THOMAS MILLER INVESTMENT

Investment Commentary

September 2017

Recent economic developments

Economic reports over the past month have been broadly positive. Data showed that across the OECD area, quarterly growth of real GDP accelerated from a pace of 0.5% in the first quarter of 2017 to 0.7% in Q2. On a year-on-year basis, GDP for the OECD area increased by 2.4% in Q2 2017 compared with a growth rate of 2.1% in the previous quarter. GDP growth accelerated strongly in Japan and the United States while also showing slight quarter-on-quarter improvement in the United Kingdom. Also, growth was stable in France and Italy while it slowed marginally in Germany.

The chart below compares GDP growth data over the first two quarters of 2017 for selected countries and regions.

In the US, second-quarter GDP growth was revised higher to 3% from an initial estimate of 2.6%. That marked the fastest quarterly pace of growth in two years. The better-than-forecast data was driven by a larger gain in business investment and stronger consumer spending.

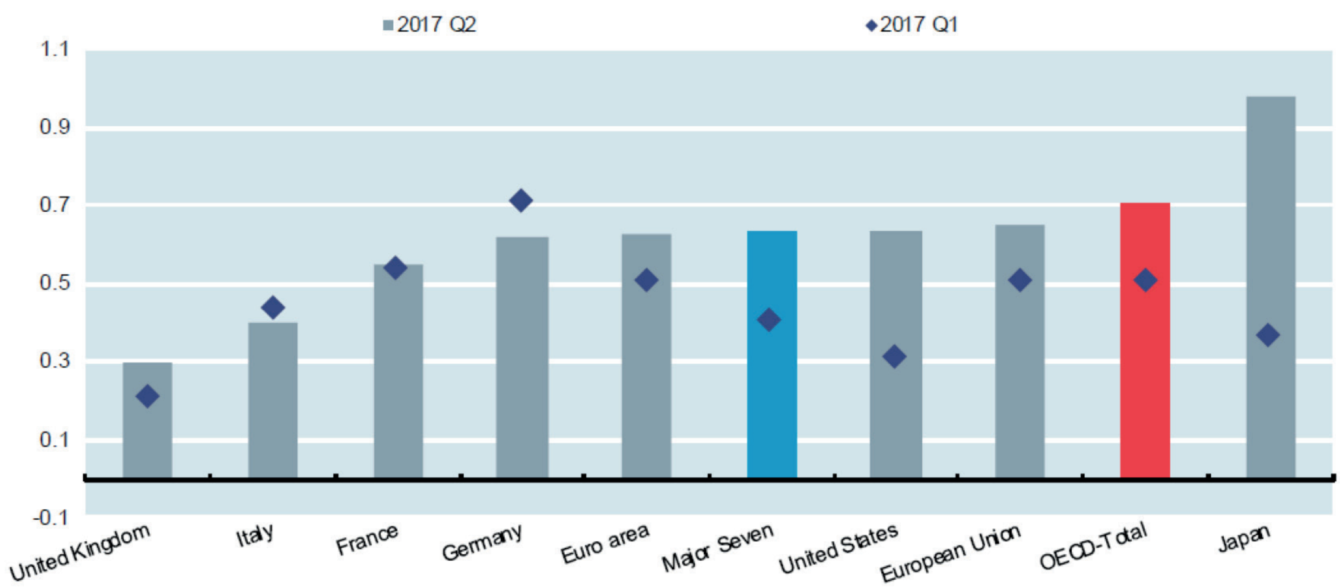
"... Looking ahead to the next few months, some of the pressure should ease as inflationary pressures wane ..."

In the UK, economic performance in the first half of the year was lack lustre and early indications are that the momentum of growth has not picked up in the third quarter. While there has been some positive news from the manufacturing sector where a recent survey of purchasing managers flagged the fastest pace of growth in four months, reports have showed that the services sector grew at the slowest pace in almost a year in August. Furthermore, the combination of high levels of indebtedness, weak wage growth, sustained inflationary pressure and elevated uncertainty around ongoing Brexit negotiations has left the UK consumer unable to sustain the pace of spending seen in recent years.

Looking ahead to the next few months, some of the pressure should ease as inflationary pressures wane. Nevertheless, the balance of evidence suggests that the risks to UK economic growth remain tilted to the downside.

Gross Domestic Product

Percentage change on the previous quarter, seasonally adjusted data



Source: OECD, August 2017.

Financial markets and investment strategy

The majority of equity markets ended August on a firmer footing. In local currency terms, gains were led by emerging market equities, where the Bovespa (Brazil), Micex (Russia) and Shanghai Composite (China) delivered total returns of 7.5%, 5.3% and 2.8% respectively. In the developed markets, the UK's FTSE 100 index and the US S&P 500 index returned 1.7% and 0.3% respectively. European stock markets bucked the trend with declines across the board. The German DAX fell by about 0.5% while the broader DJ Stoxx 600 index lost 0.8% for the month.

"...Volatility also rose across other assets as investors weighed the impact of political upheaval in Washington and the risk of military conflict in the Korean peninsula..."

The monthly data masks a spike in volatility across the financial markets during August. For instance, the FTSE 100 index hit a high of about 7552 on the 8th of August and then traded as low as 7289 on the 29th of August before recovering to finish the month at 7431. Volatility also rose across other assets as investors weighed the impact of political upheaval in Washington and the risk of military conflict in the Korean peninsula.

While the rebound in risk assets in the last few days of the month would seem to imply that investors have recovered their risk appetite, the performance of safe havens over the period suggests that investors remain apprehensive. This is demonstrated by the sharp decline in bond yields (and rise in bond prices) and the strong rally in gold. In the UK, Gilts returned about 2% in aggregate while US Treasuries and German Bunds returned 1.1% and 1.3% respectively in local currency terms. Likewise, gold (spot) rallied 4.1% over the month.

Monetary policy expectations

The key trend in currency markets in recent months has been the broad weakness in the US Dollar. Arguably the key factors weighing on the USD have been investors' exasperation with the ineffectiveness of the Trump administration and recent downward revisions to expectations for monetary policy tightening by the Fed in the face of waning inflation and dovish comments from various members of the Fed's Board.

Looking ahead, the evidence suggests that the downturn in US inflation since the middle of the first quarter looks set to continue while some important leading indicators are starting to flag diminishing growth momentum. These suggest that the Fed's scope for more substantial monetary policy tightening may be limited.

The euro's trade-weighted exchange rate has appreciated significantly since the start of 2017. This has reflected the Euro-zone's stronger economic performance and investors' expectations that the European central bank (ECB) would soon start to rein in liquidity by tapering its quantitative easing programme. The ECB faces a delicate balancing act. While it seeks to avoid inadvertently providing incentives for excessive risk taking by flooding the markets with liquidity, it is also mindful that, over time, the euro's strength could pose a significant headwind to growth while also weighing on inflation. On balance, the ECB seems more likely to take measures to curb the euro's strength rather than amplify it.

Unlike the euro's rally, which has been driven by improving fundamentals, sterling's strength in recent weeks has taken place in the context of weakening UK economic fundamentals. Indeed, while GBP has held up well against the US Dollar, it has lost further ground against the euro in recent weeks. The primary driver of GBP's gains has been investors' concerns that persistent inflation may force the Bank of England (BOE) to adopt a more hawkish tone and potentially tighten policy earlier than previously expected. At the time of writing, sterling is trading above $1.3260 against the USD and markets are fully pricing one rate hike by the BOE by August 2018.

"...key factors weighing on the USD have been investors' exasperation with the ineffectiveness of the Trump administration and recent downward revisions to expectations for monetary policy tightening by the Fed..."

Monetary tightening can often serve as a positive signal if it is a response to strong economic growth. However, rate hikes by the BOE at this point would be counterproductive as it could undermine economic activity at a time when both consumer and business confidence are already flagging. Looking ahead, sterling looks likely to trade within the $1.28 to $1.35 range against the USD. In the shorter term, there is scope for further upside towards the upper end of this range. Greater clarity on the Brexit negotiations will be required for a sustained break above this range.

Investment strategy summary

In broad terms, our asset allocation views remain largely unchanged from last month. In recent months we have positioned portfolios in anticipation of an increase in market volatility and downside risk. At this point, our assessment of the economic and financial market landscape leads us to retain that cautious stance.

Consequently, we continue to trade off underweight positions in equities for overweight positions in a selected range of alternative investments which exhibit lower volatility and modest correlation with mainstream asset classes. The fixed income asset class, particularly developed market government bonds, continues to provide an effective hedge in the prevailing environment. For this reason, we maintain benchmark weighting to fixed income investments across key developed markets. Our more positive longer term outlook for equities means that we will view any market correction as an opportunity to add to risk assets at more attractive entry levels.

Abi Oladimeji
Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 7th September 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	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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