THOMAS MILLER INVESTMENT

Investment Commentary

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Global economic developments and outlook

Recent reports on the state of the global economy have reinforced the picture of slow growth albeit with small improvements relative to the pace recorded at the start of the year.

In the US, in light of the weakness recorded in the first quarter, investors had anticipated a brisk recovery in the second quarter. However, while better than the growth rate seen in the first quarter, the Q2 growth rate of 1.2% (annualised) was notably below consensus forecasts of roughly double that pace of growth. More recently, data showed that US services industries expanded in August at the weakest pace in about six years. Likewise, reports flagged an unexpectedly sharp slowdown in the manufacturing sector.

Nevertheless, the ongoing resilience of the US labour market and the recent uptick in inflation (particularly core inflation which excludes the impact of food and energy prices) have led many investors to anticipate a resumption of the rate tightening cycle by the US Federal Reserve Bank (Fed) as early as September 2016. In our view, the probability of a rate hike this month is low. This is because there is little evidence to suggest that the pace of US economic growth is about to pick up sufficiently strongly to justify a resumption of rate hikes at this time.

Turning to the UK, the improvement in economic and investor sentiment in the post-referendum period has been palpable. However, the welcome news ought to be set in context. With hindsight, it is clear that in the aftermath of the referendum vote, investor sentiment took a big hit and consensus expectations became overly bearish. For instance, shortly after the vote, surveys of expected economic activity suggested stagnation in key sectors of the economy. A few weeks later those same surveys have indicated a rebound in the pace of economic activity.

A pragmatic approach would average out those surveys to smooth out the sharp decline in July and the equally vigorous rebound in August. Importantly, looking beyond the noise in the July-August data, it is increasingly clear that while the UK economy is performing well relative to depressed consensus expectations, the reverse is true when the current pace of economic activity is compared with that recorded in the first half of the year. Moreover, as the fog of the immediate post-referendum period clears, the UK economy seems likely to settle into a more pedestrian pace of growth than the recent spike in optimism might suggest.

Elsewhere in the developed markets, data on the Euro-zone economy has been mixed, with evidence of a slowdown in Germany being of particular concern. In Japan, the latest reports have confirmed the trend of slowing growth and rising expectations of further policy intervention to boost the country's flagging economy. In contrast, recent reports on the major emerging markets have been more encouraging. Chinese economic reports in particular have boosted investor sentiment as a range of key indicators, including consumer purchases and industrial production, beat expectations in August.

Financial markets & investment strategy

After the initial flurry of activity in the weeks following the UK referendum, global equity markets settled into a period of calm. That calm has recently given way to renewed volatility as investors fret about the outlook for monetary policy support in general and the risk of a sudden hawkish turn by the Fed in particular. Investors' angst is understandable. Several Fed officials have appeared to display a bias towards rate tightening in recent weeks even as the incoming data flow has steadily undershot expectations. Given that the Fed insists that it remains data-dependent, its communication strategy clearly leaves a lot to be desired.

For equity investors, it is also notable that corporate profits resumed their declines in Q2 following a bounce in Q1. Corporate profits have now fallen in five of the last six quarters. Overall, looking to the rest of the year, there seems to be more reasons to be cautious than there are to be enthusiastic about the outlook for equity markets.

The positive investor sentiment that has driven equity prices higher and equity market volatility lower has also meant that government bonds have given back some of the gains made in the period after the UK referendum. However at this point, the rise in government bond yields (and the corresponding fall in bond prices) has had more to do with shifts in investor sentiment than any meaningful changes in economic fundamentals. Indeed, while the backdrop of modest growth and benign inflation persists, government bond yields are likely to remain low. We still prefer carefully selected corporate bonds of companies with strong balance sheets to comparable government debt.

In the currency markets, the US dollar has remained well supported by expectations of tighter monetary policy. The bulk of the US dollar's gains in recent weeks have come at the expense of EM currencies. Sterling has also staged a recovery since the lows set in early August when the Bank of England expanded monetary stimulus. Over the next few months, political uncertainty is likely to be a key driver of financial markets in general and foreign exchange markets in particular as investors weigh the risks of a lurch towards populism in the US. Such an outcome will have material implications for the outlook for the global economy and financial markets.

In light of the current economic and political backdrop, we believe that investors should err on the side of caution in asset allocation. Consequently, our client portfolios remain positioned in line with longer term target weightings to the major asset classes.

Abi Oladimeji
Chief Investment Officer

ASSET ALLOCATION

TMI ASSET ALLOCATION SCORECARD (as at 1st September 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)	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
Alternatives	0					

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

THOMAS MILLER INVESTMENT

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

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

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