CANACCORD Genuity
Wealth Management

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A season for change? Autumn leaves markets faded

October 2016

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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.

Typically, September is a difficult month for equities. It was therefore unsurprising - with most equity indices at or around all-time highs - that markets paused for breath during the month, with the recent rally losing some of its momentum. During this period, the FTSE All-Share Index moved sideways in a relatively tight 2% performance band.

The picture was somewhat weaker in government bond markets. Having hit historic low yields in mid-August, UK Gilts went on to fall – in price terms - by around 2.50%, pushing the yield on the 10-year bond from around 0.50% to nearer 0.75%.

Corporate bonds fared a little better, but also gave back some ground; sterling moved sideways; and in commodities, the oil price was very volatile, ending the month up 4% at just under US$50 a barrel, but having been as low as US$45 at one stage.

The global stage

Economic data for the month was mixed across the globe, with some signs of weakness in both the US and Europe. Up to now, there are no signs of the anticipated sharp downturn in the UK following the Brexit vote.

The US Federal Reserve Committee elected to leave interest rates unchanged, as anticipated. However, the tone of its post-meeting news conference was decidedly more hawkish - and expectations are firmly rooted for a 0.25% increase by the end of the year. Conversely, here in the UK, the door remains open for another interest rate cut to 0.10% in November.

The sell-off at the long-end of government bond markets, which started in Japan, could soon spread elsewhere - given the present high correlation between global bond markets. However, we do not believe it was as a result of panic selling. It was more a result of the Bank of Japan's decision to take some 'froth' out of an over-extended market and to engineer a steeper upward yield curve – essential if banks are to make any money in the present interest rate environment.

In Europe, ECB President Draghi did not extend the asset purchase programme out to September 2017 as expected, citing both the lack of inflationary pressures and the resilience of the Eurozone economy to “continuing global economic and political uncertainty.” He is, however, well aware that further stimulus is required to maintain the recent modest improvements in the European economy, especially as there is still the risk of deflation given August's inflation number of a mere 0.2%.

Future trends

There are a series of events over the coming months that could be potential catalysts for change in markets. These include:

- The political uncertainty surrounding elections in the US, France, Germany, Netherlands and Spain, and the constitutional referendum in Italy
- The ongoing geopolitical instability in Syria and further afield
- Fears of the well-publicised level of bad debt in the Chinese banking system.

It is fair to say these events may not be market-friendly and that we could witness the effects in the form of market slowdowns and falls in investor confidence.

While the short-term future remains so uncertain we are in no mood, at present, to add further risk in our clients' portfolios - and remain underweight in equities and fixed income and overweight in cash and alternatives. That said, during periods of market volatility, we will always look for opportunities to build positions in good, long-term investments.

Richard Champion
Deputy Chief Investment Officer

Our investment views as at September 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.

Contact

Australia
Canada
Guernsey
Isle of Man
Jersey
United Kingdom

United Kingdom
41 Lothbury, London, EC2R 7AE

T: +44 20 7523 4500
F: +44 20 7523 4599

Guernsey
Trafalgar Court, Admiral Park,
St. Peter Port, Guernsey, GY1 2JA

T: +44 1481 733900
F: +44 1481 711982

Isle of Man
Anglo International House,
Bank Hill, Douglas,
Isle of Man, IM1 4LN

T: +44 1624 690100
F: +44 1624 690101

Jersey
PO Box 3, 37 Esplanade,
St Helier, Jersey, JE4 0XQ

T: +44 1534 708090
F: +44 1534 708050

canaccordgenuity.com

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