Quarter 1 2016

Tactical Asset Allocation Views & Commentary

Tactical positions are relative to the long term strategic allocations for our five proprietary risk rated portfolio benchmarks which are at the core of our investment process. They are expressed as seen in the key below.

- -	-	N	+	+ +
Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight

Please contact us if you require further information.

Asset Class	Tactical Position	Commentary
Global Government Bond	N	No change here despite Federal Reserve rate increase, as data dependency of next moves means that growth worries are likely to restrict significant further rises in 2016. Much is in the price and we value the flight to safety effect if markets fall
Investment Grade Bond	N	We move to neutral as spreads are more attractive in a challenging environment, especially with our more dovish interest rate view. Liquidity is a tail risk, but we are long term investors and yield is hard to come by. Credit risk is still subdued
High Yield Bond	+	No change here. Strong yield and continued low default risk (outside the US Energy sector) justifies our overweight position. If our dovish interest rate views are wrong HY should help limit damage due to lower interest rate sensitivity.
Emerging Market Sovereign Bonds	- -	We are at the lower limit of our allocation here due to concerns over further currency devaluations if China fails to support the RMB. $ bond issues may restrict further falls, but may increase default risk if currency capitulates
UK Equity	+ +	We maintain strong overweight reflecting comparative strength of UK economy whilst trusting our manager's defensive characteristics to provide protection from future market stress. We prefer to take risk here than in some other asset classes
Developed Market Equity	+ +	US shows comparative strength and $ safe haven play is a bonus despite valuation concerns. We maintain bias to Europe due to lower valuations and QE support from ECB. Asia is struggling. In Japan we fear Abenomics shows signs of failure
Emerging Market Equity	- -	We stay very defensively positioned with many issues in EM driven by China's growth concerns and serious structural problems. Currency devaluations would increase stress but might also provide opportunity for the long term investor
Commodities	- -	We see no compelling reason to move from strong underweight as deflation, slowing global growth and China's problems still cast a long shadow. The sector has fallen far, but we still cannot see a catalyst to a meaningful rebound yet
UK Commercial Property	+ +	Stay strongly overweight taking a long term view here. We expect subdued capital growth with a healthy yield. Relative certainty and lower volatility profile of returns from this basket are valuable in the current investment environment
Absolute Return	+ +	We stay strong overweight in funds that aim to provide diversification and volatility reduction as well as genuine alpha. We feel that our allocations allow for continued equity exposure as their characteristics should restrict downside
Cash	+ +	We stay overweight cash to keep some ammunition which will be helpful in the event of further heightened market volatility. For short periods cash can be king but over the long term, time in the market is the real key to good real returns

Please Note: The views expressed are those of the Investment Committee. They should not be taken as a personal recommendation to invest or refrain from investing. Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements.

Looking Back

Global equities delivered positive returns for the fourth quarter despite generally poor performance in December. US equities gained against a backdrop where the Federal Reserve increased its main policy rate in December following stronger domestic data.

The UK equity market recovered from the summer's sharp correction when global growth and the outlook for the Chinese economy dominated sentiment. October saw a strong rally as China's central bank eased monetary policy and the ECB hinted that it would do likewise. The FTSE All-Share Index delivered a total return of 4.0% over the quarter, but ended on a negative note amid fresh concerns about the outlook for the Chinese economy and weakness in oil prices.

Eurozone equities posted positive returns overall, buoyed by hopes for further quantitative easing. However, the eventual ECB announcement disappointed investors and weighed on returns in December.

Japan was the best performing equity market over the quarter. A sharp rebound in October was driven by a recovery in cyclical sectors.

Emerging market equities underperformed their developed world counterparts. The Chinese equity market posted a solid gain after further central bank support to the economy. Brazil's data continued to deteriorate.

Government bond market movements broadly reflected the diverging policy trajectories of the world's major central banks. Expectations of a rate rise from the US Fed were fulfilled in December; with the 25 bps rate rise the first in almost a decade. The 10-year Treasury yield rose from 2.04% to 2.27% over the final three months of the year.

In the eurozone, the ECB's measures fell short of market hopes. The 10-year Bund yield rose from 0.59% to 0.63%. The UK 10-year gilt yield rose from 1.76% to 1.96%.

In corporate bonds, investors in EUR and GBP markets balanced improving domestic economic data with the negatives from EM and high profile companies such as Petrobras, Glencore and Volkswagen. In the US, the falling oil price weighed on corporate bonds, especially high yield.

Total returns for the investment grade BofA Merrill Lynch Global Corporate Bond index were broadly flat over Q4 at 0.03%, while high yield bonds declined -0.7% (local currency). The weakness was led by US dollar credit. US dollar investment grade corporate bonds fell -0.6% while high yield bonds fell -2.2%. Euro and sterling corporate market returns were positive in Q4 across investment grade and high yield.

Looking Forward

"The trouble with the world is that the stupid are cocksure and the intelligent are full of doubt" **Bertrand Russell**

The New Year has started in the same vein as the end of the last, with equities losing ground. Some blame the increase in Fed funds rate for this move, but surely the decision to raise rates by 0.25% should be considered a positive as it confirms that the economic recovery is well established? Instead, concerns about China and its effect on global growth have dominated market sentiment. This issue should not be underestimated as, if as we suspect, China is not growing, then it may have the effect of bringing global GDP growth down closer to 2% rather than the 3% widely assumed. If the number proves to be below 2% this is recession territory.

Uncertainty about the Chinese exchange rate is troubling investors who fear another round of currency wars. There will be no rapid resolution to these issues and we expect the Chinese economy will struggle to regain momentum until the authorities tackle their structural issues, confront the ridiculous pace of credit growth, and act to reduce the foreign currency outflows which threaten to exhaust reserves by mid-2016.

Nevertheless, our central view is that the global economy will stay above stall speed in 2016. Monetary policy remains loose, even after the Fed move, and fiscal policy should also add to demand in the US and Eurozone. Meanwhile the latest fall in commodity prices, although bad news for producers, will give a further fillip to consumer spending. Already, consensus interest rate expectations in the US have come down, with 2 further rises expected in 2016. Data dependency and the threats abounding may lead to further revisions and government bonds may not suffer as much as previously feared.

The environment remains difficult for investors who must balance the potential effects on markets of Fed tightening, a strong dollar, China slowing and potential currency wars. The lack of real corporate profits growth in the US is a challenge to equities when put alongside reduced demand for bond issuance, continued low Cap-ex and a reduction in share buy backs at a time when the bull market has sustained beyond the post WW2 average.

We favour UK, Europe and US Equities, as prospects appear better than elsewhere. We expect bouts of higher equity volatility, placing a premium on asset allocation and fund selection. We value managers who have proven stockpicking ability, identifying quality businesses, superior ROE and good cashflow as we still value dividends.