# Investment Commentary January 2018

Incorporating
Stan Gaskin Ltd
Financial Advisers

This document is designed to provide clients of SG Wealth Management and Stan Gaskin Ltd with background information on our latest opinions on investment matters, covering the economic environment and how we are positioning clients' portfolios with this in mind. *Your attention is drawn to the risk wording and caveats at the end of the document.*

## Comparative Market Data – to end December 2017

The following table shows the performance of different global markets over recent months and years:

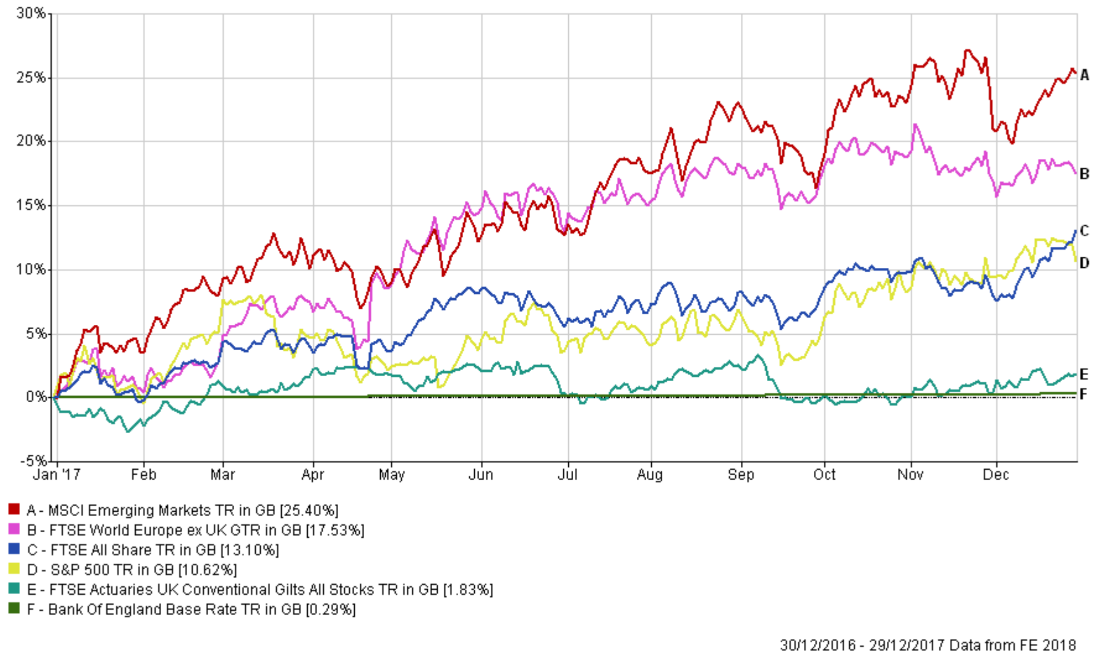
| Market Index | 1m | 3m | 6m | 1yr | 3yr | 5yr | 10yr |
|---|---|---|---|---|---|---|---|
| FTSE 100 | 1.96 | 3.38 | 5.56 | 12.47 | 27.07 | 50.43 | 101.29 |
| FTSE 250 Index | 1.02 | 3.12 | 5.93 | 17.22 | 36.12 | 82.63 | 188.49 |
| FTSE All Small ex Inv Trusts | 2.48 | 3.49 | 5.54 | 14.4 | 46.9 | 96.96 | 156.6 |
| FTSE World Europe EX UK Index | 2.52 | 1.58 | 4.39 | 19.92 | 46.04 | 78.18 | 119.38 |
| FTSE World Index | 1.57 | 3.9 | 6.68 | 14.99 | 51.05 | 100.53 | 185.61 |
| MSCI EM (Emerging Markets) | 4.83 | 5.9 | 10.28 | 26.42 | 45.24 | 48.16 | 109.63 |
| Hang Seng (HK / China) | 6.09 | 9.37 | 15.55 | 32.08 | 57.32 | 88.17 | 169.65 |
| Nikkei 225 (Japan) | 3.2 | 7.77 | 12 | 16.54 | 57.67 | 108.59 | 150.58 |
| S&P 500 (US) | 0.97 | 4.47 | 7.13 | 13.25 | 54.99 | 130.94 | 243.17 |
| FTSE British Government All Stocks | -0.57 | 0.28 | -0.42 | 2.27 | 7.66 | 23.36 | 72.06 |
| LIBOR GBP 1m (Cash) | 0.04 | 0.12 | 0.19 | 0.31 | 1.22 | 2.21 | 10.07 |
| ARC Sterling Equity Risk PCI* | 2.7 | 4.23 | 5.71 | 12.2 | 30.24 | 57.4 | 75.94 |
| ARC Sterling Steady Growth PCI* | 2.0 | 3.42 | 4.54 | 9.86 | 25.34 | 47.6 | 65.65 |
| ARC Sterling Balanced Asset PCI* | 1.3 | 2.41 | 3.13 | 6.84 | 18.24 | 35 | 53.17 |
| ARC Sterling Cautious PCI* | 0.7 | 1.3 | 1.83 | 4.37 | 11.51 | 21.71 | 41.31 |
| Bank of England Base Rate* | 0.04 | 0.12 | 0.18 | 0.31 | 1.19 | 2.21 | 8.98 |

*Figure 1 Data source: Financial Express Analytics. Cumulative gross total return, rebased to GBP, to 29/12/2017.*
**These indices have been added to the above table as comparators for our risk adjusted model portfolios.*

## Quarterly Market Commentary – written as at end December 2017

12 months ago when reviewing 2016 we commented how resilient markets had been in the wake of surprise election results in the UK and US. Politics was front and centre in the news and the political uncertainty that lay ahead fed into a cautionary tone in our investment outlook. However, during the last 12 months we have seen equity markets deliver excellent returns in most areas of the world as some of the political risks dissipate slightly and economic fundamentals continue to remain strong. Indeed it was pleasing to see how the economic recovery, now entering its 10th year, broadened out by geography and sector. Deflationary concerns receded whilst inflation stayed under control, thus dubbing the state of play being dubbed the "Goldilocks" period – i.e. neither too hot nor too cold.

The year came to an end with stock markets in the US and the UK around all-time record high levels. Whilst good returns have been enjoyed for a second consecutive year, investors are starting to wonder whether equity valuations are getting stretched, how long this economic cycle can continue for, and whether tighter central bank policy in some parts of the world will adversely affect markets.




*Total returns, in GBP*

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**Review of 2017**

Donald Trump was inaugurated at the start of the year, however it was a relief to see that the various checks and balances built into the US political system managed to restrain some of his influence on domestic policies. The year started with concerns around the North Korean missile programme and nuclear testing and despite strong rhetoric from both men with the buttons during the year, the ramifications of actual conflict were deemed too catastrophic or too unlikely to be priced in.

Political promises for fiscal expansions and lower taxes by President Trump did play a role in lifting the spirit amongst investors and businesses alike in the US. Yet in the first few months of the year Mr Trump failed to deliver on these promises which helped lead to a fall in the Dollar. This however, proved beneficial for US exports and in return emerging markets found themselves in a better position economically. Towards the end of the year Trump finally got his tax reform bill passed which promises to be significant for the prospects of the US and global economy going into 2018.

The rise in populism was causing nervous anticipation of general elections in the Netherlands, France and Germany in 2017. It was feared that the anti-EU sentiment that was shown in the UK's Brexit Referendum the previous year would carry forward and help fracture the Union further. However political risks abated with satisfactory election results from a pro-Euro perspective, the most notable of which is potentially Emmanuel Macron's election as French President. At the age of 40 with a background in investment banking as well as civil service, he was viewed as being pro-business, buoying markets accordingly.

However election shocks did continue into 2017, with Theresa May's decision to call a snap election in June to strengthen her "strong and stable" government looking like one she would live to regret from the moment the exit poll was published at 10pm. The UK appears more divided politically than ever and with the Labour opposition's policy proposals moving more towards their socialist roots, the potential next change of government (whenever it may happen) would appear to lead to the most significant change in direction for the country's economic policy for some time.

In the meantime, the Brexit negotiations rumble on at a seemingly tepid pace. Following the formal act of Article 50 being served at the end of March it took until December for the negotiators to get to a position whereby EU leaders could announce an agreement to begin the next phase of negotiations, discussing trade relations and a transition period from March 2019. The mood music coming from politicians at present is that the UK could be heading towards a potentially "softer" Brexit than might otherwise be the case. This could potentially manifest itself as some form of trade agreement with watered down other pillars of EU membership such as financial contributions, movement of people etc.

Whilst this saga certainly has plenty of mileage left to run, the risk of economic catastrophe that was predicted before and immediately after the referendum appears to be lessening slightly. It is likely to be some time until true clarity materialises around the UK's future trading status and this is likely to mean some time until businesses regain full confidence to make investment decisions as they were doing before the vote.

Over the year Emerging Markets (EM) equities were the best performing of the main asset classes we consider for investment (yes, we do not see Bitcoin as a sensible investible option for our clients monies currently despite the gains made in 2017!). This was due in part to the weaker dollar, rising commodity prices (thanks to the general global growth climate) and the continued success of the Chinese economy. We are fans of the long-term structural growth drivers of the urbanisation of and therefore consumption by the huge populations of China and India, and other emerging markets. By 2050, it is predicted that Asia will have 3 of the world's 4 largest economies by GDP and by adding Mexico, Russia and Brazil 6 of the top 7 economies will be from current "emerging" markets (source PwC). This is based around potential growth from EM of around twice that of current advanced G7 economies.

Bond investors experienced less attractive returns with low yields and the challenge of potential gradual monetary policy tightening starting to act as a headwind for returns. The Federal Reserve in the US rose rates 3 times during 2017 and in October started to gradually reduce its balance sheet from the effects of Quantitative Easing. Given the Fed's assets had risen from c$1tn pre-credit crisis to around $4.5tn over subsequent years, a potential reduction of around 10% during 2018 represents a very significant reversal of flows.

**Looking ahead into 2018**

The fundamentals for the global economy currently seem in decent shape. Global GDP is at reasonable levels, is broad based across sectors and countries and is forecast to rise modestly for 2018. Whilst central banks are moving into an environment of tightening money policy, in general low rates are still at extremely supportive levels and the moves away from these are expected to be very slow and gradual. Unemployment is low in the US and the UK and falling in Europe, although we have not yet seen pressures for higher wages build as yet and thus inflation is under control, for now.

In this environment we would still expect to find support from investors for risk assets such as equities which can still provide a real return from both income and capital growth if company earnings meet expectations. However in this environment we see less attraction for fixed income investments, such as government bonds, which may see yields drift up, thus constraining total return by nudging prices down.

As ever, risks to the investment outlook persist and 2018 may be the year when we focus more on the economic risks as opposed to political risk. The factor we are likely to be watching most closely is inflation as if it raises its ugly head central banks may be forced to react and raise rates more quickly than markets are expecting, which would feed through into asset price volatility. It is possible to envisage wage growth starting to materialise due to low unemployment levels and coupling this with prolonged rises in commodity prices, one could envisage a scenario where inflation levels could surprise on the upside. However, we live in a fast-paced changing world and factors such as technology, automation and globalisation can help suppress inflationary pressures.

There is also a concern over asset price levels in general. Valuations of many types of investments including equities, bonds, real estate and even crypto-currencies are at very elevated levels having gone through prolonged periods of growth which potentially leave them exposed to shocks. Predicting shocks is inherently impossible and as such with no obvious pockets of deep value, we feel more than ever that a diversified and active approach to investment, whilst remaining exposed to assets that have the ability to provide real returns, is a prudent approach to investing in 2018.

## Risk Warnings and other Important Information

We hope that this document is helpful in explaining the background to investment decisions that are being made within the portfolios of our clients. Please bear in mind the following important points:

- Any past performance is not guaranteed and not necessarily a guide to future returns. The value of investments and the income they produce can be affected by a number of factors and can go down as well as up, and the value you get back may be less than your initial investment.
- Opinions are those of SG Wealth Management Ltd and Stan Gaskin Ltd at the time of writing and are subject to change. They are based upon our investment research and philosophy and there are no guarantees of any particular outcome.
- It is important that your investment portfolio is regularly reviewed to ensure it continues to be appropriate for your circumstances, needs and underlying economic conditions. We will do this with you as part of an ongoing client agreement.
- Investors should not construe this document as specific advice and we take no responsibility for the outcome of any individuals taking actions personally (i.e. not via SG Wealth Management or Stan Gaskin Ltd) based upon the contents of this, or other published investment documents
- All figures quoted are bid-bid, total return, source FE Analytics, unless otherwise specified. Charts shown reflect market returns converted to GBP currency.