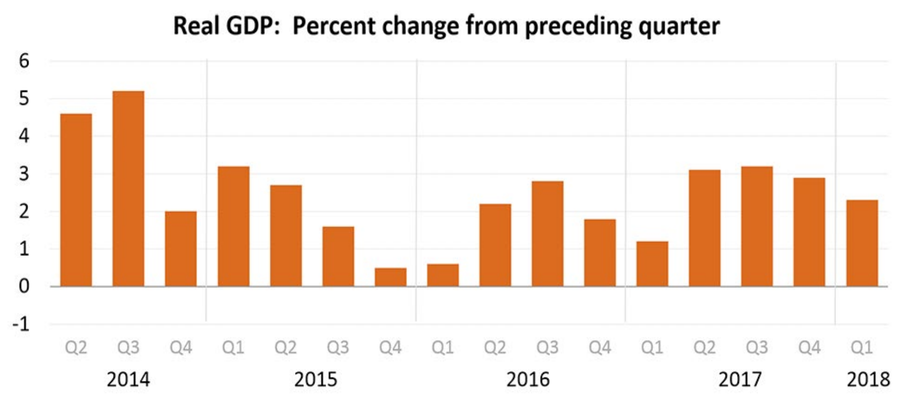
THOMAS MILLER INVESTMENT

Investment Commentary

May 2018

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



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

Synchronised global growth momentum fades

■ In line with the trend that has become apparent over the past few months, further signs of slower economic growth emerged over the last month. While the slowdown in growth momentum has been global, there have been notable regional variations in its severity, with the deceleration being more pronounced in Japan, UK and the Euro-zone than in the US and major emerging economies.

■ In Japan, GDP growth rate turned negative during the first quarter, marking the first such contraction in two years and halting the longest stretch of economic expansion since the 1980s. The weak performance was driven by several factors including severe weather, a slowdown in global demand for Japanese exports (partly due to the strength of the yen) and decline in corporate investment as the threat of protectionism has weighed on business sentiment.

■ Elsewhere, the preliminary estimate of UK GDP growth rate indicated that the economy ground to a halt in the first quarter. The reported quarterly growth rate of 0.1%, which followed a pace of 0.4% in Q4 2017, was the slowest reading in over 5 years. While severe weather contributed to the sharp slowdown, flagging composite leading indicators and weak money supply growth suggest that the soft patch may not be entirely transitory. On a more positive note, the combination of ongoing strength in the labour market with improvement in wage growth and falling inflation should provide some respite for the stretched UK consumer.

■ In the US, the first estimate of first quarter GDP showed that the economy expanded at an annualised rate of 2.3%. That pace was lower than the outcome in each of the previous three quarters, during which GDP growth had averaged in excess of 3% annualised. The US Bureau of Economic Analysis reported that the slowdown in real GDP growth rate from 2.9% in Q4 2017 reflected decelerations in private consumption expenditures, residential fixed investment, exports, and state and local government spending. More positively, there was an upturn in private inventory investment during the quarter. Furthermore, emerging data showing stronger than expected retail sales, ongoing strength in labour market and a recent upturn in homebuilder sentiment suggest that the US economy looks set to have a strong second quarter.

■ Data on the Euro-zone economy has been particularly disappointing in recent months as key economies including Germany and France have experienced sharp decelerations in GDP growth rates. In Q1 2018, Germany's GDP growth slowed to half the pace recorded in the previous quarter. Likewise, France's GDP grew at a pace of 0.3% in Q1 versus 0.7% in the final quarter of 2017.

■ As with other regions where severe weather has played a part in the tepid pace of economic growth recorded in the first quarter, there are indications that the slowdown in the Euro-zone economy may not be entirely transitory. For instance, the ECB's chief economist recently noted that the recent slowdown could be a sign that supply-side constraints are becoming increasingly binding in some sectors and countries. If correct, this would have important implications for monetary policy in the months ahead.

Monetary policy, financial markets & investment strategy

■ Early in the first quarter, consensus expectation was that growth would accelerate over the course of the year, driving up inflation and forcing central banks to rein in monetary stimulus. Central bankers also shared this expectation and major institutions including the US Federal Reserve (Fed), the Bank of England (BOE) and the European Central Bank (ECB) guided investors to expect some tightening in policy settings. Perhaps the most striking example of the failure of this guidance has been in the UK where, following its meeting in February 2018, the BOE argued that earlier and more frequent rate hikes were needed. On the back of the comments by Mark Carney, the Bank's governor, sterling rose sharply on the currency markets and the yield on the 2-year Gilt jumped to its highest level since late 2015. Those market moves have since reversed and the BOE has done another about turn.

■ Overall, the past month has seen sharp gains in equity markets, led by the UK and European indices. Stock market performance has been boosted by a strong earnings season, diminution of geopolitical concerns and easing (at least temporarily) of US-China trade tensions. In the currency markets, the dominant theme has been the strong rebound in the US Dollar. This has driven down other major currencies and weighed on emerging market assets. The strength of the USD has also fuelled an outperformance by domestically focussed US small capitalisation stocks relative to their more international large cap peers. With the exception of US government bond markets, where yields have continued to rise on the back of lingering expectations of two further hikes by the Fed this year, fixed income markets have also performed reasonably well. In the US, concerns have shifted to implications of a flattening yield curve for the economic outlook, with investors worried that the Fed may miss the signs of waning growth and tighten too much.

■ From an asset allocation perspective, we retain an overweight position in risk assets, including equities and a selected range of alternative investments. Fixed income markets require greater regional variation in investment strategy. Looking across the UK and European markets, the prevailing level of yields still means that government bonds continue to offer poor value for the risk involved. That view is less clear cut in the US where yields have risen above 3% and 2.5% at the 10-year and 2-year maturities respectively. In anticipation of further flattening of the US government bond yield curve, we favour the long end relative to the short end of the curve. We are starting to cut back on corporate bonds as spreads have tightened materially and there is now much less reward for taking credit risk.

Abi Oladimeji
Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 3rd May 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	+	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	0/+					
Cash	-					

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

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