QUARTERLY MARKET OVERVIEW – APRIL 2016

"….fear drives fear and irrational behaviour…"

The first six weeks of 2016 saw panic engulf the markets; this was a classic time to test investors' nerves.

There appeared to be a myriad of factors driving this but everyone was scrabbling for some finite explanation. It became the mantra to opine on the fears of a global recession. When markets are tumbling it is very hard to see through the fog of panic; the reality though was that the indicators which would point to a recession were simply not there.

Fear drives fear and irrational behaviour; the market descended into a spiral downwards and nobody knew when this would stop. Markets became oversold and in mid-February we saw a realisation with a massive bounce which ran to the end of February. Although this has slowed the markets continue on an upward trajectory.

Allowing the market to settle shows us firstly that volatility is normal (QE in the US for a time flattened this) and secondly that it can be a friend to investors. Touching on the second point we saw stocks significantly oversold (banking sector, oil, mining etc) and in some cases these have seen a significant correction.

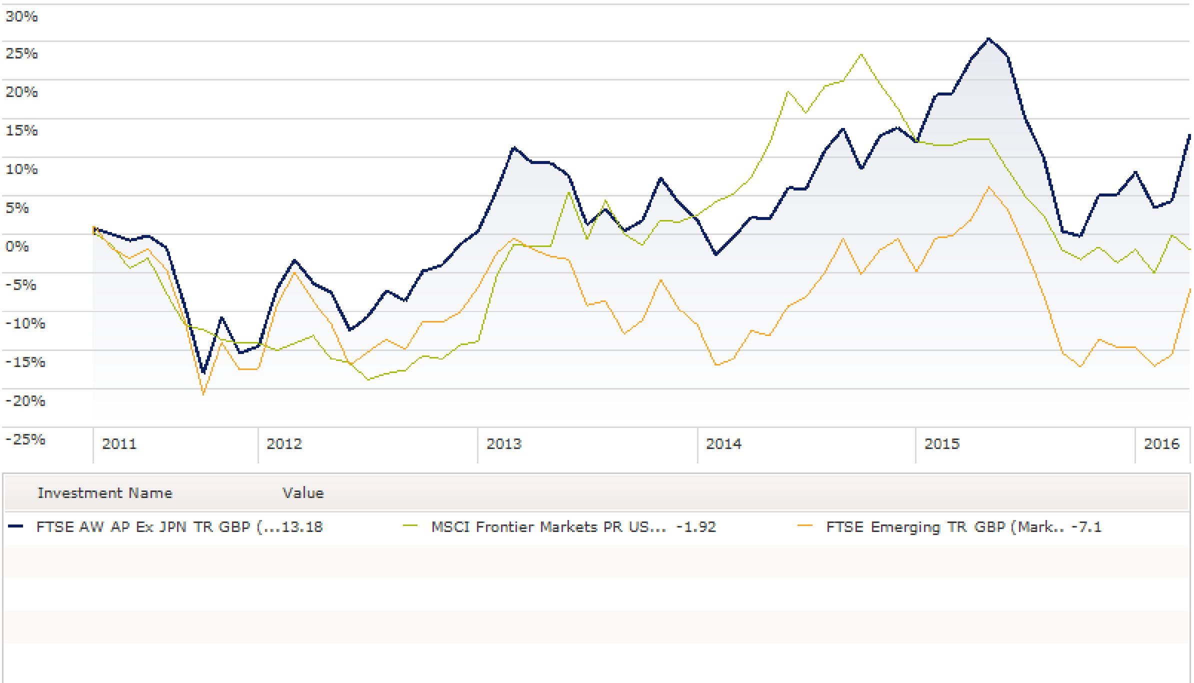
In the last update we considered whether Asia and Emerging Markets were hitting a base low and a correction was due. Emerging markets have underperformed developed markets by nearly 50% since 2011 but year they have started to show a positive correction.

In this update we will consider some of the factors coming through from the first quarter and highlight things to think about moving forward.

George Ladds
George Ladds, Director, April 2016

EMERGING, ASIA AND FRONTIER MARKETS

Five year returns 1 April 2011 – 31 March 2016



Special note to graph: *You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.*

We often say that the best time to invest is when others are fearful and certainly investing in Asia, Frontier and Emerging Markets may seem a crazy thing to do. In fact, from 2011 emerging markets underperformed developed markets by nearly 50%!

But there are some misconceptions; China, India, Indonesia, Mexico and Turkey continue to outgrow developed market economies. Additionally, over two thirds of emerging market economies are commodity importers and several who used to be exporters are now importers (including Indonesia and Mexico). The fall in commodity prices is therefore good news for many of these economies and we are starting to see this underperformance reverse.

This may not fully come through in 2016 but the expectation is that this will feed through into 2017. Turning to China, the economy is in a period of change moving from a manufacturing base to service led and this is important for its long term future. The markets have interpreted moves by the government as that of a government not in control of their destiny and this seems somewhat harsh. Much of what they have done in terms of fiscal policy is an important part of this change.

It is worth adding that whilst much of the focus is on overcapacity within property construction, China has invested massive amounts in key infrastructure including the expressway network which has grown from 300km in 1990 to 123,000km in 2016, a high speed rail track stretching 19,000km, and a vast mobile network. Combining this with its own dominant search engine, instant messaging platform and ecommerce business, China is in a lot stronger positon that many would lead you to think. Growth will slow and is expected to be around 5% by 2020 but this is a natural part of change and would still be considerably more than many developed market economies.

Touching on other economies, Brazil appears to be in a terrible place with interest rates above 14%, inflation above 10% and unemployment over 7%. The currency has weakened significantly and austerity measures together with an unstable government appear to make this a place to avoid. However, there is a school of thought that we are now reaching the bottom and the 2016 Olympics could be a chance for Brazil to shine. It is currently operating a trade surplus helped by fewer imports and a weak currency pushing up exports.

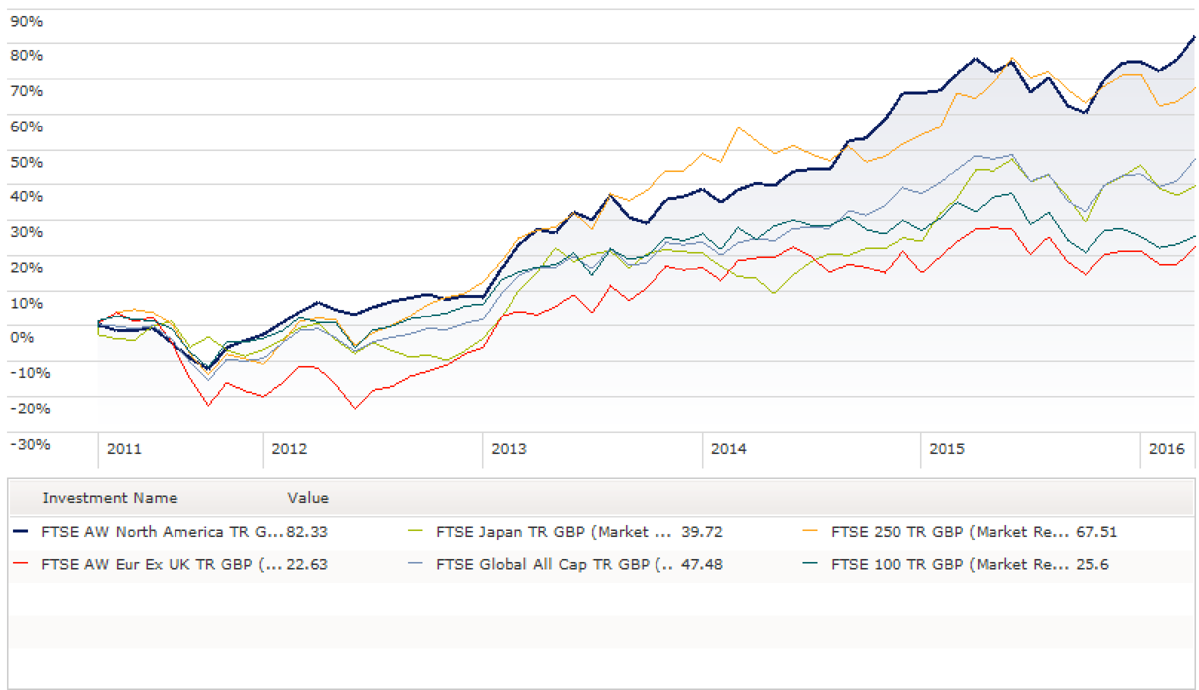
Another Latin American country is Mexico. Oil is only 10% of exports, it has a liquid currency and it has a stable fiscal and macroeconomic environment. Added to this are structural reforms which encourage competition and investment (Mexico is now the world's 7th largest automobile manufacturer) and a high value added exporting franchise with the US.

Of course it is easy to highlight the good in emerging markets. There are challenges, commodity focused economies need to adjust and there remains political instability, but this doesn't apply to all economies as many would like us to think.

In summary there are a lot of positive things happening within many of these economies. Falling commodities will hurt some, but in the main it is a massive help combined with weaker currencies. We continue to believe in emerging markets and perhaps we are starting to see an uptick in returns.

DEVELOPED MARKETS

Five year returns 1 April 2011 – 31 March 2016



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As the good and great searched for a reason for markets to be falling they all seemed fixated on a global recession possibly driven by falling commodity prices (in particular oil), and the declining powerhouse that was emerging markets.

However, what we see in the markets is not necessarily what is happening on the streets and the signs do not show a global recession. What we are seeing is low global growth mixed with low inflation. This scenario naturally brings uncertainty and causes markets to move on any news (good or bad).

In the US the markets are expecting one or two rate rises this year. Although rate rises are seen as negative they will likely be small and therefore any impact will take time to feed through. On the flip side many US consumers are benefiting from lower oil prices which is effectively a tax cut. The US is seeing strong employment figures filtering through and house prices are rising which wouldn't be a sign of an impending recession. The challenge for the US is the election and whether Donald Trump could become the next President, the results of which we won't know until the end of the year.

As a sign of divergence in monetary policy both Japan and Europe have moved to negative interest rates. In both cases there are arguments that the central banks are running out of options when it comes to stimulating the different economies. In Japan corporates have benefited from a previous weaker yen but it has now started to strengthen and this has slowed profits.

There are different views on where next for the yen, some argue that it cannot fall any further and it is likely to rise from this point, others argue that it has to weaken further to drive through the much needed reforms. At the moment there are no clear signs as to what will happen and this is something to watch.

Japan is a global exporter and it is sensitive to global conditions. Although it is benefiting from lower oil prices any slow down or sluggish growth does have a direct impact. We should expect further QE and it is worth watching for the result of the upper house elections in July.

Turning to Europe, like Japan we are now in negative rate territory. QE continues and the big change was the opening of this to non-financials. Although there were concerns of the impact of negative rates to financials the reality is that it is net positive, and financials are considerably stronger than they were in 2008. Across Europe returns are mixed; Ireland continues to show strong returns as does Spain, Italy is showing a slowdown in growth and in France growth is neutral.

Germany faces challenges, exports have slowed due to lower demand from emerging markets but one to watch is slowing demand from developed economies. Germany is also facing a rise in government spending due to asylum seekers and this is clearly going to be a challenge moving forward.

In the UK continued austerity will slow growth, and there are signs that the BREXIT vote is delaying investment with contracts being signed subject to the result of the vote. Although opinion polls seem to swing between the two campaigns, it appears betting shops are a useful indicator and at the moment these are pointing to the UK staying in Europe.

It is worth noting that nearly 45% of UK exports head for Europe, with just over 17% going to the US and only about 3% going to China. To exit Europe will take a minimum of two years and it will likely take longer, especially with elections in Germany and Italy which will slow any agreements. Whatever our views there are three main impacts of a vote to leave:

1. Uncertainty over the UKs access to the single market is likely to reduce net foreign domestic investments and therefore slow domestic investment
2. Households are likely to save rather than spend which will slow consumption
3. Sterling will fall

The overall impact is that it will slow growth which will hit employment and wage growth. We should expect to see inflation rise but not so for interest rates. Long term, the benefits of staying in or leaving are less certain with much dependent on the trade agreements that are put in place. It is worth adding that although immigration will have a part to play on the vote (the impact of the Belgium attacks showed a spike to leave Europe) the actual impacts of immigration to the UK are minimal.

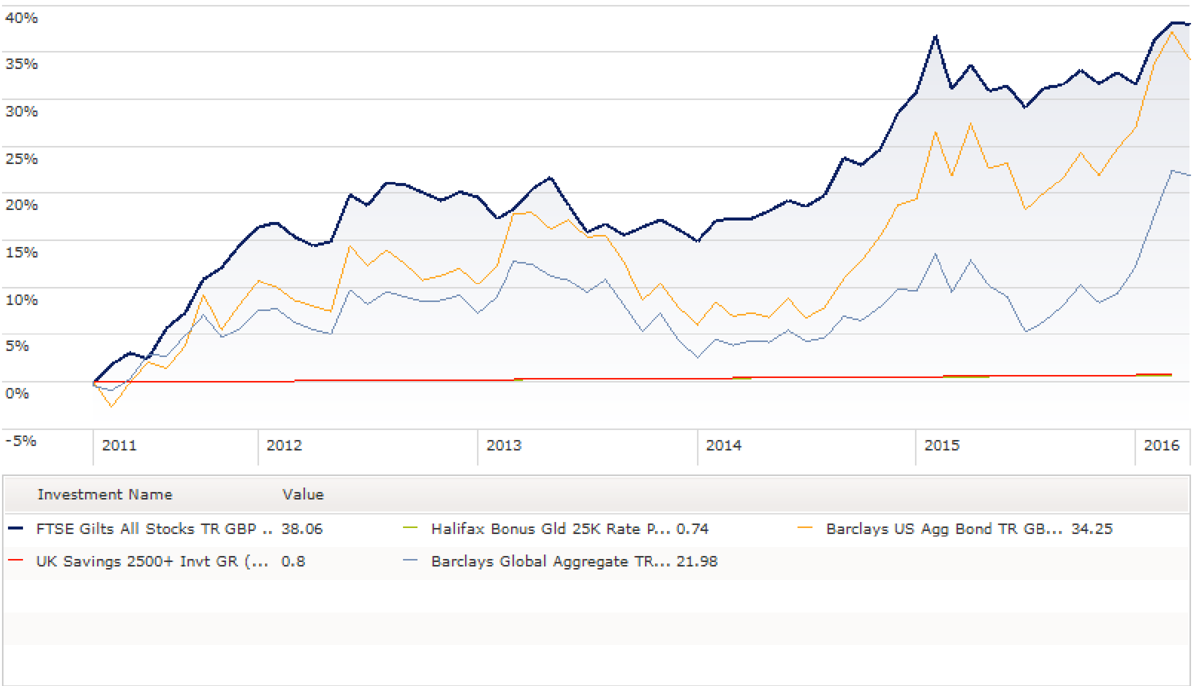
One final food for thought, for expats there is potentially greater uncertainty as the countries they have chosen to live in may operate differently if the UK is outside of Europe.

There is no doubt that BREXIT is the dominant factor for the UK at the moment, and there will be volatility in the lead up to the vote. What happens after the vote is anyone's guess but whatever the result the markets will adjust and settle to that outcome.

In summary, there are challenges in the developed economies and perhaps moving to a lower growth environment is the new normal. Low growth will mean low interest rates but we can expect to see inflation rise. There will be political uncertainty in the US and BREXIT has an impact on the UK but not necessarily globally. The 'Information Age' in which we now live contributes to market volatility because everything gets priced in as soon as it becomes available! All of this means that markets are susceptible to greater volatility and it is something we need to get used to moving forward.

CASH

Five year returns 1 April 2011 – 31 March 2016



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For the last 8 years "savers" have suffered near zero returns and I have considerable sympathy. Journalists would like us to think this is something new, but it isn't and there are other options open to investors.

The frustration remains when we see headlines bemoaning over 4,000 rate cuts since 2012; the reality is that banks/building societies cannot subsidise rates as they did in the past and this is something investors in cash have to accept. We have also seen National Savings cut their rates and the fact is that this is not going to change anytime soon.

The fixation on cash has created confusion as some investors think an ISA is cash only! The joys of journalists.

The point of all of this is that for 8 years rates have been low and continue to be cut. Banks/building societies have to ensure they have sufficient capital assets and they are not going to be quick to increase rates. We suggested a few years ago that rates wouldn't rise until 2017, this seems to be the earliest now and it could be that rates don't rise until 2018 or 2019. If we vote to leave Europe it could be longer.

Holding cash is important for short term needs and can be our friend in times of market volatility as it enables us to invest when bargains appear! But anyone holding cash for the last 8 years would likely have suffered real negative returns and nothing is really going to change over the next 5 years.

There of course are other options like peer to peer lending or investing in overseas banks but all of these carry risk.

In summary ever since I have written the update on cash little has changed, I just wish journalists would write something useful rather than bemoaning something that isn't going to change anytime soon!

CONCLUSION

The first six weeks of 2016 seemed to have been an overreaction to an unknown event. If the event was a global recession, then the signs are simply not there. Growth is slow and we can expect this to continue. This is not a sign of a recession with many countries benefiting from lower oil prices.

What we can expect is greater volatility as the markets are not strong enough to soak up good or bad news as perhaps they have done so in the past. BREXIT, Trumpit etc will be terms we need to get used to over the coming months but also ISIS, China and Oil Prices will all have an impact on how the markets behave.

It is early days but are we starting to see a bottom with emerging markets and Asia and could we see a correction in 2016/2017? Are unloved stocks like financials, miners etc coming to a point where they are so cheap that this will correct? And how will technology change things, the recent deal between Morrisons and Amazon is an interesting sign of things to come.

To conclude we of course don't know about the unknown but in a world of low growth, low interest rates, increasing inflation and greater volatility it is probably fair to see that returns of between 5% and 7% are the new normal.

Source: Charts have been sourced from Morningstar. Other data sourced from Schroders, Templeton, Threadneedle, and JP Morgan. Any reference to a fund or share is not a recommendation to buy or sell that asset. Past performance is no guide to future performance and investments can fall as well as rise.