THOMAS
MILLER
INVESTMENT

View from the Front

26th February to 4th March 2018

Front and centre of our thoughts this week include

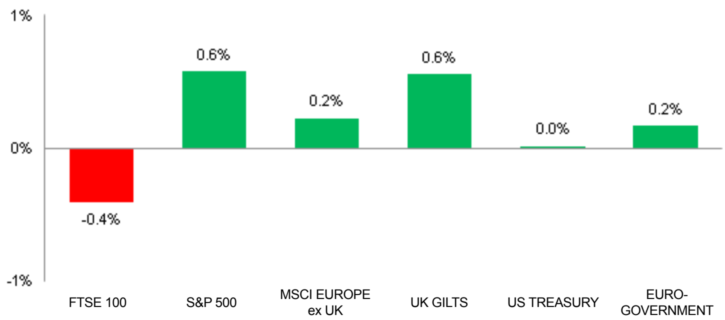
- One of the main concerns in markets at the moment is that global growth is "as good as it gets" with a peak reached in growth and earnings momentum. A good indication as to whether this is the case will be the release of the global manufacturing confidence surveys on Thursday as these forward looking readings are highly correlated with future growth. Last week saw preliminary readings for Europe, Japan and the US which showed a steeper-than-expected decline in European business confidence, albeit from extremely elevated levels, a moderate decline in Japanese business confidence and a better-than-expected pick-up in US business confidence, which on balance left an inconclusive message. The worldwide release of the business confidence surveys this week will provide a broader and better indication of the outlook for global growth. Arguably, of all the confidence readings released the Chinese confidence readings will be the most closely watched due to the on-going concerns that measures undertaken by the government to tighten credit conditions is slowing growth.
- Confidence readings aside, the main highlight of the week will be new Federal Reserve (Fed) Chair, Jerome Powell's inaugural semi-annual Monetary Policy Report to Congress. Powell is not expected to deviate too much from the upbeat message conveyed in the last Fed minutes. However it will be interesting to hear his views on inflation, especially in light of the recent higher-than-expected inflation and wage growth numbers. Staying with the inflation theme, this week sees the release of the Fed's preferred inflation metric, the PCE deflator. Should this inflation reading follow the same pattern as other inflation measures and start to trend higher then it may add to the growing concerns that the Fed is falling behind the curve and will need to raise interest rates at a faster rate than currently anticipated.
- It is also a busy week on the political front with Theresa May set to outline her Brexit strategy on the 2nd March while Italy holds a general election on the 4th March. Various press reports have cited that Ms May and her Brexit subcommittee agreed last week that a "Canada plus plus plus" model is the UK's preferred future trading arrangement with the EU. This trading arrangement will essentially see the UK mirror EU regulations in some sectors, abide partially in others and completely diverge in some sectors. The problem with this proposal is that it resembles the "cherry picking" approach that the EU strongly disapproves and it will not suit the demands of the 62 Conservative lawmakers that signed a letter demanding a Brexit divorce that leaves few ties to the EU. Add in the expected announcement from Labour leader, Jeremy Corbyn that he is in favour of keeping the UK in a custom union with the EU and the next couple of weeks look set to be a difficult time for Ms May's tenure
- In Italy, opinion polls continue to show that 30-40% of the voters remain undecided which leaves a multitude of possible outcomes and an election result that is too close to call. Consensus estimates are that no one single party will win an outright majority. Most of the major parties in the election have substantial difference in economic and political policies which makes forming a coalition a difficult task. This means a hung parliament or a second election remain viable options. For Italy, the longer-term risk is that whoever comes to power does so with a weak political position, making it difficult to implement the long-term economic and fiscal reforms that are needed to tackle the structural issues within the economy.

In the rear view mirror of last week we saw

- The minutes for the US Fed meeting held in January indicated a more positive view on the growth and inflation outlook amongst Fed officials. A number of officials raised their forecast for growth relative to predictions made in December's meeting and also expressed confidence that inflation will return to their 2% target. The minutes make another interest rate rise in March a near certainty with markets currently pricing in a 99% probability of this outcome.
- Staying with central banks, the inflation numbers for January in both Europe and Japan are unlikely to alter the European Central Bank's or Bank of Japan's near-term plans for monetary policy. Core CPI, both central banks' preferred inflation measure, increased moderately in Japan to 0.4% p.a. (from 0.3% p.a.) with the euro area's remaining at 1.0% p.a. More importantly, the data shows that inflationary pressures in both economies remain subdued and against this backdrop we would expect both central banks to continue their current accommodative monetary stance.
- In the UK, the labour market report for December provided mixed messages. On the positive front, wage growth came in stronger-than-expected and continues to trend higher. However, unexpectedly, the report also showed the unemployment rate increased by 0.1% to 4.4% - the first increase in the unemployment rate since August 2016. Separately, we also learnt that the UK economy grew at a slower rate than first thought in the final quarter of 2017 with the second estimate of quarterly growth revised down from 0.5% to 0.4%. The reduced rate of growth was a result of a number of small revisions to mining, energy and services growth rates.

In the side view mirrors of corporate activity we notice

- Shares in Reckitt Benckiser, the consumer goods company behind household brands such as Dettol, tumbled last week after the company reported sluggish sales growth and profit margins below investor expectations. The group noted that costs relating to the integration of Mead Johnson baby formula business had reduced operating margins whilst also warned that intense competition from retailers like Walmart and Tesco had made it difficult to raise the price of its products.
- Centrica, the owner of British Gas, announced plans to shed a further 4000 jobs as part of a wider cost saving programme that will lead to £500m in annual savings by 2020. The company announced a 17% decline in operating profit for 2017 and warned that intensifying competition and government plans to introduce a temporary price cap on electricity and gas tariffs had created a difficult UK energy market.



Source: Bloomberg. Figures are for the period 19th February to 25th February 2018. Where the index is in a foreign currency, we have provided the local currency return.

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The above charts provide the performance for the three developed market geographies where the TMWM MPS portfolios maintain their largest exposure. **All investments and indexes can go down as well as up. Past performance is not a reliable indicator of future performance.**