INVESTOR INSIGHT

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A look at the markets by RSMR

January 2017 Welcome

Welcome to this latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

We hope you find this useful.

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The global economy: What's going on?

2016 will forever be remembered as the year UK and US voters delivered seismic shocks at the polls to reject globalisation.

In June, the UK voted to leave the EU and in November the US elected Donald Trump President after a campaign of 'putting America first.'

Although overall global economic conditions changed little in 2016, with an economic consensus towards a 'lower-for-longer' environment for global growth, inflation and interest rates, the final quarter of 2016 was dominated by these surprising political events and the valuation of stocks took a back seat to changes which influenced governments across the globe.

A more welcome surprise was the US markets' strong rebound after the Trump victory based on a change from fears of recession to optimism about reflation.

In the UK, the economy performed better than expected in the final quarter of 2016, given the Brexit uncertainties. The stock market ended at an all-time high, which looked highly unlikely in June after dire economic warnings from politicians and economists who campaigned for Britain to remain in the EU.

> ***"In the UK the economy performed better than expected in the final quarter of 2016"***

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The asset classes – a quick update

EQUITIES

Although markets fell significantly at the start of 2016 over fears of a China slowdown and further falls in commodity prices, they ended with the UK benchmark indices reaching all-time highs on December 30. Wall Street saw a 32% rise in value in sterling terms and was the strongest market.

The UK performed better than expected in the final quarter of 2016 after the vote to leave the EU, based on the belief that the exit will be harmonious, something which remains to be seen.

A major effect of the referendum result has been a significant weakness in sterling, which fell to a 31-year low against the US dollar and a five-year low against the euro. This was a key factor in the UK avoiding a technical recession. A lower value pound makes exports far more competitive and imports more expensive but it will also stimulate inflation.

In the US, economic uncertainty will continue until President-elect Trump announces details of his policies and it becomes clear which of these Congress will approve.

FIXED INTEREST

Fixed interest markets have faced expectations of rising inflation and the prospect of more aggressive US monetary tightening. Whilst factors such as demographics and debt act to suppress inflation, there are also pressures pushing it up – such as the rise in the oil price – and there are signs in some economies, including the States that wage inflation is picking up as labour markets continue to tighten. On balance, further weakness in government bonds with higher yields seem likely over the course of 2017 although periods of consolidation after the recent upward sharp moves are always possible.

PROPERTY

The initially severe effect of the UK's Brexit vote on the UK commercial property market has reduced but the much lower numbers of transactions following the referendum and falling prices show that the short-term impact was generally negative.

The vast majority of the UK direct property funds which were suspended after the leave vote have re-opened and the adjustments to market values have been removed or greatly reduced, suggesting almost a return to business as usual.

The property market basics have not changed greatly but property valuations may continue to be affected, especially in sectors and regions that have seen the highest price rises during the last few years, including central London.

To counter this, the large fall in the valuation of the pound against overseas currencies makes property more attractive to overseas investors and there have been reports of overseas buying, particularly from property funds having to sell assets to meet

withdrawals. Returns were reasonable in 2016 and are expected to remain so into 2017, but with absolute returns much lower than recent years.

Even so, property remains a solid option for investors seeking income and for portfolio diversification but there is increased concern about its underlying liquidity as a result of recent events.

The gap between the yield for secondary property markets compared with prime property remains attractive but the selection of individual properties will remain important.

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Global round-up

- Geopolitics became more significant for markets in 2016 and will continue their influence in 2017.
- Government bond markets started to see higher yields driving a rotation in equity markets.
- US currency has strengthened significantly since the election.
- US and UK manufacturing data has strengthened.
- OPEC cuts have steadied the oil price and commodities in general have found a floor.
- The Trump election victory and dollar strength has harmed emerging market currencies and stock markets, with Mexico particularly affected after Trump's derogatory comments during the election campaign.
- Chinese economic data is more positive but concerns remain over corporate debt.
- Uncertainty is increasing in Europe as it awaits the results of a number of elections in the coming year but it is in a stronger economic position overall.
- Singapore has continued to suffer from weak global trade and still faces oil service sector problems as large players continue to reduce capital expenditure.
- Indonesia's economy doesn't have a large export sector apart from commodities, which benefited from a strong price rally in 2016.
- Indian growth has been hit by the removal and exchange of high value bank notes.
- Brazil's economy remains in recession but there is hope that the worst is over and that economic recovery can begin following a change in the political landscape.
- There are signs of economic stabilisation in Russia after the strengthening in the oil price and hopes of more relaxed foreign relations with the US.

> ***"The Trump election victory has harmed emerging market currencies and stock markets"***

So, what's next?

Global politics is likely to continue to dominate the economic landscape in 2017 but Europe is in a stronger position than 12 months ago, especially in terms of the economic health of peripheral countries, apart from Greece and Turkey.

UK Prime Minister, Theresa May, has remained taciturn about the government's strategy for leaving the EU, increasing uncertainty. A plan is expected to be announced early in 2017 but how detailed this will be given the complexities and various vested interests remains to be seen.

Because of this, it is likely that the real effects of the UK's Brexit vote are yet to be felt as, superficially, little has changed. Debate so far has been about the type of exit the UK is likely to pursue and whether it will remain in the single market. The UK's Brexit vote has caused uncertainty and instability across several European countries by giving succour to the populist movement.

Meanwhile, in the US, a financial chart following the last meeting of the Federal Reserve showed expectations for three interest rate rises this year, a more severe financial tightening than had been priced into the markets for 2017. Trump and his supporters have said that they are targeting 3.5% – 4% real GDP growth and, if the new administration is successful in quickly lifting the US growth rate, monetary tightening may prove more aggressive than the Fed has outlined.

As a result, many feel that global market expansion in 2017 may well depend on the effectiveness of President Trump's economic policy.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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