

Market overview

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With the atmosphere of gloom pervading every market, except gold, it should have been no surprise to see a decent attempt at a rally kick off in the middle of February. The G20 meeting in Shanghai came and went without any consensus on what to do next. Which was again, no surprise, as the G20 nations are all pursuing different options in an attempt to make their own economies more competitive; a policy doomed to failure.

The Federal Reserve predictably raised interest rates in December last year, but with the European Central Bank (ECB) and the Bank of Japan (BoJ) now taking the negative interest rate route that decision looks increasingly suspect. If the Federal Reserve is to persist with the raised interest rates then the dollar will maintain its strength, which will mean;

- continued weakness in oil and commodities,
- more pain for emerging market currencies and economies and
- a continuing headwind for US exporters.

It does however support the argument that the Federal Reserve needs to be vigilant on the inflation front and there are signs that recent deflationary moves are coming to an end.

However, trade is the driver of economic growth and the US needs it as much as everyone else, including China. The People's Bank of China (PBoC) have said that they will not be in any hurry to devalue the yuan, but the slow erosion of China's foreign exchange reserves cannot go on forever. It is quite conceivable that the PBoC will devalue the yuan all in one go, as they did back in 1994, which triggered massive inward capital flows and the start of the latest Chinese renaissance. It would however have a massively deflationary effect on the rest of the world and the US reaction would almost certainly be to join the negative

interest rate club. Not the most promising strategy, but "as long as the music is playing, you've got to get up and dance", as Chuck Prince the CEO of Citigroup said in 2007 about subprime debt trading.

The next important event on the horizon is the ECB meeting during the second week of March. Draghi is already reiterating the "we will do whatever it takes" platitudes, which resulted in a brief rally and then the markets fell away again. This is typical of bear markets and in Europe in particular there is no evidence yet that the trend has changed. The meeting will in all probability herald further rate cuts. If Draghi finds a rabbit in his hat (more bond purchases) then we may see a stronger rally. To add to the uncertainties, the spectre of Brexit makes life doubly difficult for the European markets. It may come as a surprise and some may disagree, but Europe needs the UK far more than the UK needs Europe.

Debt is, of course, the "Big Issue". There is much more of it globally than in 2007/08. It maybe that negative rates are a cynical way of reducing government servicing costs on their debt. Last week's 10 year Japanese Government Bond auction went at minus 0.1%; buyers paid the government to lend them money! Debt in the Chinese banking system has gone from \$3trillion in 2008 to \$34 trillion. In somewhat less heroic fashion US corporate debt has been rising too, more often than not to pay for share buy backs at inflated prices to boost earnings per share or used to buy into asset plays of now dubious value; think oil exploration.

We have been taking risk off the table for some time now with our portfolios well below their long term risk budget targets and we see no reason to change that stance yet. We will be watching the central bank narrative as closely as ever.

The table below shows our current view across all asset classes in terms of the relative weighting of each asset class against our own strategic asset allocation:

TPO VIEW
ACROSS ALL ASSET CLASSES

ASSET CLASS VIEW		TPO VIEW	LAST MONTH	NOTES
Government Bonds	Developed market conventional	↓	↓	Short dated and absolute return strategies preferred
	Developed market inflation linked	↔	↔	A hedge against future inflation?
	Emerging market conventional	↓	↓	Continuing dollar strength will be an issue
Corporate Bonds	Investment Grade	↓	↓	Too expensive
	High Yield	↓	↓	Yields and spread too low to justify risk
Equities	UK	↔	↔	The UK indices have started a correction, potentially more downside after a relief rally
	US	↓	↓	Still expensive after the correction potentially more downside after a relief rally
	Europe ex-UK	↔	↔	Relatively cheap but political concerns may come back to centre stage in 2016
	Asia ex-Japan	↓	↓	Attractive long term but Chinese economic weakness is a concern
	Japan	↑	↑	Not expensive but economic concerns are bubbling to the surface once again BoJ action has helped in the very short term
	Emerging Markets	↓	↓	Long term value, but dollar strength and commodity weakness a concern
Commodities	Gold & Precious	↔	↓	The trend may be changing. Mining shares are very cheap
	Industrial	↓	↓	The super-cycle is over. No change until the global recovery improves significantly
Currencies	US Dollar	↑	↑	Benefits from being the main reserve currency but a reversal on rates would change things
	Euro	↓	↓	Structurally challenged
	Japanese Yen	↔	↔	BoJ action has created something of a floor
			Key	
			↑	Overweight compared to strategic allocation
			↔	Neutral position compared to strategic allocation
			↓	Underweight compared to strategic allocation
Past performance is not a reliable guide to future performance.				