SIGNIA WEALTH

## Monthly Investment Review – April 2017

### Macro Outlook

**The end of reflation?**

After a good first quarter for equity markets (the MSCI World Index was up between 6% and 7% for the quarter), April was a fairly dull month as far as markets were concerned. Until the last week of the month, equity markets were down modestly, as a few political issues took the front page: the US bombing of Syria, more tension between North Korea and the US, China/US diplomatic links strengthening while the Russia/US diplomatic links weakened, British Prime Minister, Theresa May, calling for a snap election on 8th June, further Greek negotiations (that went almost unnoticed) a Turkish Referendum and finally the first round of French elections on April 23rd. With Emmanuel Macron in the lead as the potential next French President, markets reacted positively with EuroSTOXX up +4% on the following Monday. Equity markets finished the month up, with the exception of the FTSE 100, which was down due to the strength in GBP after the snap election was called. On the back of uncertainty, fixed income markets rose and commodities were modestly down.

At the end of April, the Trump administration reached the famous "100 days" milestone. Mr Trump's election coincided with the beginning of the "reflation trade": higher yields, higher commodity prices, banks and cyclical stocks outperforming, value stocks outperforming growth stocks. Whilst on the surface, nothing seems to have changed, some of the financial assets that had been most impacted by this "reflation trade" have retraced: in the US, 10 year yields have fallen from 2.62% mid-March to a low of 2.16% mid-April, value stocks in the US have lost most of their advance vs. growth stocks, in the US, banks have consolidated against the broader S&P index, commodities (as measured by the BCOM Index) are down -6% year to date, inflation breakeven rates are down or flat from their highs, in the US (20 bps), in the UK (40bps), in Europe (flat), in Japan (-20bps).

Are these signs that inflation is not picking up any longer? Why is this important? For two reasons: inflation can be a sign of sustained growth (higher growth means higher demand including workforce, and higher demand with higher income should push prices up), and also inflation will be a guideline for the speed at which central banks will either change their policy direction (from accommodative to tightening) or the speed at which they tighten monetary policy. Both growth and interest rates have the most direct influence on the price of financial assets: interest rates on the prices of bonds and currencies, growth on the price of commodities and equities.

**Table 1: Sample of inflation data**

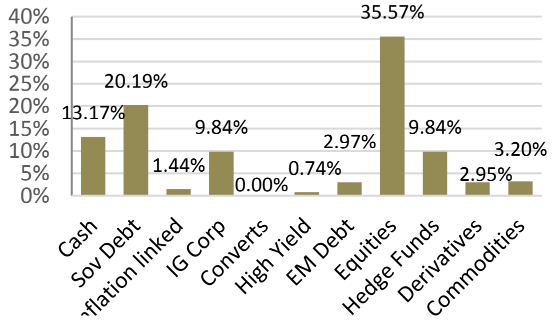
| | Headline Inflation | Core Inflation | Wage growth | Headline CPI | Bloomberg Survey Median |
|---|---|---|---|---|---|
| **US** | -0.20% | -0.20% | -0.10% | 2.40% | 2.60% |
| **UK** | -0.10% | -0.20% | -0.20% | 2.30% | 2.30% |
| **EU** | 0.40% | 0.50% | | 1.50% | 1.50% |
| **France** | 0.10% | 0.00% | 0.00% | 1.40% | 1.40% |
| **Germany** | 0.40% | -0.20% | -0.30% | 1.50% | 1.90% |
| **Italy** | 0.40% | -0.10% | 0.00% | 1.30% | 1.60% |
| **Japan** | -0.10% | -0.20% | -2.10% | -0.40% | -0.20% |
| **Canada** | -0.40% | 0.00% | -0.20% | 1.60% | 1.80% |
| **Australia** | 0.60% | 0.00% | 0.00% | 2.10% | 2.20% |

Source: Bloomberg, Signia Wealth

Table 1 shows how the latest inflation numbers have changed compared to the previously published figures. With the exception of Europe and Australia, headline inflation numbers are not increasing, and when they do, the core inflation number (usually ex-food and energy) is not increasing either. Wage growth is not improving, and this should have a dampening effect on core inflation. Furthermore, the latest inflation figures appear to be weaker than generally expected.

These numbers are just the latest release of this data, and may not show the beginning of a trend but this coupled with recent disappointing GDP growth data in the US, UK, Japan and, as expected, Europe makes us wonder whether the reflation trade is just "pausing" after a good four month run or whether this is the beginning of a change. In light of this, we have not made much change to our portfolio allocation. Last month's performance was slightly disappointing against benchmark but this is mainly due to the defensive nature of the derivatives we hold. Year-to-date we remain in line with benchmark.

**Chart 1: April Balanced Mandate Asset Allocation**




Source: Signia Wealth

**Funds**

In April, the strong trend in our fund performance continued with Jupiter Europe and Franklin UK Manager Focus being our two stand-out performers and supported this month by Memnon and BlackRock in particular, also from Europe and Fundsmith and T. Rowe Price in the Global sector. The latter two each gained over +2.5% of alpha last month on the back of the strong performance of reliable earnings staples and high growth technology. T.Rowe Price Global Focused Growth fund is however not just exposed to technology, it has a moderate allocation to US regional banks, which also contributed strongly. However, it is not surprising that in this environment, our value-oriented managers have not performed as well. Our conviction in them remains very high in anticipation of the market turning, however, in the meantime, Artemis Global Income for example, is working very hard to stay roughly in line with the benchmark.

In terms of fund trading activity, the second half of April was a busy period, where we principally executed a trim of our underperforming Odey European Fund and increased our allocation to Jupiter European Fund to its full weight in the portfolio. As mentioned in previous commentaries, the rationale for this was that the manager was running a large portion of cash and the risk/return profile going forward for our clients no longer validated a large core holding of the fund. Due to our conviction in the talent of the manager, we cut the position in half to reduce the potential adverse effects of the holding, whilst maintaining exposure to the fund, which we still believe holds immense upside potential when markets eventually 'normalise'. The increased allocation to Jupiter Europe at this time was to take advantage of the unprecedented underperformance of the manager after which we added capital. Whilst we do not time markets before deploying capital, we always look for managers with explainable short term underperformance, and excellent long term track records, which it did in this instance and which has benefitted the performance. Finally, we added to the positions in our three chosen global managers so that they are now at full weights. Some have performed exceptionally well recently which can be a concern when adding to them, however we think the blend of the three act as a core holding for the long term, and crucially that this is the start of a trend of strong outperformance.

**Equities**

**US**

Equities finished the month in the green with the S&P500, Dow Jones Industrial Average, NASDAQ, and Russell 2000 indices up +0.91%, +1.34%, +2.30% and 1.05% respectively on the back of positive corporate earnings releases and hopes throughout the month for tax reform implementation, however the result was disappointing due to the lack of detail over the implementation plan.

In macroeconomic news, only labour data continued to support the case for a strengthening economy, whilst a release of various economic indicators conflicted with the "reflation case". The labour market continued to tighten as the number of Americans claiming unemployment fell to a 17-year low in April. However, GDP missed expectations of 1.2% growth by only expanding 0.7% in the first quarter of 2017 according to preliminary official data. This was far from the 2.1% growth seen over the previous quarter. Headline inflation came in lower than expected as revealed by the latest CPI report for March, -0.3% versus 0.0% expected. Core inflation was also lower than expected coming in at -0.1% versus +0.2% expected. Manufacturing production fell -0.4% in April whilst US industrial production increased +0.5% in the month. The NAHB housing market index declined 3pts to 68 from its 12-year high.

**UK**

UK equities finished the month down -1.62% mainly on the back of weakness in mining and oil stocks and a surge in GBP following Theresa May's call for a snap election, which also triggered a fall in the FTSE index. Stronger GBP tends to hurt the UK equities index as over 70% of its constituents derive their earnings from overseas and an appreciating domestic currency makes it more expensive to convert foreign earnings back to UK currency earnings.

In macroeconomic news, retail sales in March declined (-1.8% month-on-month versus -0.5% expected) for the first time since 2010. GDP growth came in at 0.3% in the first quarter of 2017 missing expectations for 0.4% growth and less than the 0.7% growth seen in the final quarter of 2016. UK Manufacturing and Services PMIs came in at 57.3 and 55.8 respectively both beating expectations. Finally, UK inflation as measured by the consumer price index came in at 2.3% and remained flat compared to the previous month.

**Europe**

The MSCI Europe ex UK returned 2.7% in April in Local terms, continuing the trend of the best performing region of the month. The main market event in April was undoubtedly the first round of the French presidential election. Markets rallied in relief as centrist candidate Emmanuel Macron made it through to the second round.

The European Central Bank ("ECB") left monetary policy on hold in April, making no changes to its key interest rates or bond buying programme. ECB

President, Mario Draghi, said the likely victory of Emmanuel Macron in French presidential elections had no impact on its monetary policy decisions. He has poured cold water on hopes as to when the ECB could start exiting its stimulus programme, saying that the bank's governing council had not discussed it.

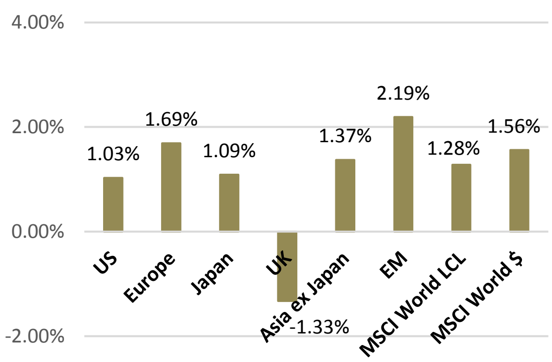
The final Euro area headline was CPI for March confirmed at 1.5% year-on-year. Core CPI was at 0.7% year-on-year, which is the lowest print since April 2015. The main driver of this month's weakness was energy inflation, due to lower oil prices and base effect. Lower than expected food inflation also contributed to this month's weakness. Final Purchasing Manager Index ("PMI") numbers were revised down from flash estimates in March. This was largely driven by a 0.5pt fall in the Final Service PMI. The Euro Area consumer confidence reading improved in April, at -3.6 up from -5 in March and above consensus estimates of a -4.8 reading. This was the largest monthly increase since December of last year.

**Japan**

In March, the MSCI Japan NR Index was up +1.3% in local currency terms. Most of the positive return came after the first round of French election.

Japan posted the second consecutive monthly trade surplus in March, at ¥614.7 BN. Exports also grew on the month, up 12% year-on-year, supported by the weaker Yen. Exports to China and the US continued their upward trend. In March, exports to China grew 11.9% year-on-year in March, for a tenth straight month of growth. The consumer confidence index increased to 43.9 in March and is now at its highest level since just after the launch of Abenomics. Exports to the US rebounded this month, at 4.5%. February national Core CPI (ex. fresh food) came in at 0.2% year-on-year, increasing from the January reading of 0.1%. The unemployment rate fell to 2.8% in February, down from 3% in January.

**Chart 2: April 2017 Equity Performance**




Source: Bloomberg

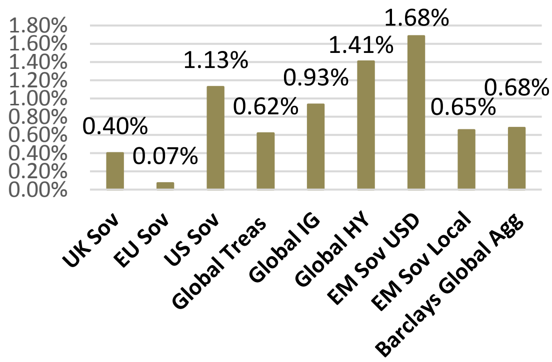
**Fixed Income**

In April, the heightening of geopolitical risks around Syria and North Korea saw Donald Trump seek to define his first 100 days in office by shifting from a waning Pollyanna policy agenda on the US economy, towards a more authoritative and existential mantra of war. This produced a bid for safe haven sovereign bonds, whilst a strong start to corporate earnings season and a growing probability of a market-friendly French election outcome also helped riskier fixed income assets post healthy gains.

The Bloomberg Barclays Global Agg Hedged USD Index advanced +0.68% during the month, led by US Treasuries and French Government bonds, which saw respective 7-10 year benchmark indices gain +1.13% and +1.67%. German government bonds were the most subdued sector but still managed to post a positive return of +0.07%. The best returns were seen in the credit and emerging market space, where global high yield bonds and emerging market hard currency sovereign bonds increased +1.41% and +1.68%, respectively.

There were several changes to our fixed income asset allocation during the course of the month. Firstly, we took profits on our tactical US high yield bond position that had been held since early December following a +12.1% annualised gain and recycled the proceeds into emerging market local currency sovereign bonds. Secondly, we changed the composition of our investment grade credit allocation by rotating out of a global strategic bond manager into a European bank capital securities manager. Lastly, after twelve months of providing a 2% per calendar quarter coupon and a partial portfolio hedge against rising US yields, the portfolio received final principal and coupon payment on expiry of a structured product for a total return of +8%.

**Chart 3: April 2017 Fixed Income Returns**

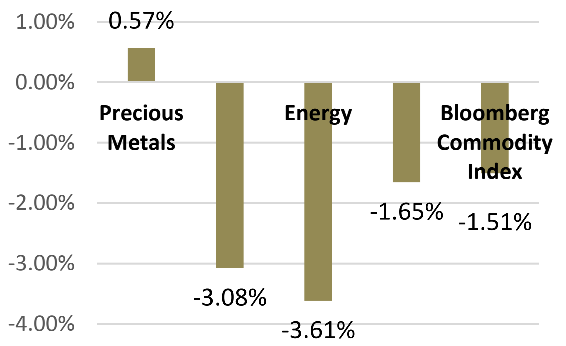



Source: Bloomberg

**Currency and Commodities**

The Bloomberg Commodity Total Return index finished the month at 170.22 down -1.51%. It was a tough month for the Energy, Industrial Metals, Petroleum and Softs Sub Index. Coffee had a tough month closing at 27.04 (-5.73%). The industrial metals complex continued its weakness from the previous month, the sub index was down -3.40% with Lead (419.92 -3.94%), Nickel (194.76 -5.85%) and Zinc (156.53 -5.53%) being the key detractors. Industrial metals plunged as traders capitulated amid stock market declines and scepticism surrounding the outlook for commodity demand from China and the U.S. Metals have pulled back in the past two months, after surging last year, as investors question the boost from President Donald Trump's infrastructure spending plans and the sustainability of Chinese demand growth. Livestock was the star performer in the commodities Index with Live cattle ending the month at 152.41 +11.93%.

**Chart 4: April 2017 Commodity Performance**



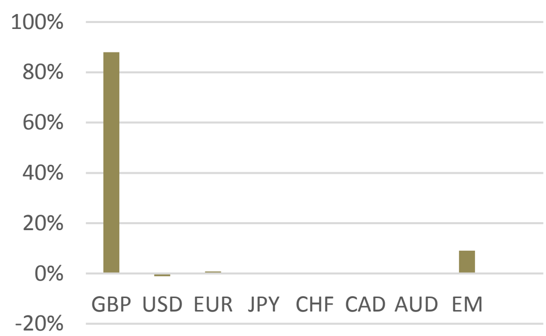

## GBP/ USD

GBP had its strongest month in 2017 closing the month at 1.2951 (+3.20%). The pound jumped sharply as Prime Minister, Theresa May, shocked the markets by calling a snap election to be held 8th June. Theresa May is expected to increase the Conservatives' majority in parliament.

## EUR/USD

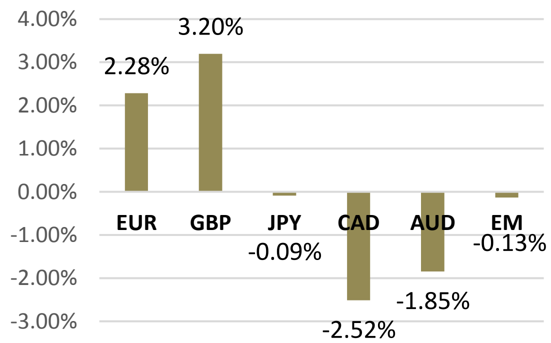
The EUR moved in lockstep with GBP having its second strongest month of 2017. The bulk of the Euro's strength was (as with GBP) on the back of political news flow regarding the French general election and the assuaging of fears of a Marine Le Pen government, as Centrist Emmanuel Macron topped the first round. ECB President, Mario Draghi, took the euro for a ride. He started off with optimism, talking about better growth and diminishing downside risks. Yet after sending the euro higher, he showed more caution on inflation and said there was no discussion on an exit strategy. This sent EUR/USD back down. The currency pair also received a boost from inflation data. Eurostat Eurozone Core MUICP year-on-year Core CPI was up 1.2%, the highest since 2013. All these factors combined led some of the sell side to speculate whether this is the turning point for the Euro.

**Chart 5: April 2017 Currency Allocation**




Source: Bloomberg

**Chart 6: April 2017 Currency Performance vs USD**




Source: Bloomberg