THOMAS MILLER INVESTMENT

Investment Commentary

March 2018

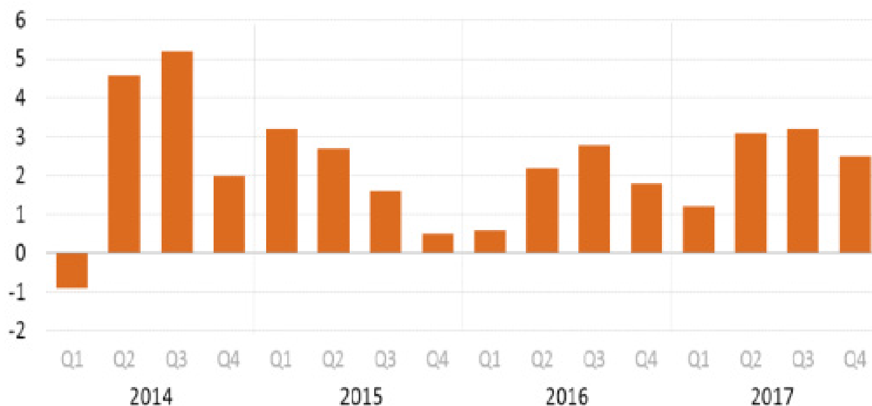
Recent economic developments

■ Over the past few weeks, economic reports across the G10 have been weaker than consensus forecasts. In the US, the second estimate of GDP growth rate for Q4 2017 was revised lower to 2.5% from a growth rate of 3.2% in the previous quarter. The initial estimate was for a growth rate of 2.6% in Q4. As the US Bureau of Economic Analysis noted, "the deceleration in real GDP growth in the fourth quarter reflected a downturn in private inventory investment that was partly offset by accelerations in PCE [personal consumption expenditures], exports, state and local government spending, non-residential fixed investment…and an upturn in residential fixed investment."

■ In the UK, recent reports showed a slightly slower pace of growth in the last quarter than previously reported as GDP growth rate in Q4 was revised lower to 0.4% from 0.5%. Overall, UK economic growth in 2017 was revised from 1.8% to 1.7%, the slowest pace since 2012. It is notable that data from the ONS also showed that in 2017, household spending grew at its slowest annual pace since 2012, highlighting the effect of the combination of rising inflation and weak wage growth. In this regard, it is worth noting that more recent data on inflation and wage growth indicate that the squeeze on consumers should ease in the months ahead. In terms of international comparison, The UK's year-on-year growth rate of 1.4% in Q4 2017 puts it at the bottom of the G7 growth league for the year.

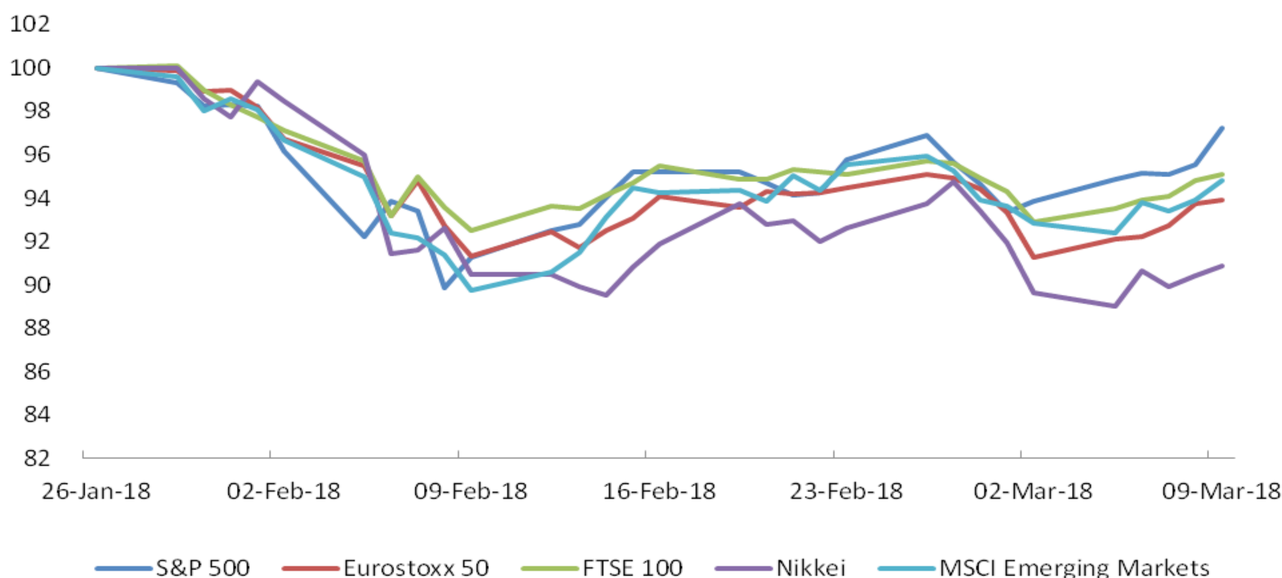
■ Looking across to the Euro-zone, year-on-year GDP growth rate was reported at 2.7% for the fourth quarter of 2017. Unlike the US and UK, the data was unrevised from the second estimate and also matched the previous period. However, the estimate for economic growth over the full year 2017 was revised lower to 2.3% from earlier estimates of 2.5%. Nevertheless, it was comfortably ahead of the 1.8% growth rate recorded in 2016.

Chart 1: US Real GDP - Percent change from preceding quarter



Source: US Bureau of Economic Analysis
Seasonally adjusted at annual rates

Chart 2: Decline and recovery in major equity markets; January - March 2018



Source: Bloomberg Data, Thomas Miller Investment

Financial markets & investment strategy

■ Most stock markets suffered significant losses in February. The notable exceptions were Brazil's Bovespa and Russia's MICEX which managed gains of 0.5% and 0.3% respectively in local currency terms. In the US, the S&P 500 index declined by -3.7% over the month. The worst of the sell-off was seen in Asia and Europe. In Asia, the Shanghai Composite and the Hang Seng lost -6.4% and -6.0% respectively (local currency terms). In Europe, losses of -3.8% and -3.4% were recorded on the Stoxx 600 and FTSE 100 indices respectively (again in local currency terms).

■ The losses were not limited to equities. Over the month corporate bonds, government bonds and a broad range of commodities, including gold, also recorded losses. This meant that there was little safe-haven cushion for diversified portfolios. Nevertheless, despite the sharp spike in volatility and widespread risk-aversion, equity markets have staged a recovery from the lows reached in February (illustrated in Chart 2).

■ Over the past year, the strong economic backdrop has boosted corporate earnings. For instance, Thomson Reuters recently reported that fourth quarter 2017 earnings in the US are expected to rise by about 14.8% from the same period a year earlier. Importantly, the strength in earnings has been broad-based, although the gains in the energy sector have been particularly notable. As at March 9th, 76% of the 493 S&P 500 companies that have reported earnings to date for Q4 2017 had beaten analyst expectations. This is above both the long-term average (c.64%) and the average over the past four quarters (c. 72%).

■ Overall, we continue to expect a moderately positive economic environment over the next few quarters and that should support corporate earnings. For this reason, we retain a modest overweight position on risk assets, including equities and selected alternatives. Downside risks to equities (and risk assets more broadly) derive from the potential for growth to undershoot consensus forecasts and elevated political risks, particularly relating to the increasingly heated protectionist rhetoric emanating from the US.

■ In the fixed income markets, we remain neutral on government bonds while slightly cautious on corporate debt which offer relatively little value as credit spreads remain tight. We also retain a neutral stance across the major currency pairs.

Abi Oladimeji
Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 8th March 2018)

	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	-	-	-	-	-	-
Govt guaranteed bonds	0	0	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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