Monthly Investment Review – March 2017

Macro Outlook

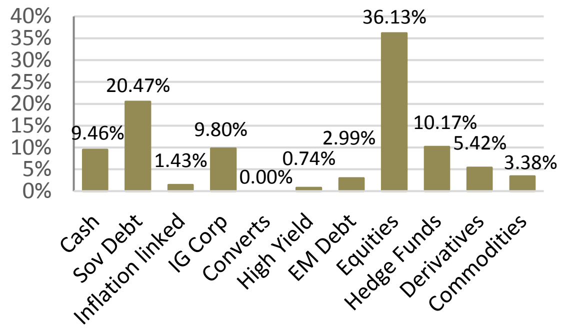
March was a quiet month. Three political events were closely watched but their impact on financial markets was fairly muted. The first was the Dutch general election held on 15th March. The failure of Mr Wilders's Freedom Party to get a majority allayed some fears that the populist movement would gather traction in Europe. The second event was the replacement of the Affordable Care Act in the US. After delaying the vote by a day to try and secure enough votes to get the new bill passed, the Republicans decided to pull the vote. Most Americans agree that this was the most complex piece of legislation that Mr Trump has tried to tackle so far and therefore no surprise that he failed to gather enough support to get the bill passed. This was one of the most publicised measures announced during the election campaign and it has raised doubts as to whether Mr Trump and his administration will be able to deliver on the rest of the agenda, mainly fiscal, deregulation and infrastructure measures. Last but not least, the UK triggered Article 50 on 29th March.

Next month, we will be closely watching the French elections. Whilst we do not expect Mrs Le Pen to win, we believe that the probability of her winning is higher than is commonly accepted. As an example, in 2002, her father lost the election against Jacques Chirac and managed to get only 17.8% of the vote in the second round. Today, Mrs Le Pen is credited with 40% votes in the second round. This is quite astonishing progress even taking into account polling errors. Never-the-less, the parliamentary elections in June will also be closely watched as the decomposition of the political landscape in France leaves ample room for additional uncertainty.

Developed equity markets made the most of their gains in the first week of the month, the most noticeable event was the S&P falling 1.24% on 21st March. The Federal Reserve (Fed) short term rate hike of 0.25% was widely anticipated by the markets. We took advantage of a fairly quiet month to restructure our portfolio: given the performance of equity markets since the US presidential election, we took profit on some of our equity options (and rolled them) and lowered our equity exposure. We did a similar trade with our fixed income options: we partially took profit and restruck them.

Our portfolios behaved as expected versus their respective benchmarks: for the quarter, our balanced portfolio has outperformed its benchmark by 0.51%

Chart 1: March Balanced Mandate Asset Allocation



Source: Signia Wealth

Funds

Our selected fund performance in March mirrored the February trend where growth and defensive styles boosted performance and value strategies marginally detracted or were in line. One of the biggest beneficiaries was Jupiter Europe, a holding that we added in early 2017 after unprecedented underperformance in 2016, that we believed was temporary. So far, the thesis has played out strongly, and the manager has been generating very strong alpha each month. In Japan, Tokio Marine's smaller cap, growth approach also benefitted after a few months where its approach was out of favour. Similarly, our holding in Franklin UK Manager Focus fund, which is more sensitive to the FTSE 250 mid-cap index rather than the FTSE 100, started to perform well. Odey European Focus fund remains our stand-out underperformer, because it holds cash and hasn't participated as strongly in the upside. After meeting with the manager this past month, and discussing his rationale in depth, we are not losing conviction in his skill. However, for risk management purposes, we may trim the position down to give capital to our other managers. In the long run, we are likely to keep the fund to retain a balanced approach despite what style is in vogue, and the Odey manager is an exceptional, original thinker that would benefit immensely if the current run of markets where to change, something we always need to prepare for.

In terms of fund trading activity, March was a moderately busy month, with partial additions to Jupiter and Memnon in Europe, as well as Fidelity Smaller Companies in Asia. We are likely to complete our Global manager trades in the weeks to come, before any disruption or volatility from the French elections in April/May and are still considering how to best blend the new value or cyclical-orientated strategies in Europe that we mentioned in previous updates.

Equities

US

US markets had a mixed month as the S&P500 Index, Dow Jones Industrial Average Index and Russell 2000 Index generated -0.04%, -0.72%, and -0.26% respectively whilst the NASDAQ delivered +1.48%.
Markets seemed to pause for breath in order to gauge the Trump administration's ability to deliver on its policy agenda, in particular following the inability to repeal and replace the affordable healthcare act. Looking at macro-economic numbers, fundamentals generally still seem supportive, especially US consumers and business indicators.
The March non-manufacturing PMI and services PMI, although slightly below expectations came in at 52.8 and 51.6 (numbers over 50 indicating growth). Factory orders were reported as rising +1.0% month-on-month in February putting them up +7.3% year-on-year. The University of Michigan consumer sentiment reading came in at 96.9, ahead of February's reading of 96.7. Inflation numbers were confirmed as rising +0.1% and core inflation +0.2% on the month.
Finally, US fourth quarter (Q4) GDP was revised up in its final revision at +2.1% quarter-on-quarter. Q1 2017 GDP estimates vary within the FED between 0.9% and 2.9%.

UK

UK equity markets finished slightly positive on the month with the FTSE100 Index delivering +0.82%. Meanwhile the Bank of England's (BOE) decision to leave rates unchanged at 0.25% and leave its quantitative easing program untouched helped miners and oil stocks (a large proportion of the FTSE index). An attack on the British parliament, the setback in the ability of the Trump administration to pass one of its key bills and the triggering of Article 50 by the British PM (which spells a lengthy period of tough negotiations between the UK and Europe), all contributed to subduing market performance this month. On the data front, revised numbers from the Office for National Statistics (ONS) showed that Britain's economy expanded in the fourth quarter of 2016 to a lesser extent than initially expected with GDP coming in at 1.9% year-on-year versus 2.0% expected. The ONS also revealed that the services sector declined in January, as did the savings ratio indicating that national growth will be negatively affected which should keep interest rates grounded for a while yet. Finally, UK consumer inflation (CPI) numbers published by the ONS hit 2.3% in February, above market expectations of 2.1%.

Europe

The MSCI Europe ex UK returned 4.6% in March in Local terms, the best performing region of the month.

In Europe, business surveys have risen to their highest levels in over five years and consumer confidence has recovered close to pre-crisis highs. The improvement in business confidence is widespread across the Eurozone and European companies are finally starting to show broad-based earnings growth. Eurozone consumer confidence for March came in at -5.0 vs last month's reading of -6.2. The Q1 figure is the strongest quarterly print since mid- 2007. Final February CPI numbers in the Euro area confirmed an unchanged picture, with a headline CPI of 2% yoy, and core CPI of 0.9% yoy.

ECB left interest rates unchanged and made no changes to the asset purchase program at their March meeting. The market took Mario Draghi's comments as mildly hawkish, as he stated that risks are now more balanced, and the growth picture in the Eurozone has improved somewhat. The European banking sector rallied subsequently.

Political risk in Europe has subsided somewhat following rejection of anti-euro politicians in both Austria and the Netherlands. Focus now turns to the French election where centrist candidate Emmanuel Macron continues to poll with a comfortable margin to Le Pen in the second round.

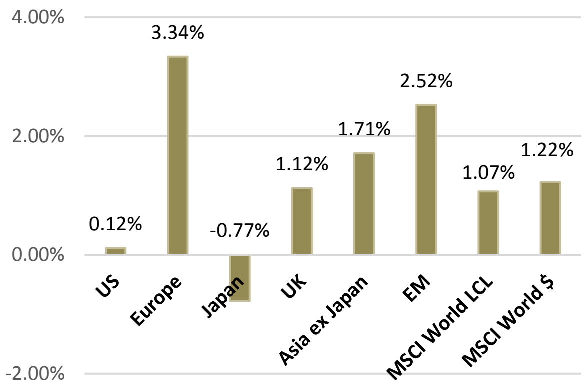
Japan

In March, the MSCI Japan NR Index was down -0.50% in local currency terms. The strength in the yen so far this year has weighed on the performance of Japanese equities.

Japanese data has been reasonably positive, with business surveys indicating expansion and falling unemployment, now down to only 2.8%. Inflation was positive in January, with national core CPI (ex. Fresh food) coming in at 0.1% yoy, national new core CPI (ex. Fresh food and energy) came in at 0.2% yoy, and headline CPI (all items) was up 0.4 yoy. Basic wage came in a sharp rise from the previous reading of 0.4% to 0.8%. February Consumer Confidence was broadly unchanged, at 43.1, slightly lower than consensus expectation.

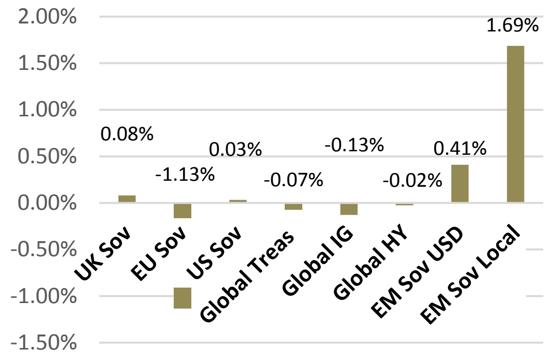
Towards the end of March, Bank of Japan (BoJ) sold Japanese government bonds with repurchase agreements for the first time since 2008, aiming to ease the tight supply and demand conditions over the fiscal year end.

Chart 2: March 2017 Equity Performance



Source: Bloomberg

Chart 3: March 2017 Fixed Income Returns



Source: Bloomberg

Fixed Income

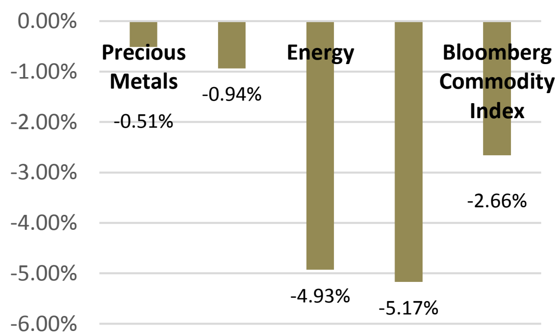
After a strong February it was a mixed month for fixed income assets in March, as an air of deflation lingered across markets that echoed the vaunting wind of superiority being let out of President Trump's sails following his failed attempt to repeal Obamacare in Congress. Whilst the Bloomberg Barclays Global Agg Hedged USD Index was broadly flat, declining -0.05% over the month, other parts of the universe were slightly more volatile. Emerging market local currency bonds and global convertible bonds increased +1.7% and 1.0%, respectively, as riskier cohorts benefitted from the continued synchronised upswing in global growth and trade. On the other side of the returns spectrum 7-10 year German government bonds and 1-10 year European inflation linked government bonds declined -1.1% and -0.8%, respectively, reflecting speculation that recent solid economic data from the region could trigger a policy change from the European Central Bank away from its ultra-accommodative stance. We think that these concerns are unfounded and the ECB will likely remain on course with their QE program as planned until the end of the year before tapering its purchases in early 2018.

There were several changes to our fixed income asset allocation during the course of the month. Firstly, we reduced our investment grade corporate bond allocation from overweight to neutral as global IG corporate yield spreads declined to their lowest levels in over a year. Secondly, we changed the composition of our emerging market debt allocation by reducing emerging sovereign hard currency bonds in favour of emerging sovereign local currency bonds, based primarily on cheap FX valuations and improving EM fundamentals. Lastly, after exiting our position in January we have added back to our underweight French government bond position as we feel that relative valuations to German government bonds have cheapened too far ahead of the French elections and now offer good value.

Currency and Commodities

The Bloomberg Commodity Total Return index finished the month at 172.83 down -2.66%. The Softs Sub Index (95.37 -6.21% MoM) had a tough month with Sugar the key contributor to the underperformance, it was down -12.79% to close the month at 226.47. Soybean was the key detractor for the Agriculture Sub index closing at 1,460.13 (-8.86% MoM). The energy complex had a mixed month. Natural Gas ended the month +11.23% at 0.92. This was due to inventory data and signs of thawing in political tensions between the US and Mexico. The U.S. Energy Information Administration (EIA) reported that U.S. natural gas stocks decreased by 150 billion cubic feet for the week ending March 17. Analysts were expecting a storage decline of 153 billion cubic feet. The five-year average for the week is a withdrawal of around 21 billion cubic feet. Natural gas inventories fell by 53 billion cubic feet in the week ending March 10. The crude complex was negative amid questions on whether OPEC production cuts would be rolled over and a mixed bag of inventory data. This is while the US rig count reached its highest reading of 662 for the week ending 31/03/2017.

Chart 4: March 2017 Commodity Performance



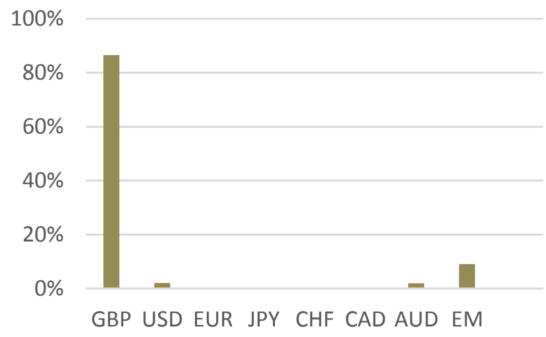
GBP/ USD

GBP started the month at 1.23 and subsequently moved higher to close the Month at 1.2550. With the government triggering Article 50 it seems the GBP was buoyed by firmer inflation numbers, with some discussion over whether the BoE would be raising rates. One member of the Monetary Policy Committee, Kristin Forbes, decided to vote for raising rates in the UK amid rising inflation. Others considered it seriously, especially if price rises persist. On the inflation front, month over month CPI rose by 0.7%, pushing the year on year CPI to 2.3%. Core CPI was also up to 2%.

EUR/USD

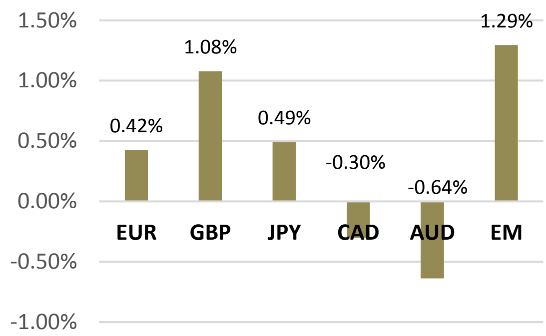
The EUR ended the month at 1.0652 (+0.72%). The drop in the final quarter of the month masked what was otherwise a very strong month for the euro. The cross reached a high of 1.09 on the back of talk of ECB tapering talk and improving economic conditions in the Eurozone. Talks of ECB's tapering have been growing of late, thanks to Eurozone's improving economic developments, especially in Germany, adverse effects of negative deposit rates on financial institutions, bigger-than-expected targeted longer-term refinancing operations (TLTROSs) take-up last week, as well as the asset buying program's ongoing deviation from its capital key. Bundesbank president Jens Weidmann has been vocal about a less expansionary policy and a review of the forward guidance, while other members of the Governor Council reiterated the need to maintain accommodative measures to boost inflation. There was also an easing of political fears for the bloc as elections in the Netherlands were absent of any shocks. This was countered by mixed polling in French elections. The election debate poll showing that far-left leader Jean-Luc Mélenchon won the debate, with 25 per cent of people saying he was the most convincing. Mr. Macron ranked second, with 21 per cent, while Ms. Le Pen trailed with just 11 per cent. If Mr. Mélenchon were to edge ahead of Mr. Fillon, it would mean that all the top three candidates in the election are not from the main political parties, the first time in French postwar political history. This has also got some market participants jittery on potential outcomes and scenarios.

Chart 5: March 2017 Currency Allocation



Source: Bloomberg

Chart 6: March 2017 Currency Performance vs USD



Source: Bloomberg

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