CANACCORD Genuity
Wealth Management

To us there are no foreign markets.™

Good things come to those who wait

August-September 2016

The speed at which financial markets have rallied recently – largely in response to the latest round of central bank stimulus – means that most markets require a period of consolidation, and possible setback, before we take further opportunity to reduce our modest equity underweight.

The rally that we have enjoyed over the last few weeks has also partially occurred because Brexit has become something of a short-term, non-event, as it is looking increasingly likely that the beginning of negotiations is well down the road.

However, there seems to be a degree of complacency concerning the UK economy at present and we must bear in mind that it is too early for adverse post-Brexit sentiment to show up in most economic data. There is, therefore, the potential for a few nasty economic surprises in the months ahead and a real chance that the UK could return to recession next year.

The placebo effect

While we believe that both the global economy and global equities are capable of making some further progress this year and understand the market maxim of 'do not fight Central Banks', we have a sense of disquiet that Quantitative Easing (QE) and central bank monetary policy has done little to boost the real economy. Instead it has simply inflated the price of equities – to quote Jimi Hendrix, 'castles made of sand fall into the sea eventually'.

This is reflected in our decision to cautiously participate in the present rally but at the same time ensure that we have significant counter-balance and liquidity to provide some protection in the event of any setbacks.

> "Castles made of sand fall into the sea eventually"
>
> – Jimi Hendrix

Monitoring closely at home and away

Sterling has depreciated approximately 10% since the Brexit vote and by over 15% since last November. Given the high level of overseas earnings generated by FTSE listed companies, the outlook for the internationally orientated FTSE 100 is much better than for the UK's underlying economy.

Although European economic confidence has held up quite well in the face of Brexit, we remain confident in our recently reduced exposure. While the European Central Bank (ECB) will continue to do whatever is necessary to promote economic growth, there are pockets of the European banking system which are still vulnerable as they are under-capitalised. Poor performance data recently published for Italy will also likely be a source of market volatility over the next few months.

We continue to favour US equities even though they are continuously reaching new highs. While the US is relatively expensive; it deserves the premium as it is supported by decent corporate earnings and a healthy domestic economy. Obviously the November election is a major source of concern, especially given the recent behaviour of Donald Trump. Should he get elected – and this cannot be ruled out – his economic policies are unknown and also therefore, the implications for the economy and the stock market. Hillary Clinton is by far the markets' choice as her views are well publicised.

Prepared for our discretionary and managed advisory services clients in order to give them a better understanding of the current outlook in the UK equities market.

Whatever the events of the next few months, we believe there is virtue in continuing to monitor developments closely and increasing our equity exposure following any significant setback. It probably won't be until October that clear evidence is available to measure how badly consumer and business confidence has been affected by Brexit. It is likely that the Government's Autumn Statement in November will be the time for the announcement of more shock and awe tactics. We also expect to see the introduction of greater Government spending on infrastructure projects to boost the real economy.

Nigel Cuming
Chief Investment Officer

Our investment views as at August 2016

The view in this table refers to our balanced, risk profile 5 model portfolio. This risk profile has a benchmark with 57.5% in equities, 35% in bonds, 5% in alternatives and 2.5% in cash.

Asset class positioning	- -	-	=	+	++	Outlook	
Alternatives					■	↑	Viewed as a way of moderating portfolio risk.
Bonds (Govt)	■					→	Yields likely to decline further in the short term but worsening inflation outlook will need monitoring.
Bonds (Other)			■			→	Greater opportunities would appear to be available for strategic bond managers, but liquidity in certain segments needs to be monitored.
Commodities			■			→	US dollar strength, and reduced demand and supply side response will restrain prices although a partial recovery has taken hold.
Equities	■					→	Equity markets will likely remain volatile in the short term. Brexit is a game changer.
Property (direct)			■			→	Yield, rather than capital growth should be viewed as the primary reason for investment.
Cash					■	→	Cash levels raised following the Brexit result. A continued rally would likely prompt a further increase in cash weightings.

Equity allocation	- -	-	=	+	++	Outlook	
Emerging markets				■		→	Valuations in some markets are now registering as attractive, have made a small allocation to India.
Europe		■				↓	Euro area break up fears may resurface following Brexit vote.
Far East			■			→	Valuations appear cheap; China and global trade are key to the region's outlook.
Japan			■			→	Recent economic developments have been disappointing but stock market offers value and corporate Japan in good shape.
North America			■			→	Relative valuations are least appealing in a global context; but a safe haven market at present.
Sector specific					■	↑	Monitoring for potential entry point for new sectors such as Water and Agriculture.
UK	■					↓	Stock market likely to be a relative underperformer despite benefits of a weakening currency.

Currency allocation	- -	-	=	+	++	Outlook	
US dollar				■		↑	Close to previous highs. Interest rate backdrop and safe haven status continue to argue for the dollar moving higher.
Euro		■				↓	Euro as much a threat as sterling following Brexit result.
Sterling		■				↓	Sterling likely to remain weak for foreseeable future.

Indicative positioning of £ "balanced" portfolio.

'=' Weighting within 1% of benchmark. '+ / -' Weighting between 1% to 5% away from benchmark. '- - / + +' Weighting in excess of 5% away from benchmark.

** The outlook arrows indicate our expectation of future trends.

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