

November 2017 Portfolio Review

As we head towards the end of 2017, November was dominated by what was described as a “level-headed” budget; President Trump making progress with his tax reforms; North Korea continuing its missile programme with little market reaction and Brexit progress being made before the deadline for Trade talks beginning. Good news in the main?

In the UK, the chancellor provided sobering news with his budget. There was a balancing act between leaving austerity behind and directing spending towards those areas that will strengthen the longer term economic prospects of the country. Sadly, it was also more than apparent that there is not much headroom for fiscal stimulus after the economists of the Office for Budget Responsibility (OBR) finally conceded that the UK was likely to be stuck in the rut of sub 2% productivity growth for much longer than previously anticipated.

There was a softening in Britain’s Brexit negotiating position as it was reported the UK would honour c.£50bn of its liabilities with the EU. To put this in a wider context, over the course of 10 years, that is just 0.25% of GDP per year. Should this be confirmed, it will offer welcome clarity to markets keen to see tangible progression in negotiations. As a result, sterling passed \$1.35 for the first time since late September, suggesting it was shedding some of its political risk premium which has been priced in since Brexit. The risk is still if the Brexit negotiations leave the UK cut-off from its main trading partners. However, notwithstanding the current Irish border “deal or no deal”, there are encouraging rumours coming across the Channel of EU intentions to make their comprehensive free trade agreement with Canada the blueprint for the post Brexit relationship. This would be a great step forward, even if it would still leave the UK less well positioned than pre-Brexit. Nevertheless, as mentioned above, despite welcome signs of progress, the outlook for UK growth still looks sluggish.

In the US, the Senate passed the long-awaited tax reform programme at the second attempt. The bill will now move onto the next stage; a House-Senate conference committee that will work to reconcile the House and Senate versions of the tax bill. Anticipation of major tax reform has supported US markets since President Trump’s inauguration – especially those sectors with high marginal tax rates such as Telecommunications & Consumer Staples. On the down side, the high valuation levels in the US, make that particular market very vulnerable to even a modest headwind. This has potential consequence for other markets, as sell-off dynamics have a habit of spreading around the world regardless of valuation differences. At the moment, there are no particular threats to the prevailing economic environment on the horizon, but there are plenty who could come and bite over the medium to longer term. Over the coming 3-6 months, it is quite possible that slowing US economic and credit growth could dampen further upside fantasy of US investors and lead to a market correction. Likewise, the notable slowing in China’s activity growth could impact emerging and commodity markets, as well as reduce China’s contribution to Global demand growth.

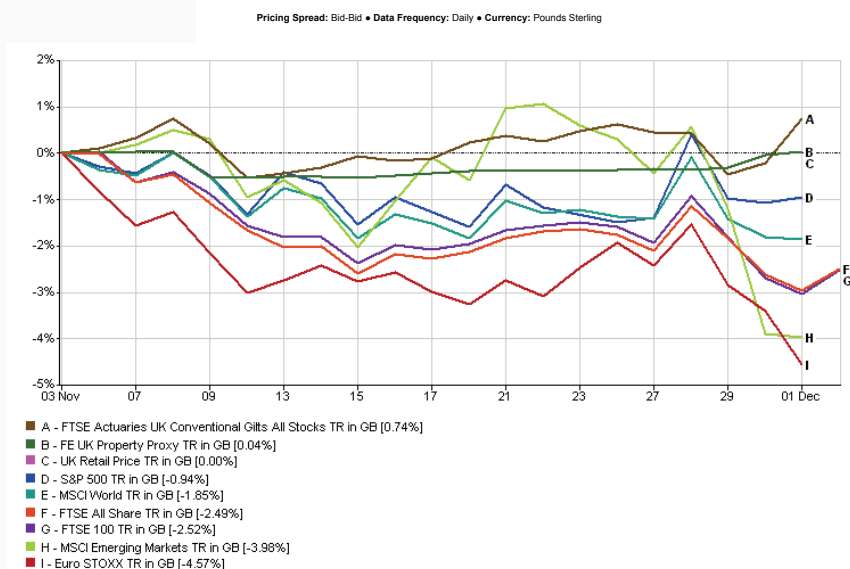
In the longer term of the next 2-3 years, the vast expansion in the volume of global credit finance, which was made possible by the low interest rates over the past decade, could become a millstone of

financing costs, should central banks be forced to raise rates faster than currently expected. Even if this does not happen, at the very least we cannot expect credit expansion to continue to boost economic growth, when rates start to rise and end 3 ½ decades of falling cost of debt.

North Korea announced the successful completion of a missile launch with long-distance strike capability which, theoretically, puts the entire US within range. Whilst previous recent tests have caused unease, stock markets reacted to this announcement with relative equanimity. Strong global growth data and the continuation of supportive liquidity positions appear to be outweighing concerns. In the main, the global economic outlook remains positive. But, whether it is quite as bright as current market dynamics imply is questionable. The extended valuations of US equities are of some concern, while Europe, Asia and much of the developing world still trade with further upside potential and here, despite the sometimes paralyzing Brexit uncertainty, the UK remains a trading nation at heart and will not be left behind when the rest of the world begins to accelerate.

Portfolios

November saw the major indices give up much of the gains from the previous month. The FTSE 100 stepped back c2.5%, while Emerging Markets and the Euro STOXX receded by c4% to c4.5% respectively (see graph below).



Again, what helped portfolio stability, albeit fending off the full effect of the falls, was a fairly dramatic weakening of the dollar which dropped approximately 3% against sterling.

Over the month, the more cautious growth portfolio (Portfolio 3V12) saw a -0.5% drop, whilst the higher risk portfolios with greater equity exposure only adjusted by c-1.4% and -1.6% for the income portfolio.

Interestingly, leading the field in terms of overall return for the month, the Baillie Gifford Japan Smaller Companies fund gained +4.87% substantially outperforming its index tracking counterpart, the Vanguard Japan Stock index fund which returned +1.06% gross.