WEALTH MANAGEMENT
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MARKET COMMENTARY

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A surprise result in the US Presidential Election but some familiar global issues nonetheless

Global equity markets generated positive returns over the quarter as investors speculated that President-Elect Trump's surprise victory in the US Election might ultimately benefit US economic growth. US equities made strong gains as economic data continued to indicate that the US economy was improving. Emerging market economies, which had started 2016 in good form, suffered as the US Dollar went higher based on the improving US economy.

Politics continued to be the driving force through the fourth quarter with the anti-establishment vote proving victorious in in both the US and Italy. President-Elect Trump's victory raised fresh concerns over Europe's political and economic stability. The prospects of higher growth and inflation accelerated the recent rotation into interest-sensitive and commodity-related sectors of the market, with financials, and energy gaining and defensive sectors declining.

Bond markets experienced a challenging period with broad losses across the asset class. The sell-off in bonds highlighted the belief amongst investors that a Trump Presidency would likely result in an expansionist policy programme, leading to inflation and with it, future interest rate rises.

President-Elect Trump's economic policy

Following President-Elect Trump's victory, there were expectations that US economic policy would change significantly. The general view being that there will be a move away from the monetary stimulus of recent years, toward the fiscal stimulus of tax cuts and public spending on defence & infrastructure.

Central banks took centre stage in December providing some relief from the political agenda of previous weeks. The US Federal Reserve's decision to hike interest rates in December, coupled with a signal for three further rises in 2017, sparked a rally in the US dollar. The Fed's announcement also provoked the biggest drop in the market since the 8 November US elections. However investors were back in rally mode after absorbing the rate hike and assessing that the US economy was heading in the right direction.

Markets have however, cast doubt over the Fed's ability to follow through with its revised rate path for 2017, as Donald Trump's policies remain an unknown entity. Although the labour market continues to strengthen and economic activity is expanding, Janet Yellen, Chair of the Federal Reserve, took a dovish stance highlighting her concern over the year ahead and the uncertainty over economic policies. The frequency and magnitude of further rate hikes will mainly be reliant on the timing and impact of Donald Trump's pro-growth inflationary policies.

Bond markets slump

In recent weeks, investor expectations for inflation and interest rates have risen quite rapidly. This has partly been due to the prospect of post-election fiscal stimulus in the US (infrastructure spend and tax cuts) and partly due to a recovery in commodity and energy prices. Thus, bond prices have fallen and there has been a rotation in the stock markets towards financial and commodity stocks. At the same time, the share prices of many predictable dividend payers have fallen back due to their perceived similarities to fixed coupon bonds.

Market participates are concerned that this is the start of the great bond rotation, however in reality, the extent of future bond losses is very much dependant on how rapidly inflation rises and how aggressive central banks are in raising interest rates. Although inflation is rising, wage growth remains historically low and needs to rise significantly to create widespread inflationary pressures over the longer term.

Political challenges in Europe

While President-Elect Trump announced his high-profile cabinet nomination, politics also dominated throughout Europe. The Italian referendum result saw the defeat of Prime Minister Renzi and his constitutional reforms, while Austria saw the narrow defeat of the anti-European, far right nationalist party.

Matteo Renzi, Italy's prime minister suffered a heavy defeat as recently predicted. Italian voters feared that his constitutional reforms would provide too much power to the central office. This has created more concerns and uncertainty about Italy's banking sector and raised further questions about the future of the European Union. Renzi tendered his resignation as Italy's prime minister to the country's President, Sergio Mattarella, and a caretaker government, headed by Paolo Gentiloi, has been appointed until the next parliamentary elections, due in 2018.

Although political risk within Europe remains elevated and the threat of a banking crisis remains high, fundamentals have been improving in the Eurozone with inflation starting to return. The European Central Bank announced it will scale back the number of bonds it buys every month from €80bn to €60bn, but have prolonged the purchases past the March deadline, until the end of 2017. The decision initially created a volatile backdrop as investors interpreted this as the start of reducing back the current stimulus measures aimed at supporting growth. Mario Draghi, President of the European Central Bank, later toned down the move, highlighting a "slower for longer" strategy as risks were still tilted towards the downside.

Good news elsewhere in the Banking sector

Banking shares in the US, Europe and Japan delivered strong returns over the quarter, marking a change of fortunes, as the sector was previously characterised by low profitability, low interest rates, weak balance sheets and strict regulation. Sentiment for these institutions quickly improved following the prospect of inflation and higher interest rates providing them with a higher level of profitability. This could continue in 2017, particularly as company valuations are extremely low.

Oil prices aren't just about OPEC

In the commodity arena, OPEC reached a historic agreement to cut oil production for the first time since the global financial crisis. However, we are witnessing the return of the US shale oil industry and the conflict-ridden nations that were left out of the output cut agreement. Both could have an impact on global oil prices in the near term. Also, market participates will assess the OPEC agreement over the coming months as it remains to be seen whether these nations will fully commit to their pledges. Alongside oil, industrial metals such as zinc and copper also climbed on hopes that stronger global growth would underpin demand.

Brexit still looms large

Sterling lost ground after the Bank of England kept interest rates on hold and revised down its inflation forecasts. The Bank of England will remain sensitive to any slowdown in economic activity next year, with real income growth squeezed by rising inflation and Brexit uncertainty continuing to impact corporate investment plans.

While UK employment remains relatively healthy, wage growth remains muted, growing at roughly half the pace that was typical before the financial crisis of 2008. It's likely that companies will look to clamp down on workers' pay over the coming months as they strive to manage costs as prices of imported goods rise following the devaluation of Sterling. There is also the matter of what Brexit means for the future of the Euro with France, Holland, and Germany holding elections in 2017.

Conclusion

A wave of populism continues to surge through Western societies. The Brexit vote was followed by the dramatic election of Donald Trump to the White House and the rejection of constitutional change by Italian voters. Despite all of this this, the reaction of equity markets was largely favourably. Economic data is improving and company earnings appear to have stopped falling. The one-quarter point rate rise pushed through by the US Federal Reserve shows that confidence in the US economy is building and this is likely to ripple through to the global economy.

The Trump fuelled rally continued into December, with the prospect of higher growth and inflation in the year ahead as the anticipated fiscal stimulus is implemented. However, it of course remains to be seen quite how much of President-Elect Trump's campaign policies will be implemented. Furthermore, President-Elect Trump's victory has produced a stronger dollar which looms over multinational US companies, offsetting any cuts in taxes and regulation.

For now, the equity market rally continues and is supported by improving fundamentals. How sustainable this is given the level of geo-political events in 2017, remains questionable. Politics and the volatility that this brings looks set to stay.

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IA Sector Returns

Sector	3 Month %	6 Month %	1 Year %	3 Years %	5 Years %
Cash & Near Cash					
Money Facts 90 Day Notice Account (£10K)	0.2	0.39	0.77	2.26	4.47
IA Money Market	0.04	0.11	0.23	0.37	1.10
UK Fixed Interest					
IA Sterling Corporate Bond	-2.48	3.43	9.08	19.48	35.89
IA Sterling High Yield Bond	1.80	6.23	10.09	10.72	41.32
IA Sterling Strategic Bond	-0.81	3.43	7.33	13.64	32.42
IA UK Gilts	-5.06	-0.75	11.06	26.85	22.60
Commercial Property					
IA Property	-0.04	3.60	8.19	29.05	53.31
UK Equities					
IA UK All Companies	3.71	14.21	10.82	16.96	69.84
IA UK Equity Income	2.36	11.76	8.84	19.24	70.20
IA UK Smaller Companies	3.82	19.32	8.05	22.07	105.30
International Equities					
IA Asia Pacific Excluding Japan	-0.98	12.42	25.66	32.96	56.94
IA Europe Excluding UK	4.96	14.38	16.41	26.01	89.18
IA European Smaller Companies	1.48	14.07	14.02	34.05	112.94
IA Global	5.70	15.52	23.33	35.73	80.70
IA Global Equity Income	5.53	12.84	23.21	33.48	76.36
IA Global Emerging Markets	0.03	12.96	30.84	21.25	31.62
IA Japan	4.27	17.25	23.34	43.54	86.93
IA North America	9.68	19.28	29.31	58.68	121.99

Important Notes:

- Source: Financial Express Analytics
- Bid to bid pricing
- Total return basis
- Returns shown in local currency (Sterling)
- Time period ends at end of last quarter (31/12/2016)