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 after the Federal Reserve kept rates on hold citing data dependency. Growth worries and China are likely to postpone any rises until 2016 unless the Fed change course. Still valued for flight to safety play if markets fall
Investment Grade Bond	-	We move to underweight as spreads over government bonds have improved and represent better value given our interest rate view. Liquidity still a worry, but we are long term investors and yield is hard to come by. Credit risk still subdued
High Yield Bond	+	No change here as attractive yield vs other fixed interest and continued low default risk justifies our overweight position. If our interest rate views are proven wrong this allocation should be helpful due to lower interest rate sensitivity.
Emerging Market Sovereign Bonds	- -	We remain very concerned about EM debt burdens and potential for further currency devaluations. EMD has suffered from unwinding of carry trade and growth concerns. We favour $ bond issues as a possible hedge against further falls
UK Equity	+ +	We stay strong overweight here reflecting comparative strength of UK vs other developed markets. We retain quality/value bias as the defensive characteristics of our managers should provide protection in event of future market stress
Developed Market Equity	+ +	US shows comparative strength and $ safe haven hedge for market risk despite valuation concerns. We maintain bias to Europe due to lower valuations and QE support from ECB. Asia is struggling. Japan to continue its loose monetary policy
Emerging Market Equity	- -	We see many issues in EM with China the centre of the global growth concerns. Debt to GDP ratios are at levels comparable to 2008 developed markets and withdrawal of foreign investment a big issue. We stay defensively positioned
Commodities	- -	We stay strong underweight as deflationary environment, insipid global growth and China's problems are still plaguing the sector. We may have bottomed out, but still lack a catalyst to a meaningful rebound despite some isolated bright spots
UK Commercial Property	+ +	We stay strongly overweight despite the expectation that we will see a reversion to lower growth and good yield as the long term story. These "bond-like" characteristics are valuable in the current low growth and low interest rate world
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	+	No change here as we stay overweight cash to keep some ammunition in the event that we have further bouts of market volatility. Opportunistic buying at market inflection points can add value but historically time in the market is the real key

Looking Back

In Q3 Global equity markets have seen the worst quarterly performance since the eurozone crisis in 2011, shedding an estimated $11trn (£7trn) in share values. Despite attempts to bounce back in September, markets stayed on a downward slope from August until the quarter end. The market rout was triggered when investors began selling out of risk assets on fears of an economic slowdown in China and emerging markets. This was further exacerbated by investors questioning the US Fed's decision not to raise interest rates.

'Black Monday' saw the FTSE 100 index fall nearly 5% in one day. Thereafter, a slump in commodity prices and the falls in the share price of Glencore continued to hurt the UK's blue-chip index. The index closed at 6,061, a fall from a record high of 7,103 seen in April, representing a loss of 7% over the period.

The Dow Jones and S&P 500 in the US both shed nearly 8% over the quarter and Germany's DAX finished down 12%. The Volkswagen emissions scandal has rocked the auto industry, affecting other car makers as some investors worry about a lasting impact on the entire auto sector. Further, if VW's profit is taken out of the calculation of German GDP for the last year, the economy would barely have grown.

The FTSE Emerging Markets index was down 19%, dominated by the worst performer among global indices - the Shanghai Composite - which fell 26% in its worst quarterly run since 2008. The flows into Emerging Markets have weakened sharply in volatile market conditions this quarter. There are continuing concerns about the slowdown in Emerging Market growth, amplified by lack of visibility on China.

The continued divergence between developed and emerging economies remains one of the key themes of 2015.

Sterling weakened against all major currencies over the quarter which has provided some downside protection for UK Investors. For example, in local currency terms, FTSE World Europe ex UK index fell by -8.93% but was -6.56% for a sterling investor.

Global Government Bonds provided the highest return of the period, with both UK conventional and Index-Linked Gilts performing well with returns of 2.72% and 2.68% respectively. In the case of Index Linked this is reflective of a flight to safety rather than a re-emergence of inflation which stays very low with CPI at 0.1%

In corporate bond markets, investment grade outperformed high yield over the quarter with high yield bonds falling 6.71%. GBP corporates outperformed both their USD and EUR denominated counterparts.

Looking Forward

In Q2 Greece was the dominant country in our thoughts but as a result of the dramatic falls in Emerging Markets they and specifically China, are very much at the centre of discussions at the ISC meeting.

Between 2005 and 2014, the EM had unprecedented levels of capital inflows that gave rise to outsized foreign owned positions in their credit markets and domestic credit booms. The EM are now perhaps more indebted relative to their GDP than the OECD economies were in 2007. This year, for a variety of reasons, we have seen a dramatic reversal in the trend and they have experienced large capital outflows.

China alone has suffered a $1.5 bn capital outflow in 2015 causing a loss of FOREX reserves which has in turn created a tightening in domestic monetary conditions. As a result CAPEX is weak and property markets are softening. Recent numbers suggest that China is not easing its fiscal stance. If they are to get back in control of their own economy they need to stop expending reserves. One way to do that would be to allow the currency to devalue. If this occurs, it may lead to more world trade price deflation and spook markets.

Our economist Andrew Hunt suspects that China's actual nominal GDP is almost zero and while some commentators have been cheered by credit growth (China personal credit is now equal to 300% of GDP) he feels that rather than this being a positive, it might actually be down to capitalisation of interest…………China may actually be more indebted than Japan, a scenario unthinkable even 5 years ago.

So long the poster child of EM, reaching its position as the second largest economy in the world, China had growth rates the envy of the developed nations. It seems that 2016 might be the time that China starts to be viewed very differently going forward. We have always been suspicious of economic numbers coming from this tightly controlled command economy and it seems clear that all is not rosy in the Chinese Garden. There are knock on effects for the global economy - especially Germany and its Auto industry.

China's Asian neighbours are afflicted with the same malaise and are running massive trade surpluses due to a collapse in imports. The resulting increase in inventories has put pressure on prices, increasing deflationary pressures.

These continuing deflationary pressures seem to make the chance of interest rate rises move even further out, probably well into 2016 or even beyond. Continuing loose fiscal policy should support developed markets, especially if (as we suspect) both Japan and Europe embark on further stimulus. Expect a bumpy road ahead, but markets can often climb a wall of worry, especially if stimulus continues in whatever form the policymakers choose.