THOMAS
MILLER
INVESTMENT

Investment Commentary

JUNE 2015

The pace of global economic activity has picked up in the second quarter following a lacklustre start to the year. In the US, the economic rebound has confirmed that the contraction in GDP during Q1 was largely due to transitory factors.

There have also been positive data surprises from both Europe and Japan, whilst the People's Bank of China (PBOC) continues in its effort to stimulate economic growth in China.

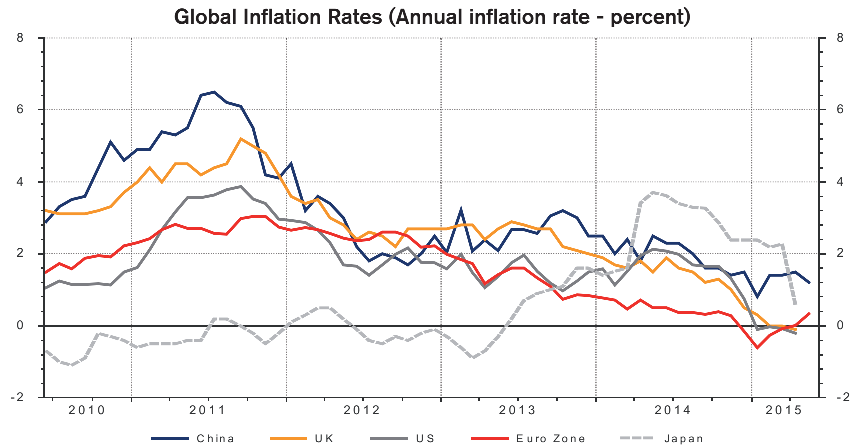
As widely expected, the updated estimate of US GDP for the first quarter showed a sharp downward revision from an initial growth rate of 0.2% to -0.7%. The GDP report noted that "the decrease in real GDP in the first quarter primarily reflected negative contributions from exports, non-residential fixed investment, and state and local government spending that were partly offset by positive contributions from personal consumption expenditures (PCE), private inventory investment, and residential fixed investment." [1]

The muted pace of economic activity has resulted in downward revisions to expectations for overall economic growth in 2015 and consensus forecasts have declined from over 3.0% at the start of the year to around 2.5%. It is noteworthy that the latest set of OECD composite leading indicators (see chart 1) show that the momentum of growth is flagging in the US. This evidence cautions against unbridled optimism on the economic outlook. The US economy has recorded five consecutive years of positive growth since the negative print in 2009. The annual average over that period has been 2.2%. At this point, it seems unlikely that the outcome in 2015 would turn out to be much better than that average.

In the UK, the surprise outright victory for the Conservative party at the May General Elections removed the threat of an extended period of political uncertainty. That brought about a relief rally in equity markets and provided some support for UK government bonds (Gilts). Sterling also strengthened on the back of the results. In terms of economic developments, perhaps the most notable event in recent weeks has been the unprecedented decline in inflation. UK CPI dropped into negative territory on a year-on-year basis for the first time since 1960. The dip into deflation should be short-lived as it has been driven primarily by transitory factors which should fade soon. However, while deflation itself should be a short term occurrence, low levels of inflation will persist for the rest of the year.

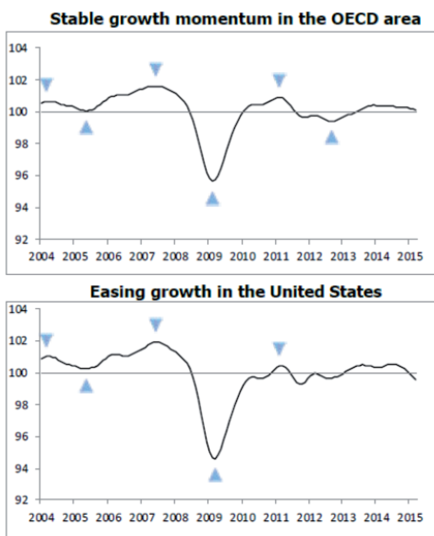
Looking ahead, as with the US, key economic leading indicators show that the momentum of UK economic growth is flagging. Overall, this suggests ongoing downside risks to consensus forecasts for growth in 2015 on both sides of the Atlantic. Among the major developed economies, the Euro-zone remains the standout performer as growth has exceeded expectations in recent months. First quarter GDP figures suggest that the region is starting to benefit from a weaker currency, lower oil prices and higher business and consumer confidence. On balance, the evidence suggests that the Euro-zone has further scope to deliver growth in excess of consensus forecasts in the year ahead.

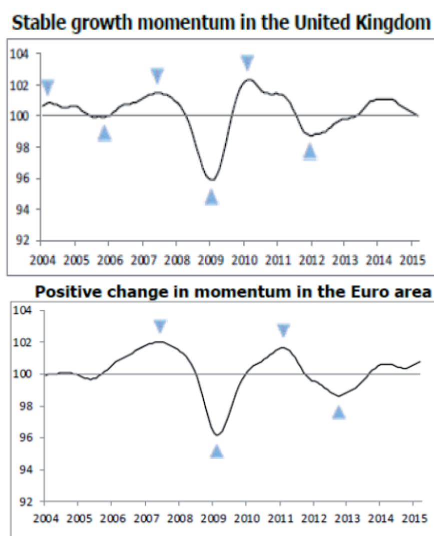
Chart 2: Inflation rates will pick up gradually over the next few months



Source: Thomson Reuters Datastream

Chart 1: Leading indicators flag easing growth momentum in the US

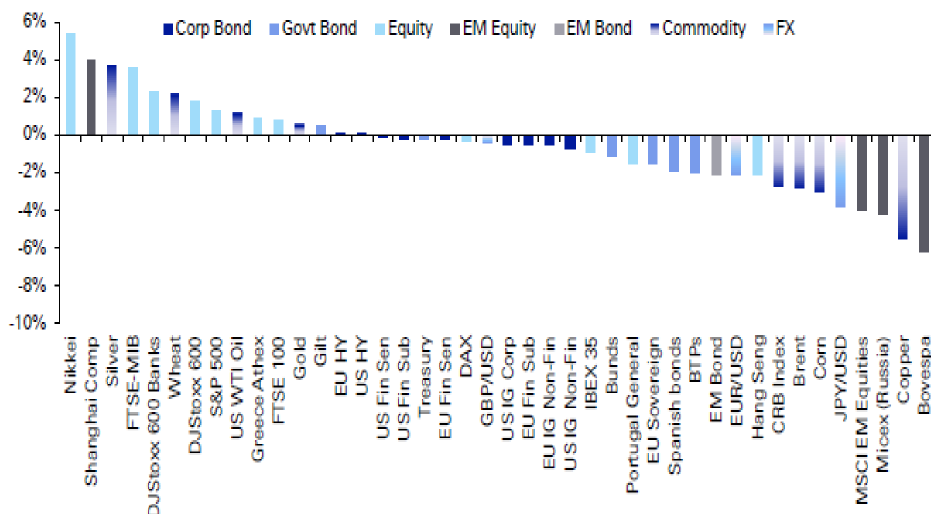




Source: OECD, May 2015

[1] News Release by Bureau of Economic Analysis on Friday May 29, 2015.

Chart 3: Total return performance of various financial assets in May 2015 (local currency)



Source: Deutsche Bank, Markit, Bloomberg Finance LLP

Turning to financial markets, despite mixed results within the asset class, equities generally outperformed fixed income during the month. The notable exception was the emerging markets where a deteriorating economic outlook led to significant losses on stock markets. For instance, Brazil's Bovespa and Russia's Micex lost about 6.2% and 4.2% in local currency terms respectively in May. The Japanese and Chinese equity markets were the best performers for the month.

The combination of the relative strength of the Euro-zone economy and the ECB's quantitative easing programme has boosted the region's equity markets so far this year. However, in recent weeks, these beneficial factors have been overwhelmed by negative sentiment driven by the ongoing crisis in Greece. The Greece-induced spike in financial market volatility is likely to persist until a longer term agreement is reached between Greece and its creditors.

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Fixed income markets also experienced high levels of volatility in May. Yields on 10-year government bonds in the US and Germany finished the month higher (and prices finished lower), whilst the 10-year Gilt recorded a modest decline in yields (and rise in prices). Elsewhere in the fixed income market, corporate bonds were broadly stable over the month, with lower rated credit outperforming their investment grade counterparts.

The combination of investors' concerns about the likely outcome of the ongoing negotiations between Greece and its creditors, uncertainties surrounding the outlook for monetary policy in the US, and seasonally lighter trading volumes during the summer months could introduce a negative skew to equity returns over the coming weeks. Consequently, relative to last month, we have reduced exposure to risk assets and moved closer to benchmark allocation across the major asset classes. However, this simply reflects short-term de-risking. Looking further ahead, we still believe that the backdrop remains broadly in favour of risk assets.

Abi Oladimeji
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ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 3rd June 2015)

	United States	Euro-Zone ex Germany	Germany	United Kingdom	Japan	Emerging Markets
Equities (overall)	0					
Equity allocation by region	0	0	0	0	0	0
Bonds (overall)	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
Alternatives	0					

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

Thomas Miller Investment Ltd's Bespoke DFM service has been rated 5 Star by Defaqto.

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