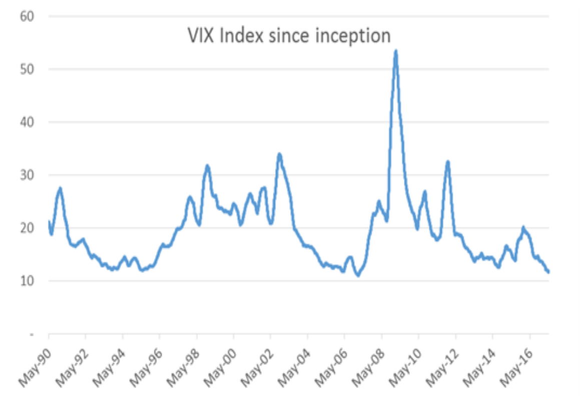
SIGNIA WEALTH

Monthly Investment Review – May 2017

Macro Outlook

May was a positive month for many assets, with the notable exception of commodities. The month seems to be representative of the way markets have behaved since the beginning of the year: good returns with low volatility. In December, markets were expecting political uncertainty, which would have raised volatility in financial markets. The political agenda was certainly volatile as expected. In the US, Mr Trump's relationship with Mexico, Russia, China and North Korea as well as the travel ban executive order and the attempt to repeal Obamacare; in Europe, elections in the Netherlands, France and in the UK, article 50 was triggered and a snap election was called. However, this had a low impact on market volatility. In fact, historically since the 1990s, the market volatility (as measured by the VIX index shown below) has not experienced 5 concurrent months' of lows apart from two brief periods in 2006 and 2007.

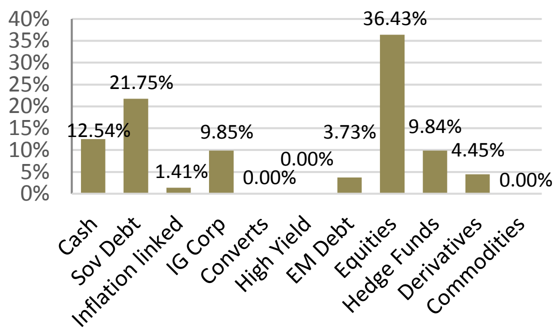


Source: Bloomberg

In May, markets performed well with low volatility. It was a good month for our balanced portfolios outperforming their benchmark by +0.33%. Nevertheless our view is that volatility might come back and as a result, financial market returns will fluctuate. We have looked at the most popular trades since Mr Trump was elected last year: value outperforming growth, small caps outperforming large caps, banks and materials/energy outperforming the rest of the S&P 500, USD strengthening on the back of higher US rates, higher US rates and steeper US yield curve, rising inflation etc. Most of these trades which have performed at some point have now petered out. Economic data from the US was mixed towards the end of the month (new home sales, University of Michigan sentiment Index, Durable goods orders, leading indicators), and so was some of the data from the UK (GDP growth, house prices, inflation) and in Europe (inflation, Economic confidence, car registrations, industrial production).

We have not made any major changes to our portfolios. We believe there might be a bit of complacency in the markets.

Chart 1: May Balanced Mandate Asset Allocation



Source: Signia Wealth

Funds

In May, our funds continued to perform well. Our selection of Japanese funds took the lead over the European and Global funds mentioned last month despite the latter still continuing to accrue outperformance. All actives in that region; Schroder Japanese Opportunities, Sparx Japan, Tokio Marine Equity Focus and Matthews Asia Japan; added on average +1.7% of outperformance each. The more quality and growth sensitive Sparx and Matthews funds benefitted most as these styles rallied well in the month. Tokio Marine was not far behind, driven in part by its growth names, but also by its smaller cap exposure. Schroder Japanese Opportunities, which we regard as a core holding, and is more balanced despite the flexibility of the mandate, rose 70bps more than the MSCI Japan index on stock selection rather than style effect. On the other hand, our holding in PowerShares FTSE RAFI US 1000 ETF detracted moderately versus the S&P 500: the RAFI index re-weights US stocks on fundamental metrics such as value and therefore did not participate in the S&P 500 rally led by expensive and large market-cap stocks, principally known as the 'FANGs' – Facebook, Amazon, Netflix, Google. This underperformance is understandable and we are aware that such performance 'crowding' is not conducive to any active management, which is reflected in our lack of other actives in the US and a smaller position in this ETF. Finally, our Asian managers disappointed this month, underperforming between 1.4% and 3.7%. Given performance of the region is already up approximately 21% on the year, and rallied a further over 4% in April alone, it is understandable our quality-focused managers did not keep up. We are aware that picking the best fund managers, who protect capital in down markets, has a cost and it is usually manifested in not fully participating in fast, large rallies. Over 20% in less than 6 months certainly counts as a fast rally and therefore we are not overly alarmed by the relative difference. We continue to monitor the situation trusting in our tried and tested approach that beats the markets in the long run, by avoiding the down markets, rather than outperforming rising markets.

The Odey European fund performed very well in the month making up some of the underperformance it was accruing. However, we are waiting for data from the fund itself before coming to any firm conclusions. In terms of trading, we initiated a small initial position in the Schroder European Alpha fund, a flexible and value-orientated fund managed by a potential star of the future. We funded this by halving our position in BlackRock European Income for two equal reasons: first our conviction in BlackRock European Income was shaken by their reactive trading around the turbulent Brexit referendum period and secondly because we wanted to remove the existing skew in our European allocation overall to quality growth. Quality growth has been the best place to be for many years, and we continue to be exposed. If our conviction in the Schroder manager grows, then we will look to grow the position. Looking forward, we are increasingly in a paradoxical although welcome position of unease: some of our funds have had such strong and consistent outperformance this year, we are unsure if it can continue and whether we should take profits in some cases. While immediate performance is welcome, we are always thinking about the future and making sure we are positioned well for the next turn, whenever it appears and whatever it may be.

Equities

US

Markets overall ended the month on a positive note as the S&P500, Dow Jones Industrial Average and NASDAQ indices were up respectively +1.16%, +0.33%, +2.50%, whilst the Russell 2000 index finished the month down -1.97%. On the macro-economic front, data releases were mixed as the job market continued on its strengthening path with continuing claims numbers released showing 116 straight weeks below the 300k figure. The Producer Price Index (PPI), a measure of price inflation, was up in April more than expected (+0.5% month-on-month vs +0.2% expected) while the core measure edged up +0.7% month-on-month vs +0.2% expected. The US inflation report released in May for the month of April disappointed somewhat as headline inflation was revealed as rising +0.2% month-on-month as expected but core inflation which strips out the more volatile food and energy prices came in at a disappointing +0.1% versus +0.2% expected. This means the annualised rate has come down from +2.3% in January to +1.9% underlining the downside risk to inflation which remains. US retail sales rose slightly less than expected (+0.4% versus +0.6% month-on-month) and manufacturing data was weak in May coming in at -1.0 versus +7.5 expected. The housing market, however, picked up to 70, its second highest reading since 2005 and Industrial production rose better than expected, +1.0% in April versus +0.4% mom.

UK

The FTSE100 index was up +4.39% on the month due, in part, to the dollar weakness which buoyed commodity players that make up a significant portion of the main UK equity index and a weaker pound.
In macro news, growth disappointed as it was revealed that the UK's first quarter GDP grew 0.2% versus previous estimates of 0.3% and 0.7% in the last quarter of 2016. The April inflation data released in May showed headline inflation rising +0.5% month on month versus +0.4% expected and core inflation rising to +2.4%. Unemployment levels improved with numbers dropping slightly to 4.6% in April. Retail sales excluding fuel jumped to a better than expected 2.0% vs +1.0% whilst Manufacturing and Services PMI both dipped slightly in May from 57.3 and 55.8 respectively the previous month to 56.7 and 53.8 respectively in May.

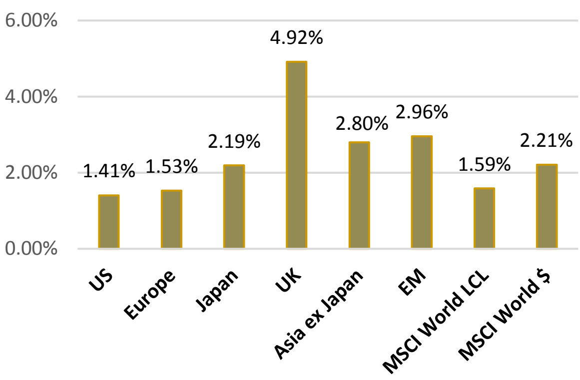
Europe

The main event in May was the final round of the French elections, which saw Emmanuel Macron defeat Marine Le Pen to become the next French President. European equity markets rose at the beginning of the month as fears over nationally led Euroscepticism faded. However markets lost some momentum towards the end of the month as European banks struggled, with the Euro Stoxx Banks Index falling 2.2%. Overall the MSCI Europe ex UK total return index added 1.78% in local terms for May. Survey data remained robust over the month, with the Euro Area composite PMI unchanged at 56.8, maintaining a six year high. The April unemployment rate across the 19 Eurozone countries continued to fall to 9.3% and consumer confidence reached a post crisis high. Notable regional economic data releases highlighted strength in Europe's largest economy, with the German IFO survey on business sentiment reaching its highest level since inception in 1991. Despite this, inflation readings eased across the region, with year on year CPI for May falling 0.5% to 1.4%, its lowest level since last December. The more stable year on year core reading fell to 0.9%. Weakness in inflation was largely due to lower service sector prices and base effects of higher oil prices continuing to fall out of readings. Elsewhere, the four major Italian political parties began talks to move to a proportional electoral system. Despite this news increasing the chances of an early Italian election, the FTSE MIB index was slightly higher in local terms.

Japan

The MSCI Japan total return Index climbed 2.2% in local currency terms, whilst the trade weighted Yen fell only slightly over the month. Economic data continued to show positive signs and year over year CPI for April came in at 0.4%, the highest rate since January. The closely followed jobs-to-applicants ratio for April reached its highest level in more than 43 years, highlighting tightness in the Japanese labour market.

Chart 2: May 2017 Equity Performance



Source: Bloomberg

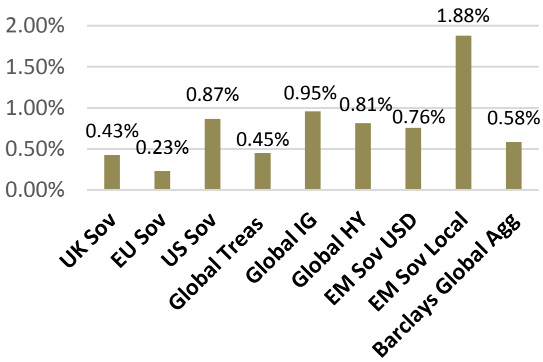
Fixed Income

The unpredictable Trump administration delivered yet another headline grabbing story in May, when President Trump fired the former FBI Director James Comey on May 9, prompting a political firestorm and accusations by critics that he was improperly seeking to hinder an FBI probe into Russia's role in the election and potential collusion by Trump's campaign. Markets have since reacted to this by pricing in a deterioration in political capital for the President with the US Dollar Index and US 10-year treasury bond yield declining -2.5% and -21 basis points, respectively, for the remainder of May. What does this mean? Given that US equity markets finished the month at or near all-time highs, suggests that the markets had not lost further confidence in the President being able to deliver substantial pro-growth policies during his first term and thus a more accommodative stance (or less 'normalisation' of interest rates) from the Federal Reserve would have been required over the period.

The Bloomberg Barclays Global Agg Hedged USD Index advanced +0.58% during the month, led by US Treasuries and European Government bonds, which saw respective 7-10 year benchmark indices gain +0.87% and +0.82%. Within Europe, French bonds performed strongly following the economic friendly win for Emmanuel Macron in the second round of the French elections – he becomes the youngest head of state since Napoleon! Elsewhere in fixed income markets the best returns were posted by emerging market local currency bonds – which benefitted strongly from the weakening US Dollar – rising +1.88%, whilst Japanese government bonds delivered the worst returns, declining -0.28% during the month.

There were two changes to our fixed income positioning in May, both within our global sovereign allocation. Firstly, we extended the duration of our French government bonds by taking profits on a 5-year zero coupon bond, which had moved from a discount-to-issue price to a premium above its issue price, we then reinvested proceeds into an 8-year bond paying a 1% coupon as we feel the outlook for French assets should remain positive. Secondly, we have initiated a small position in short dated Greek government bonds yielding 5.5% per annum and maturing in two years. We feel the European cyclical economic recovery is underway and gaining pace, and together with the ECB should remain supportive for the Greek economy which has emerged from its deep 2008-14 recession.

Chart 3: May 2017 Fixed Income Returns

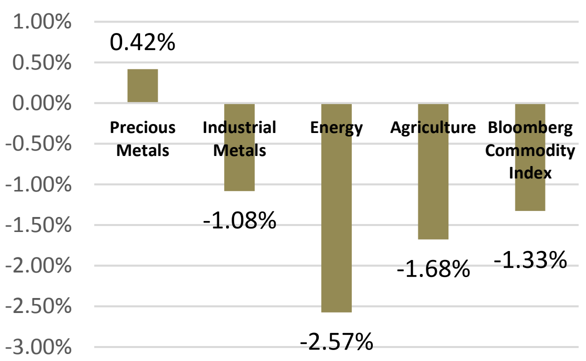


Source: Bloomberg

Currency and Commodities

The Bloomberg Commodity Total Return index finished the month at 167.96 down -1.33%. It was a broadly negative month for the index, with six of the eight subsectors down on the month. The underperforming sectors were Softs, Energy and Agriculture. The one bright spot for the Month was livestock subsector which was up 5.50% month-on-month. Lean Hogs were +12.12% month-on-month. A factor supporting U.S pork exports is the depreciation of the U.S dollar relative to multiple currencies. The U.S dollar index reflects this declining from 103.21 at the first of January to closing the month on its lows at 96.92. A lower U.S dollar supports higher U.S hog prices and their global competiveness. Sugar was down 7.74%, Coffee 2.96% and Cotton 2.32%. The energy sector had a tough month, this was despite OPEC agreeing to extend its production cuts into next year, as the oil cartel and its allies step up their attempt to end a three year supply glut that has savaged crude prices and the global energy industry. The agreement hammered out in Vienna this month will see the 1.8m barrel a day cuts, first agreed in November, extended to the end of the first quarter of 2018. Russia and other non-Opec countries have also signed up to the deal. Natural Gas was down 8.33% month-on-month and WTI ended the month at 48.32 down -2.62%.

Chart 4: May 2017 Commodity Performance



Source: Bloomberg

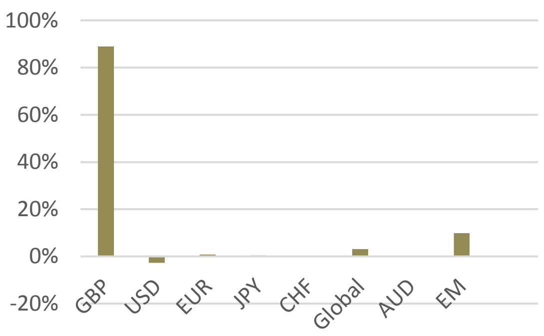
GBP/ USD

GBP had a relatively muted month closing at 1.2890 (-0.47% month-on-month). The big moves are expected in early June when the results of the general election are announced. Some brokers are estimating large swings in either direction. The possibility of a hung parliament is one of the greater downside scenarios and brokers are calling for a 300-500 pip move if this were to occur.

EUR/USD

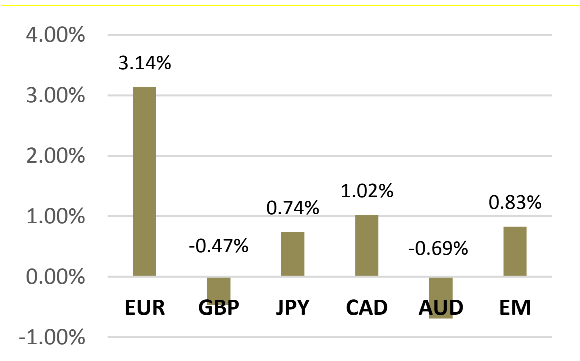
The Euro had an extremely strong month closing at 1.1244 (+3.20%). A fairly repeated theme in our monthly investment reviews has been that prospects continue looking better in the euro-zone in comparison to the US. ECB President Mario Draghi kept things balanced when he expressed optimism about growth but was seemingly worried about inflation. Inflation indeed fell back, with core CPI retreating from the highest levels since 2013 at 1.2% to 0.9%. This was primed by reports from Germany, France, and Spain. Subsequent reports about the ECB were already more upbeat: the sources said that Draghi and his colleagues are likely to upgrade their assessment of risk. The US dollar was also falling as President Trump was engulfed by more scandals. The suspicion of obstructing justice in the Comey memo towards the end of the month compounded the dollar weakness on the month.

Chart 5: May 2017 Currency Allocation



Source: Bloomberg

Chart 6: May 2017 Currency Performance vs USD



Source: Bloomberg