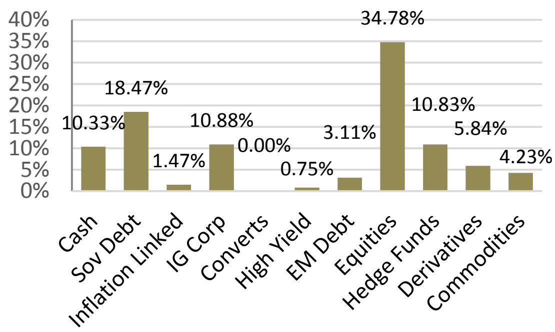
Monthly Investment Review – January 2017

Macro Outlook

Although January started on a very positive note for equity markets, the month ended being less so. The optimism that prevailed at the end of last year continued during the first days of 2017 but then a divergence in performance between assets started: as equities went up (some indices such as the Dow, the S&P and the FTSE 100 reached all-time highs), interest rates failed to go up and the USD depreciated against most currencies. This could be a potential indicator that the future might not be as bright for equities. We therefore took advantage of this optimism in equity markets to partially reduce risk in our portfolio (by buying back some puts) and adding to our volatility allocation by buying another dispersion trade. These are trades that tend to perform well when equity markets are volatile. The highlights of the month were Mr Trump's inauguration ceremony quickly followed by a few executive orders and Prime Minister, Theresa May's speech about Brexit and the subsequent vote. Although both events did not directly impact markets, it is fair to say that markets are more conscious of political risks on both sides of the Atlantic. Our performance was in line with that of the benchmark, the main detractor being currencies. We have a small short position in EUR which detracted 15 bps as dollar depreciated. We will keep this one as a partial hedge against volatility due to elections in Europe in the coming months.

Chart 1: January Balanced Mandate Asset Allocation



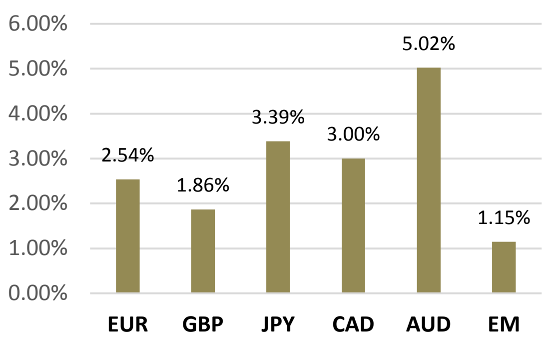
Source: Signia Wealth

Funds

January was broadly a strong month for our funds. In Europe, Memnon leads the pack of outperformers by accruing 1.45% of outperformance on the strength of its stock picking and the rise in mid-cap industrial stocks. Odey is the only underperformer (-1.04%) struggling to keep up with the index while tactically holding cash, and struggling to find under-priced earnings potential. In Japan, Sparx stood out by beating its benchmark by 1.75% as it benefitted from the continued strength of large cap value names (exporters and financials) in the region. Schroders Japanese Opportunities Fund was the main detractor lagging marginally (-0.57%) as it gave back some performance from its very strong 2016 numbers on profit-taking. Both UK funds did well in January, but Majedie stole the show by adding 2.52% of relative performance in the month. While we wait for exact performance confirmation from the fund, it ended 2016 positioned heavily in commodity, banking and mining sectors to benefit from the reflation environment and this looks to have worked very well. In Asia and emerging markets the theme continues to be the continued struggle of defensively positioned funds as they stick to their discipline, while the less constrained and more flexible BlackRock Growth Leaders and Julius Baer Emerging Equity flourished in the recent market rally. Finally, our Global managers have now been in our portfolios for more than two months and are behaving as expected: Artemis Global Income is in line with markets, Fundsmith is struggling marginally due to its lack of cyclical names in favour of quality staples and T.Rowe Price Focused Growth is over 1.2% ahead on the recent rally of large cap growth names.

In terms of activity, the first half of January was a quiet period as we met with managers and strategists to discuss past performance and 2017 outlooks. However, in the second half of the month we held many discussions on our portfolio. In terms of geographic tilts, we concluded that there are many regions in which the medium term fundamentals are favourable but need to be weighed up against uncertain and often binary political risks. We took the decision therefore to avoid tilting ourselves geographically and instead we rebalanced our drift back to benchmark allocation weights. We have made three fund selection changes. The first was to sell out of Capital Group Japan and reallocate to Schroder Japan Opportunities. We invested in the latter as a core holding, and we generated a small amount of alpha in the fund but lost conviction that it could generate alpha across several diverse sectors, rather than just electronic appliances as it had in the past. Given that Schroder behaved like a core holding but is capable of more alpha generation we are using the fund as the core allocation going forward. The second and third changes both involve our European managers: for most of our clients we reduced our passive ETF in order to make our first investment into Jupiter European Fund, taking advantage of unprecedented underperformance from a 20 year track record star fund manager to reenter the strategy. Finally, we balanced our European exposure for our US clients by adding Brown Advisory's Wellington European Fund alongside the existing T.Rowe Price Europe fund.

Chart 2: January 2017 Currency Allocation



Source: Signia Wealth

Equities

US

The S&P500, Dow Jones Industrial Average, NASDAQ and Russell 2000 indices were up on the month +1.79%, +3.34%, 4.30% and +0.28% respectively on the back of markets reacting positively to the Trump administration's fiscal policy rhetoric and its plans to relax regulatory burden on domestic manufacturers as well as financial institutions.

The US economy grew 1.9% in the last quarter of 2016, missing estimates of 2.2%. Inflation as measured by the personal consumption price index increased 2.2% whilst core inflation rose 1.3%. The US manufacturing purchasing managers' index (PMI) rose to 55.1 in January from 54.3 in December exceeding forecasts of 54.5, whilst the services PMI rose to 55.1 this month from 53.9 a month earlier beating forecasts of 54.4. US retail sales were up 0.6% in December shy of expectations of 0.7%. US consumer confidence rose to 98.5 this month from 98.2 in December, beating analysts' forecasts for a reading of 98.1.

US markets dipped at the end of the month, following Trump's controversial curb on refugees and travel ban on arrivals from seven Muslim countries.

UK

The FTSE100 index was down -0.61% this month on the back of a strengthening GBP following Prime Minister, Theresa May's speeches confirming that Britain would leave Europe's single market.

On the data front, the Consumer Price Index rose month-on-month by 0.5% in December compared to 0.2% in November, while the market had forecast a rise of 0.3%. Core inflation rose 1.6% from 1.4%. UK retail sales fell to their lowest since April 2012 as an increase in average store prices deterred shoppers. Consumer confidence fell to -5.1 from 4.6 in December following mounting concerns about rising inflation following the Brexit vote.

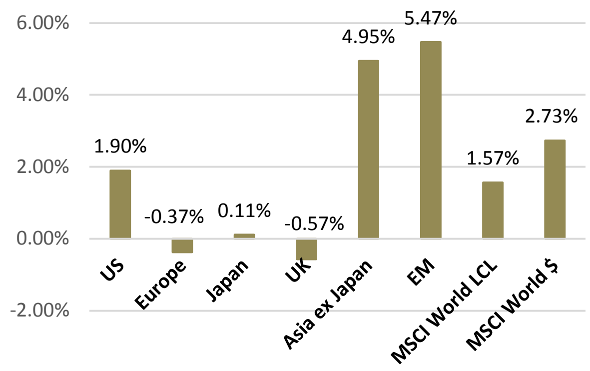
Europe

The EuroStoxx Index returned -1.82% in January. This was marginally lower principally from weakness in energy, real estate and the defensive sectors, principally utilities, as European yields moved to their highest point since January 2016. Economic data has been supportive through the last quarter and January added to the improving economic picture. German Q4 GDP moved higher to 1.9% year on year, Spain held steady at an encouraging 3%, however notably France still remains low at 1.1% marginally missing many estimates of 1.2%. German Flash Manu PMI surprised significantly on the upside with a very strong reading of 56.5, suggesting significant growth momentum in the strongest European economy and this was reflected in outperformance of +2.5% by the European autos sector. The other notable move in equity markets was the outperformance of Financials +5.25% as tailwinds from rising interest rates fed strongly into valuations.

Japan

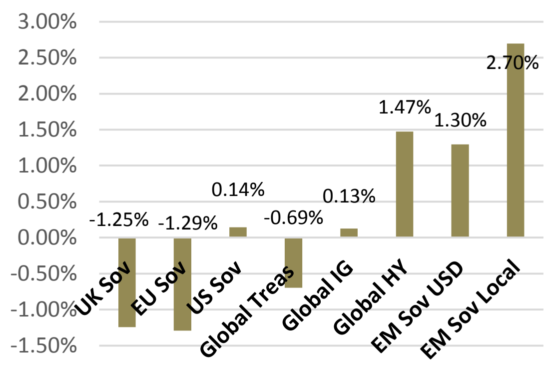
The TOPIX Index returned +0.20% in January. A stronger Yen hampered equity returns, however within equities there was strong rotation with cyclical and manufacturing industries significantly outperforming as inflation expectations moved higher in January (5yr Inflation Swap fwd @ 0.6750% [+0.2% MoM]). With the Bank of Japan keeping the 10yr interest rate close to zero, financials did see the same strength rally as in other developed markets, the banks in particular stayed flat this month. The January dataflow was fairly muted. Early January the Consumer Confidence data moved higher, however the key Inflation and unemployment reports did not move significantly. It is worth noting that the Housing Starts data slowed in December (falling from +6.7% to +3.9%) despite very low mortgage rates of <1% remaining very supportive for the sector.

Chart 3: January 2017 Equity Performance



Source: Bloomberg

Chart 4: January 2017 Fixed Income Returns



Source: Bloomberg

Fixed Income

Another month dominated by Trump saw his official inauguration as the focal point of investors' attention. Whilst the occasion itself was interpreted by markets as a non-event, with minimal impact to asset prices on the day some Trump trades that had driven market moves at the end of last year maintained their momentum into 2017, namely rising inflation expectations and declining credit spreads. There were, however, notable exceptions: firstly US sovereign bond yields which paused their three-month upward advance, and secondly the US dollar which weakened significantly following comments by the new administration highlighting its overvaluation against the Chinese yuan and Euro.

During the month the Bloomberg Barclays Global Aggregate Bond Hedged GBP Index declined -0.4%, led once again by European bond markets as upcoming political event risks in France, Italy and Germany this year began to be priced in by markets. Spreads of French and Italian government bond yields over Germany increased. The Bloomberg Barclays Euro Aggregate Government 7-10 Year Index declined -2.1%, whilst the Italy Government 7-10 Year Index declined -3.1%. Despite this, European high yield bond markets did manage to hold up in January with a +0.7% gain, however, this return was considerably lower than their US counterparts which posted a much healthier +1.5% gain.

We implemented two switches and one hedging strategy in the portfolio during January. By switching our French government bond exposure into UK Gilts, and part of our passive global corporate bond exposure into a new actively managed global corporate bond manager. In order to protect the portfolio from further rises in US bond yields this year and capitalise on current low levels of Treasury price volatility, we purchased put option protection expiring in January 2018 on US government bonds.

Currency and Commodities

The Bloomberg Commodity Total Return index finished the month at 177.18 up +0.14%.The internal sector movement within the month was significantly muted compared to the end of 2016. It was a strong month for soft commodities (106.69 +6.46% month on month), Precious Metals (340.31 +6.27% month on month) and Industrial metals (234.90 +7.45% month on month). The main detractor was Energy (74.94 -7.60% month on month). The commodity weighing down the Energy sector was Natural Gas which ended the month at 0.94 (-15.35% month on month). The unclear nature of the potential trade war with Mexico, the United States biggest natural gas export market, has led to fears of a glut. Together with the uncertain nature of President Trump's tax plan, and its effect on the Oil and Gas market, have led to caution from market participants. Base metals: lead (+17.85%), zinc (+11.02%), copper (+8.91%) and aluminium (+7.24%) continued their charge on the back of the restocking and reflation theme. The start of the year has been mixed for commodities, many analysts are waiting on clear guidance on policy and confirmation of economic data before making firm bets in these assets.

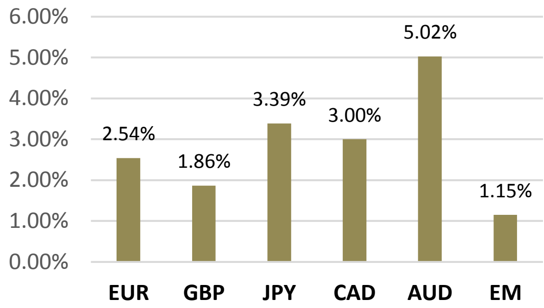
GBP/ USD

Sterling had a volatile month punctuated by large movements up and down. The GBP had lows of 1.2049 during the first sixteen days of January and then rallied from the 1.20 level seen intra month to close the month at 1.2579 (+1.94%). GBP posted its highest single – day gain since 2008 after Prime Minister May's Brexit Speech. May said the UK would leave the EU single market but was interested in a free-trade agreement with the continent. The GBP seems to be breaking the consensus view and proving that "extreme short positions" (according to CFTC data) do provide a good contrarian indicator for potential entry into trades. The news flow around Brexit continues to be the central focus; however, with the added twist of comments by Bank of England Governor Mark Carney, who hinted the Bank of England does not want the currency to dive too far, and called markets' doom and gloom around Brexit "mistaken".

EUR /USD

The Euro closed January on a firmer footing ending a streak of three months of significant losses. It closed the month at 1.0798 (+2.67%). The European Central Bank did not move policy and more importantly, did not change its view about inflation. By dismissing the recent rise as energy-related, Draghi did send the euro lower, however, he was unable to change the direction of the currency in the month of January which was one way from the lows in early January of 1.04 to the high seen at month end at 1.0798.

Chart 6: January 2017 Currency Performance vs USD



Source: Bloomberg