September 2017 Portfolio Review

Markets seem to be taking much of the recent news in their stride, almost as if the major potential concerns have suddenly lost much of their relevance, with capital market forces concerning themselves with the consistency of central bank messaging/action, current macro-economic data and the next round of corporate earnings. And this despite some anxiety about whether the US central bank would stall on the reversal of its monetary policy of quantitative easing (QE) towards quantitative tightening (QT), the continued threatening language between US president Donald and Kim Jong Un and the arguably disappointing lack of detail in Theresa May's Brexit speech to the EU in Florence.

On the USA, comments from Fed Chair Janet Yellen reinforced expectations that a rate hike looms in December and that the central bank should be expected to stick to its gradual path of hiking. The rhetoric from the majority of Fed speakers largely reflected the surprisingly strong conviction that the most recent six months of lower than expected inflation data will prove transitory.

Beyond the North Korea issue, the US political risk is reducing as well. There is now a 'risk' president Trump will actually make some policy progress around his tax reduction and infrastructure improvement plans. His proposal is for a 20% corporate income tax rate and to cut the current seven personal tax brackets to just three; 12%, 25% and 35% while doubling the standard deduction. The tax framework was broadly consistent with what had been previously reported although, with some analysts suggesting that the cost of the plan could be about $2 trillion over the next 10 years, getting the bill through the Senate will likely be challenging

Closer to home the economic data paints an encouraging picture, especially across the Eurozone with the question of the German election results largely now settled, albeit with coalition decisions still to be finalised. Even the UK had some strong retail sales numbers to report for August, despite inflation climbing even further. Comments from Mark Carney and Andy Haldane continue to prepare the market for a rate rise. Carney suggested that "if the economy continues on the track that it's been on, and all indications are that it is, in the relatively near term we can expect that interest rates would increase somewhat". As in the US story, the Governor also added that "we are talking about easing a bit off the accelerator and interest rate increases when they come – if or when they come – will be limited".

The major global economic areas continue to expand – some more dynamically, some less - but still in unison. Whether the constructive environment can last, depends on a number of factors that are very hard to predict. Will the US, China and Russia find a way out of the North Korea conflict that minimises collateral damage? How will China's president Xi Jinping steer the second largest economy once the 19th party congress makes him as powerful as Mao? And most importantly from an investment point of view, how will bond investors react, once they realise that the US economy continues to thrive despite the Fed's QE reversal - which would leave them holding assets whose yield may not even compensate them for more normal rates of inflation for years to come.

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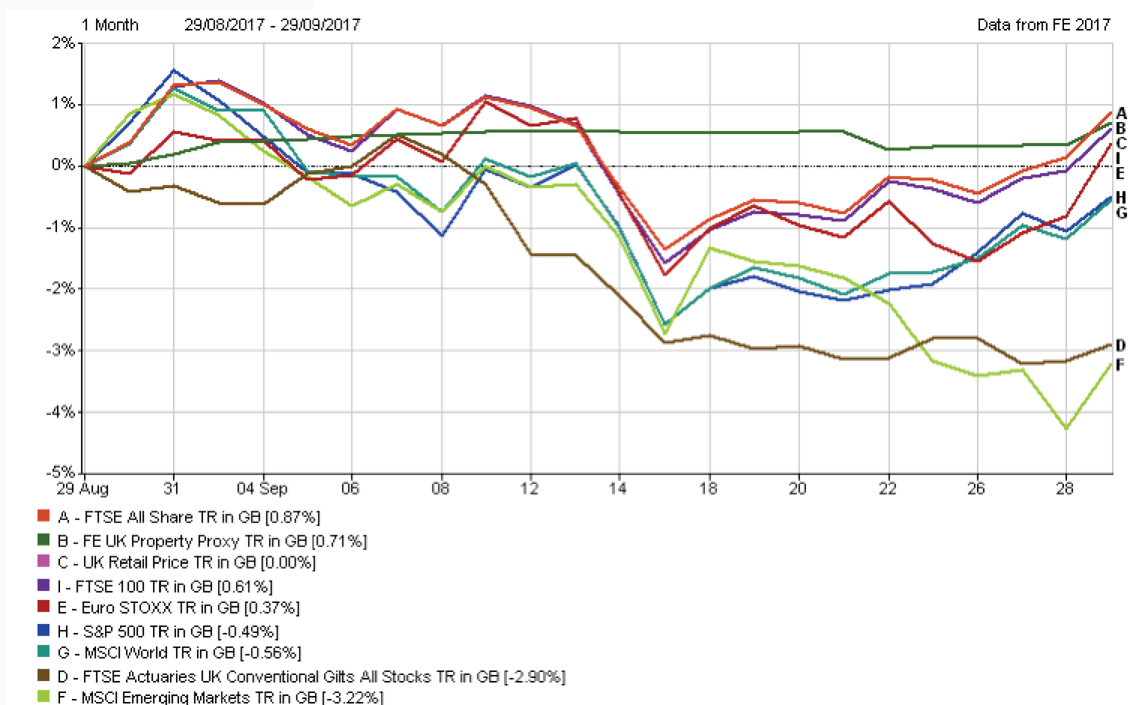
It would be unwise to be complacent but there is also no reason for particular precautionary measures such as may have been the case at the beginning of the year. Famous last words ?

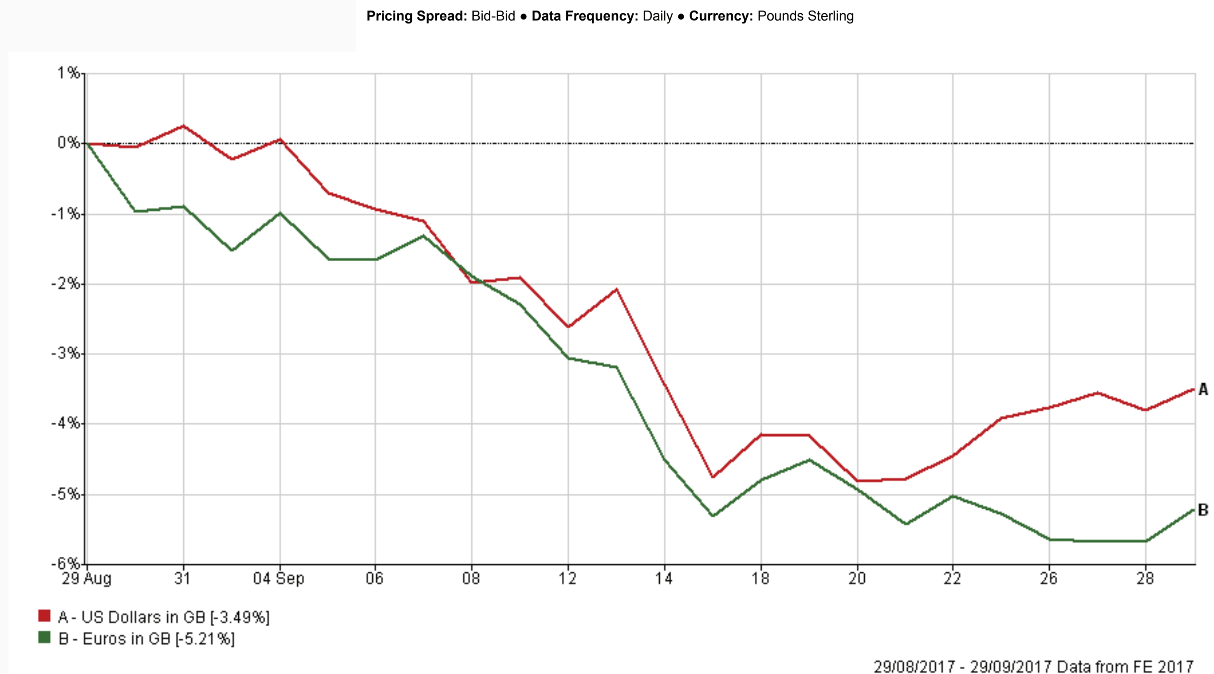
Portfolios

As the MPC 'majority' started to favour adjusting the balance from 'supporting' the economy to protecting the value of the 'notes in your pocket' in Carney's words, gilts took the brunt of the reaction. The FTSE UK Conventional Gilts All Stocks Index fell just under 3% for the month highlighting the sensitivity of fixed interest assets to interest rate speculation.

The FTSE All Share had remained relatively flat over the month, whilst emerging markets exhibited the greatest volatility of measured indices against a backdrop of geo-political tensions, giving away gains made in the first half of the month as September drew to a close.



Behind the scenes, portfolio valuations weren't helped by the strengthening of Sterling against the Euro and the Dollar, translating into lower overseas valuations when repriced when priced back into pounds, as evidenced below.



Our lower risk portfolios, which have some fixed interest exposure, were affected by the fixed interest reaction, however the complimentary uplift in the performance of the Natixis H20 Multi Returns fund, which gained just over 4.4% for the month, protected any portfolio declines to well within 1%.

The Income Portfolio posted strongest results with a healthy and stable positive return for the month, boosted by a combination of its higher UK All-Share equity content and, again, the 6% weighting in the Natixis fund.

At this stage, there is no prompt to suggest any changes in policy required, though we continue to watch the MPC monthly minutes with interest.