CANACCORD Genuity
Wealth Management

2017 – taking us to new destinations

January/February 2017

“With equity markets up by 17% in the UK in 2016 and by 34% in the US, we have certainly enjoyed the journey, even if the flight path has been bumpy and the seat belt signs have been on for much of the time.”

The seismic events of 2016 – the vote for Brexit in the UK and the election of Donald Trump in the US – have continued to cast their shadows into 2017. Equity markets rallied after Trump's election as investors quickly became euphoric over his new pro-growth agenda. Markets didn't so much accentuate the positive, they exaggerated it.

In particular, US equities have been busy pricing in all the benefits of higher infrastructure spending, corporate and personal tax reform, reductions in regulation and a much more pro-business administration (according to The Economist, one in seven of Trump's cabinet-level appointees are dollar billionaires).

Meanwhile, in bond markets prices have fallen and yields have risen in response to an anticipated fiscal boost to already strong US growth, rising inflationary expectations, a wider government deficit, wage growth and a tight labour market.

Despite currencies also following what seemed to be a clear trajectory at the end of 2016, we have seen a reversal this month. In November and December, the US dollar rallied on an early interpretation of Trumponomics, while sterling fell back as investors looked sceptically at the potential for a 'hard' Brexit. However, come January, following Theresa May's aspirational comments about an open global Britain and Donald Trump's vitriolic inauguration speech ("from this moment on, it's going to be America First") – the dollar fell back a little, and sterling rose.

So, what can we expect in the months ahead?

It remains to be seen whether the market themes which characterised the end of 2016 can be sustained, especially in the face of American protectionism and the UK's extraction from the EU. Certainly so far, markets appear to have ignored the negatives, such as Trump's potential conflicts with congress and the backdrop of record US debt levels.

Equity valuations are currently elevated, even with the prospect of around 9% earnings growth in all the major markets in the coming 12 months. And, even after the falls we have seen, bonds also remain expensive, especially at longer durations.

How are we positioning client portfolios at the start of 2017?

While in the medium term we remain confident about the outlook for equities – after all, there is still strong economic momentum in the US and abundant Quantitative Easing (QE) driven liquidity in Europe, Japan and the UK – we would rather wait for better opportunities before increasing our equity positions further. In bonds, although there is a limit to the downside, we haven't reached it yet and we continue to look for opportunities to reduce our underweight exposure further.

One thing of which we can be certain is continued unpredictability. For this reason, we remain overweight in alternatives which we believe will provide solid returns despite volatility in other asset classes.

With equity markets up by 17% in the UK in 2016 and by 34% in the US (in sterling), we have certainly enjoyed the journey, even if the flightpath has been bumpy and the seat belt signs have been on for much of the time. Now that we have arrived in these strange, unforeseen destinations, it is time to work out how these two mammoth projects – 'making America great again' à la Trump, and 'Brexit means Brexit' à la May – actually work out in the hard world of compromise and negotiation.

Until then, we continue to expect pockets of turbulence which may offer opportunities to pick up good assets at attractive prices.

Richard Champion
Deputy Chief Investment Officer

Our investment views as at January 2017

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.

Indicative positioning of £ 'balanced' portfolio.

Asset class positioning	- -	-	=	+	++	Outlook	
Alternatives					X	↑	Viewed as a way of moderating portfolio risk.
Bonds (Govt)	X					↓	Yields may give up more ground over the coming months before reaching a sustainable level. Inflationary pressures are a key risk.
Bonds (Other)			X			→	Greater opportunities would appear to be available for strategic bond managers, but liquidity in certain segments needs to be monitored.
Commodities			X			→	US dollar strength, reduced demand and supply side response will restrain prices, although a partial recovery has taken hold.
Equities			X			→	Equity markets will likely remain volatile in the short term. A more pro-growth environment after the US election has led us to add exposure.
Property (direct)			X			→	Yield, rather than capital growth, should be viewed as the primary reason for investment.
Cash			X			→	Cash levels reduced gradually over past six months.

Equity allocation	- -	-	=	+	++	Outlook	
Emerging markets				X		→	Emerging markets have pulled back since the US election, although we see value in India.
Europe		X				↓	Euro area break up fears may resurface as a raft of elections in 2017 may cause volatility.
Far East				X		→	Valuations appear cheap; China and global trade are key to the region's outlook. Chinese debt levels and housing bubble are a concern.
Japan			X			→	Recent economic developments have been disappointing but stock market offers value and corporate Japan in good shape.
North America			X			→	Valuations are least appealing in a global context, but economic momentum is strong; after the election we added to US thematic exposure.
Sector specific					X	↑	Recent additions to US healthcare, industrials and financials to take advantage of a steeper yield curve after Trump's victory.
UK	X					↓	Stock market has been boosted by a weaker currency, but company fundamentals have deteriorated.

Currency allocation	- -	-	=	+	++	Outlook	
US dollar				X		↑	Close to previous highs. Interest rate backdrop and safe haven status continue to argue for the dollar moving higher.
Euro		X				↓	Euro weakness expected to persist.
Sterling		X				↓	Sterling likely to remain weak for foreseeable future.

'=' 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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