself unable to implement the three hikes scheduled for 2017.

Away from the US, monetary policy is expected to remain loose in Europe, where the ECB recently committed to continuing its bond-buying programme until at least December 2017, while stating that it expects "interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases." Accommodative monetary policy stance is also expected to persist for some time in the UK and Japan. However, in China, the People's Bank followed the Fed's lead in raising rates in March.

As the OECD notes, divergence in global monetary policy represents a potential driver of volatility in financial markets and, if mismanaged, could generate instability and trigger policy errors.

Financial markets & investment strategy

In recent months we have written about the increasingly stretched nature of valuations across the major asset classes. It is noteworthy that the OECD's latest Interim Economic Outlook also flags this issue. The report highlights that the positive economic assessment reflected in market valuations appears disconnected from real economy prospects.

The OECD notes that "…equity valuations have increased significantly further in many major markets over the past six months, despite the large rise in nominal interest rates and with long-term nominal and real GDP growth expectations based on consensus forecasts barely changed. Expectations for corporate earnings growth in the euro area and the United States have also not been revised up over this period. The improvement in market sentiment also contrasts with continued low growth of consumption and investment, which still lag well-behind previous recoveries, and the slowdown in productivity growth with persistent inequality."

In the near term, our concerns relate to the emerging signs of stretched bullish sentiment and the risk that the acceleration in growth momentum that has occurred in recent months may now be past its peak. Consequently, we would expect to see incoming economic data begin to undershoot lofty expectations over the next few weeks. If this happens, risk assets could come under selling pressure.

Fixed income markets, particularly in the US, had been under intense pressure in the run up to the US central bank's decision. However, there are signs that the much anticipated tax and infrastructure programmes proposed by the new US administration may not materialise until late 2017 or even 2018 in which case, the pace of real US GDP growth in 2017 may be materially lower than consensus forecasts. Such an outcome would be supportive for US government bond prices.

Overall, we advocate broadly diversified portfolios with asset class exposures close to their longer term strategic weightings. Within equities, we prefer Euro-zone (excl. UK) and Japan to UK and EM. We have a neutral allocation to the US and Asia excl. Japan. Within fixed income portfolios, we are broadly neutral across the key segments but continue to prefer floating rate instruments where possible. We also continue to favour a carefully selected range of alternative assets such as social infrastructure, niche property sectors and re-insurance securities with low correlation to traditional assets.

Abi Oladimeji
Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD Effective March 2, 2017

	United States	United Kingdom	Euro-zone ex UK	Asia ex Japan	Japan	Emerging Markets
Equities (overall)	0/-					
Equity allocation by region	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 Guarenteed Bonds	+	+	0	0	0	0
Index-Linked Bonds	0	0	0	0	0	0
Alternatives	+					
Cash	-					

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

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