THOMAS MILLER INVESTMENT

Investment Commentary

SEPTEMBER 2014

Global economic review & outlook

Last month, we noted that the global economy had made a strong start to the third quarter as output growth accelerated to multi-year highs. Although the rate of expansion dipped slightly in August, the general trend of improving growth continued.

Importantly, leading economic indicators suggest that the positive trend should continue over the next few quarters. Likewise, survey data compiled by Markit (a provider of financial information services) are broadly consistent with an increase in the growth rate of the global economy from an annual rate of 2.1% in the second quarter to a rate of just over 3% in the third quarter.

In a continuation of the pattern seen over the past few months, the distribution of global growth remains unbalanced. In particular, global growth has been reliant on the strength of economic activity in the US and UK. Moreover, looking ahead, leading economic indicators still paint a mixed picture of the growth outlook. For instance, in a recent report, the OECD noted that "The CLIs [composite leading indicators] for the OECD area as a whole as well as for the United States, Canada and the United Kingdom continue to point to stable growth momentum. In Germany the CLI continues to point to slowing momentum, whereas in Italy the CLI exhibits tentative signs of a loss of growth momentum. In the Euro Area as a whole and in France, the CLIs remain stable. In India growth continues to gain momentum while in China and Russia CLIs point to stabilisation of growth momentum. The CLI for Brazil suggests a tentative upward change in momentum."

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Overall, given that monetary policy remains broadly supportive (even if it tightens at the margin), business and consumer confidence continue to improve, and financial conditions remain benign, global economic growth is likely to remain robust over the rest of 2014.

Financial market review & asset allocation summary

Key concerns for investors in recent weeks have included the outlook for monetary policy in the US and UK, escalations in geo-political crisis in various parts of the world; and uncertainty surrounding the outcome of the Scottish referendum. Despite these, financial markets delivered strong performance during August and early September, with strong gains across both equities and bonds.

In the fixed income market, August marked the best month since January for both European and American government bonds. European bond markets led the rally as yields on government bonds across the Euro-zone fell (prices rose) on the back of disappointing data which

Chart 1 – Developed world v emerging markets
PMI Output / Business Activity Index

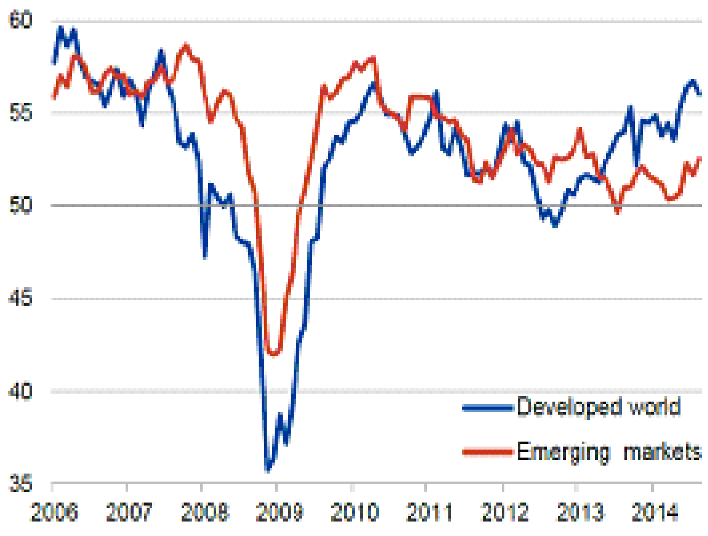
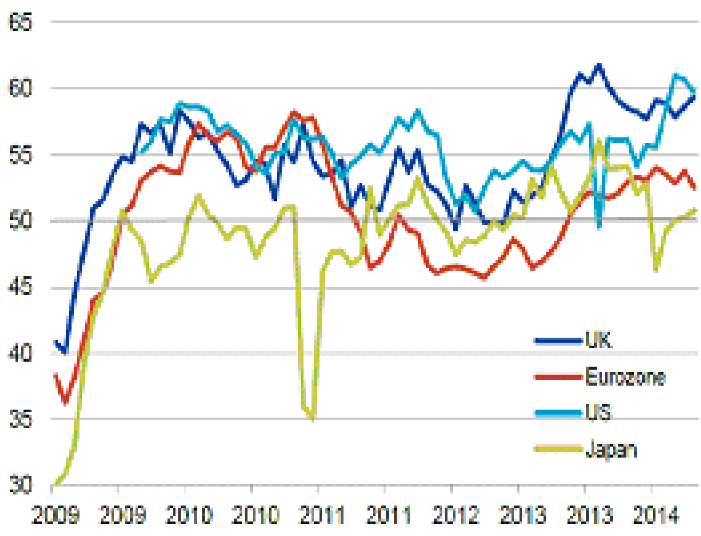
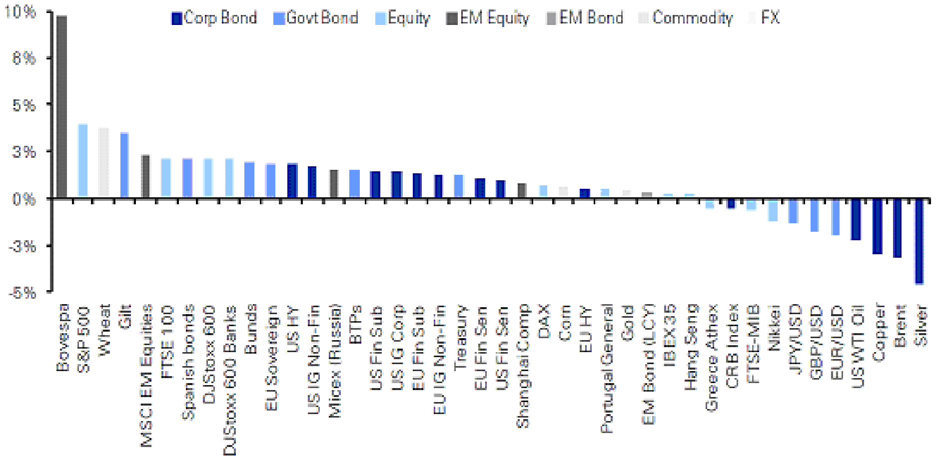


Chart 2 – Developed world (manufacturing & services)
PMI Output / Business Activity Index



Source: Markit

Chart 3 – Total Return Performance of Major Global Finance Assets August 2014 (Local Currency)



Source: Deutsche Bank, Bloomberg Finance LLP, Markit

fuelled expectations for more policy accommodation from the ECB. In the equity markets, both developed market (DM) and emerging market (EM) equities delivered strong returns. In the DM, the S&P 500 index was the standout performer, with gains of about 4% for the month. In the EM, Brazilian equities led the move higher as the BOVESPA recorded its best monthly performance since January 2012 with gains of about 10% for the month.

Looking ahead to the rest of the year, it is difficult to see a catalyst for further significant declines in bond yields from current levels. Beyond the Euro-zone, the pace of economic recovery is picking up and monetary policy is expected to become incrementally less accommodative. This backdrop is likely to see government bonds come under some pressure. The unknown variable in this assessment relates to the scope for escalations in geo-political crisis which would be expected to trigger further safe-haven demand for government bonds. On the other hand, equity valuations are not cheap either and gains are likely to be more measured in the months ahead.

The table below outlines some of the important considerations that guide our asset allocation decisions.

On balance, the evidence suggests that conservative investors should not stray too far from benchmark allocations to the major asset classes for now. For more risk tolerant investors, a bias in favour of risk assets, including equities and a selected range of alternative investments seems appropriate.

At the turn of the year, we contended that monetary policy divergence between the major central banks would be a key driver of FX markets in 2014. That remains the case and we continue to favour the USD against the other major currencies. Following the Scottish referendum, the UK will continue to experience an elevated level of political uncertainty, resulting in GBP volatility. Nevertheless, on balance, sterling should remain well supported given the robust UK macroeconomic outlook. Consequently, we would expect sterling to hold up well against the Euro. Against the USD, sterling is arguably close to fair value and is likely to trade in a range (possibly $1.60–$1.65) until there is greater clarity on the monetary policy front.

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Director,
Head of Investment Strategy

Investment process element	Brief outline	Implication for equities	Implication for bonds
Macro outlook	Leading indicators remain broadly constructive.	+	–
	Monetary policy will start to tighten (US & UK) but remains broadly accommodative globally. Notable regional variations. Suggests sector/regional differentiation in risk taking.	+/0	–
Valuation	Relative valuation favours equities.	+	–
	Absolute valuations suggest regional differentiation in risk taking. Growth/policy outlook flag scope for further increases in bond yields.	+/0	–
Momentum & Investor Sentiment	Although elevated, momentum and sentiment indicators are not at extreme levels for equities. Sentiment weakening for bonds.	0	0
Other notable risks	Geo-political risks: This is likely to persist for some time. An escalation of the crisis in Ukraine for example could undermine risk assets while boosting safe haven demand for bonds.	–	0
Conclusion		0/+	–

TMI ASSET ALLOCATION SCORECARD

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

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

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