February 2017 Portfolio Review

2017 has started well for investors with stock markets climbing to new highs and bonds also posting gains. The bond gains are probably a bounce back from oversold levels in the last quarter of 2016. Equities around the world have been buoyed by a combination of further improvements in corporate earnings and a surprise continuation of rising business and consumer sentiment. The world does appear to be displaying synchronised economic growth without major structural for the first time since the immediate recovery from the Global Financial Crisis.

This encouraging outlook is however still overshadowed by political risks. In almost every economic commentary, the US dominates with the unorthodoxy of the US populist president Trump raising some concern around the world and the prospect of further populist shifts in major European election during 2017 also sitting uneasy with the more positive outlook.

For the moment the jury is out, whether the economic momentum that has built up since April/May last year will overcome political headwinds as it did in 2016, or whether we will witness a major paradigm shift against trade and globalisation. As at the end of February, it seems as if the 2016 mood could be set to continue for a while into 2017. This mood seems to be carried by the belief that political pressures will lead to reduced fiscal austerity but radical political shifts will not necessarily lead to radical policy changes to the detriment of the global economy.

Sadly, as is often the case when things begin to seem fine in the world of investment, sudden setbacks have to be factored in.

Two notable things happened this past week. Firstly, all three main US stock indices hit record highs at the same time, in a dizzying surge which saw the S&P 500 index gain 1.4% on Wednesday alone. Secondly, and perhaps more surprisingly, Donald Trump showed his presidential side which we had not seen since his acceptance speech in the election night.

In his first address before the US congress, the newest incumbent gave a performance that reflected a calmer and more composed tone. The Commander-in-chief even managed to refrain from any of the incendiary remarks that have become a hallmark of his early days in office – well at least until the weekend.

It seems that the 'Trump rally' – as it has been dubbed by many - seen from the back end of last year isn't losing any steam. As we have seen for a while now, markets are buoyed by the growing reflationary environment sweeping across the global economy, and the US in particular, with many analysts putting this in part down to Trump's promised fiscal stimulus policies and the extra growth this is expected to bring.

There is a caveat to add to last Wednesday's stock market boom of course. The President's speech happened to coincide with comments from New York Federal Reserve president William Dudley that suggested that a rate rise at the Fed's March meeting in 2 weeks was likely. This more hawkish turn seen from the Fed of late has undoubtedly had a positive effect on market sentiment, with investors emboldened by the Fed's vision of an expansionary economy and what this might mean for stocks. Banks in particular being aided by a rising rate environment and the increased profitability this brings to their lending margins.

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However, the causes for this sustained rally are not quite as clear cut as many would like to have it. Some even suggest the markets are rallying despite him, rather than because him. The events of the week certainly provided some support for the latter view. There were high expectations and considerable nervousness in the markets that Trump needed to deliver some policy details or risk disappointed markets. What they got was no detail, no policy announcements but a more measured sounding president – on the back of which they rallied.

It would appear that the investing public has begun to make up its own mind which of his policy targets appear achievable and which do not. The time since his election has been sufficient for political analysts to assess what he might get through with Congress and what may come through in a neutered or perhaps even constructive transformation.

With the US market at its highest level, other regions like Europe and Japan now have the great opportunity to catch up, both in economic growth terms and also higher valuations. Observing strong investment flows from the US markets to Europe and Japan over recent weeks confirms that many are beginning to recognise this relative value opportunity shift. Recovery remains on track… if only we could get the political uncertainty out of the way.

In the UK – January's headline fiscal surplus of £9.4bn, boosted by the tax deadline, was not as big as expected (£14bn), but once adjusted for a new methodology for calculating corporation tax receipts (which took off £6bn) was better than forecast. Good news for the Chancellor, though he has poured cold water on any thoughts of a generous budget. Q4 GDP was upgraded to growth of 0.7% (from 0.6%), driven by Industrial Production and Construction, with better Exports as well. Consumption growth was revised down, consistent with the weaker Retail Sales experience in December and January.

Portfolios

'Risk Assets' continued to push portfolios higher over February, with overseas stocks given a healthy lift by the strengthening of various currencies against sterling. With a one month, gross return of 3.99%, the highest risk portfolio, 10V11 posted a total return of over 100% for the first time since launch in January 2010.

The Jupiter India fund (a constituent in growth portfolios 8 to 10) posted just a shade under 5% gross return for the month, with the strengthening of the Rupee contributing as it rose approximately 3.5% against the pound. US funds also benefitted as the dollar continued to strengthen, up a further 2.5%. Vanguard's index fund slightly 'trumped' Old Mutual's active fund returning 4.79% against 4.44%.

Interestingly, one of the 'sleeping giants' in the Equity Income sector, the Rathbone Income fund, awoke to give a welcome boost to the income portfolio with one of the higher positive returns at 4.22%. The income portfolio increased just under 3.5% throughout February.

In an atypical month, almost all funds under review generated positive returns, fuelled by the environment detailed in the earlier commentary. There were two exceptions in Natixis' H2O Multi-Returns fund and Jupiter's Absolute Returns portfolio.

It is not a surprise to see 'absolute return' type funds appearing to languish as other sector specific funds appear to race ahead, and these certainly don't cause undue concern. Indeed, throughout February the lower returns came from similar funds. We would expect them to 'come good' in more challenging times, which may be around the corner as the trigger of article 50 edges closer and as the Chancellor tells us not to expect an increase in public spending ahead of Wednesday's budget.