THOMAS
MILLER
INVESTMENT

Investment Commentary

MAY 2016

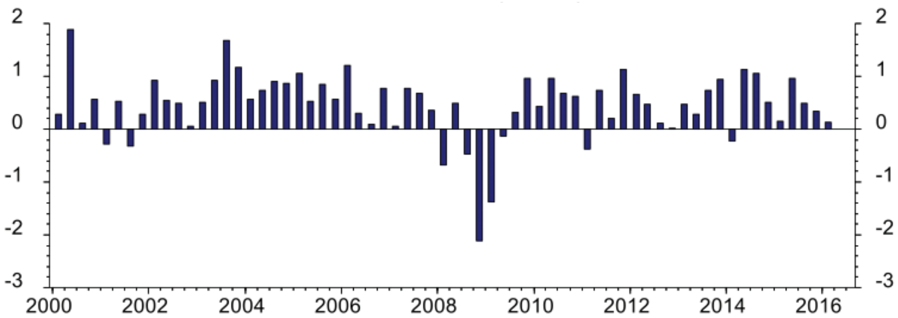
Summary of recent economic developments

Economic reports over the past month have done little to change the broad picture of softening global economic growth. The slowdown in the pace of growth over the past couple of quarters has been widespread, spanning both the developed economies and emerging markets.

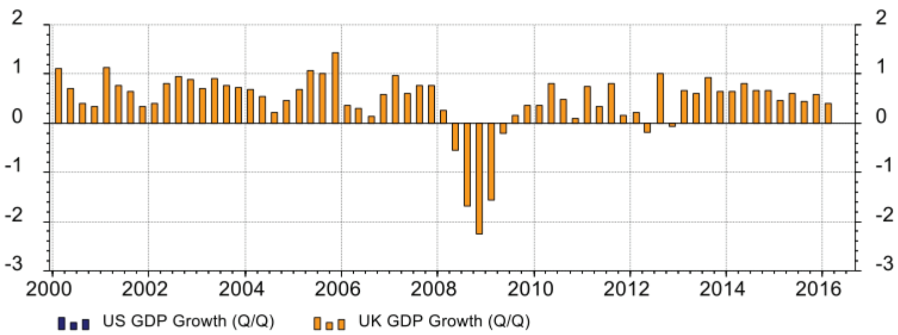
In the US, in a pattern that has become the norm in the years since the end of the Great Recession, the official estimate of Gross Domestic Product for the first quarter of 2016 was significantly weaker than expected.

US Q1 GDP data needs to be interpreted with some caution. While there is little doubt about the direction of economic growth, statistical issues complicate the assessment of the true magnitude of the decline in growth momentum over the past quarter. Essentially, there appears to be a statistical tendency for Q1 to be weaker than the full-year quarterly average. However, this should not take away from the fact that the momentum of economic activity in the US has slowed dramatically over the past six to nine months.

US GDP Growth (QoQ%)



UK GDP Growth (QoQ%)



Source: Thomson Reuters Datastream

In the UK, economic growth has stalled in recent months. Over the past few years, the UK economy has been extremely reliant on the performance of the services sector as manufacturing and construction have lagged. In this context, it is noteworthy that recent data covering the first quarter of 2016 showed that the services sector recorded its weakest performance in almost a year while the overall industrial production sector fell back into recession for the first time since mid-2012.

A weak start to Q2 suggests that the outlook for the UK economy continues to weaken. Furthermore, there is some evidence that the uncertainty surrounding the forthcoming referendum on the UK's membership of the EU is weighing on business investment and investor confidence.

Elsewhere, the Euro-zone economy continued its steady recovery during the first quarter. Data showed strong performance across the board, with the German economy growing at its fastest pace in two years. However, incoming data suggests that the pace of growth has slowed somewhat since the start of the second quarter.

In the emerging markets, the recent decline in the value of the US Dollar has brought some respite, as has the related recovery in commodity prices. For instance, official data on the Chinese economy showed a recovery in the growth rate during the first quarter of 2016 after a slowdown in the second half of 2015. During Q1 2016, GDP grew at an annual rate of 6.7%.

Financial market developments and investment strategy

After the volatility of the first quarter, financial markets have displayed relative calm so far in Q2. Risk assets including equities, and corporate bonds (across the credit spectrum) have continued the remarkable recovery that began in mid-February.

Investor sentiment has been boosted by the combination of central bank stimulus, better data from China, recovery in the price of oil and the easing in the strength of the US Dollar (which has reduced the pressure on US corporate earnings and supported commodity prices).

However, while we have seen a notable recovery in risk assets, that recovery has not been matched by changes to the fundamental outlook. Corporate earnings remain under pressure, liquidity conditions continue to tighten at the margin and equity markets appear fully valued if not stretched. Consequently, the sustainability of the rally is called into question.

Over the next few months political risks will come to the fore and financial markets will have to contend with key events beginning with the UK Referendum and later in the year, the US Presidential Elections. These events are likely to introduce volatility and downside risks to financial market returns.

For equities, the combination of high valuations, weak earnings and heightened political uncertainty suggests caution in the weeks ahead. Government bonds should benefit from the ensuing safe-haven demand as well as the low growth and benign inflation backdrop.

Corporate bonds have enjoyed strong gains over the past couple of months. However, spreads have now tightened again. Nevertheless, carefully selected bonds of companies with strong balance sheets should deliver better performance than government bonds of similar maturities. The key is to buy only those bonds that one would be happy to hold to maturity in order to ride out potential episodes of illiquidity.

In the currency markets, the key story has been the impact of "Brexit" uncertainty on the value of sterling. While the uncertainty persists, we expect GBP to remain particularly volatile. As things stand, a vote to maintain the status quo appears to be the most likely outcome. In that event, sterling should experience a short term "relief" rally. On the other hand, a "leave" vote will likely herald a period of sustained weakness in sterling.

In light of our assessment of the economic and financial market outlook, relative to long term weightings to the major asset classes, our strategy is to be slightly underweight equities and overweight government bonds. Within bonds, we have a neutral outlook on corporate credit and have moved to an overweight position on bond portfolio duration.

Abi Oladimeji
Head of Investment Strategy

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 4th May 2016)

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

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

London
90 Fenchurch Street
London
EC3M 4ST
+44 (0) 20 7204 2200

Birmingham
2nd Floor
Trigate Business Centre
210-222 Hagley Road
West Birmingham
B68 0NP
+44 (0) 121 222 5070

Edinburgh
46 Charlotte Square
Edinburgh
EH2 4HQ
+44 (0) 13 1220 9310

Southampton
Ocean Village Innovation
Centre Ocean Way
Southampton
S014 3JZ
+44 (0) 23 8038 1670

Isle of Man
Level 2 Samuel Harris House
5-11 St Georges Street
Douglas, Isle of Man,
IM1 1AJ
+44 (0) 1624 645200

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

---

tminvestment.com