Parallel
Investment Management

Quarterly Update – April 2016

Market Backdrop

Over the years the month of January has cultivated a reputation for delivering rising stock prices, but in 2016 it will be remembered for producing one of the worst starts to the year for global equity markets. Investor fear had the upper hand with economic fundamentals pushed well and truly to the background. The outlook for global growth, fresh lows in the price of oil and other commodities, rising debt levels in developing economies, and the ability of central banks to act in the event of another financial crisis were behind the gloom.

But none of these issues are new and so the extent of the fallout in January was surprising. No main equity market was immune as investors sought the shelter of 'safe haven' assets, especially government bonds and gold.

The second half of February saw a strong rally with the turn-around in sentiment primarily reflecting reduced expectations for further US interest rate hikes, whilst a perceived delay in any possible monetary tightening in the UK as well as the expectation of further central bank stimulus in Europe and Asia also added support.

The only blot on the landscape was Japan where markets went into reverse gear as the central bank moved to a negative interest rate policy. Counterintuitively the Japanese currency strengthened by about 7% in the month and could only be interpreted as a reflection of its safe haven qualities. The rising yen caused the share prices of large export-oriented Japanese companies to retreat.

In the UK media headlines were dominated by Prime Minister Cameron's return from Brussels with some proposals that seemingly gave him the confidence to announce a referendum on 23 June to decide if the UK should remain in Europe. The uncertainty of the outcome began to weigh on the pound which weakened against the dollar and the euro.

In March, investors reassessed their previously pessimistic outlook on growth prospects for the global economy and switched back to 'risk-on' mode resulting in global equities rallying. Despite frequent large intra-day swings oil prices seem to have found a new level, the US economy so far continues to beat expectations, better economic news has started to filter out of China, and central banks in Europe and Japan remain supportive. So is this the turning point investors have been longing for? In the next two pages we comment on the global economy, the threats that linger, and our short-term outlook for asset classes and the equity regions.

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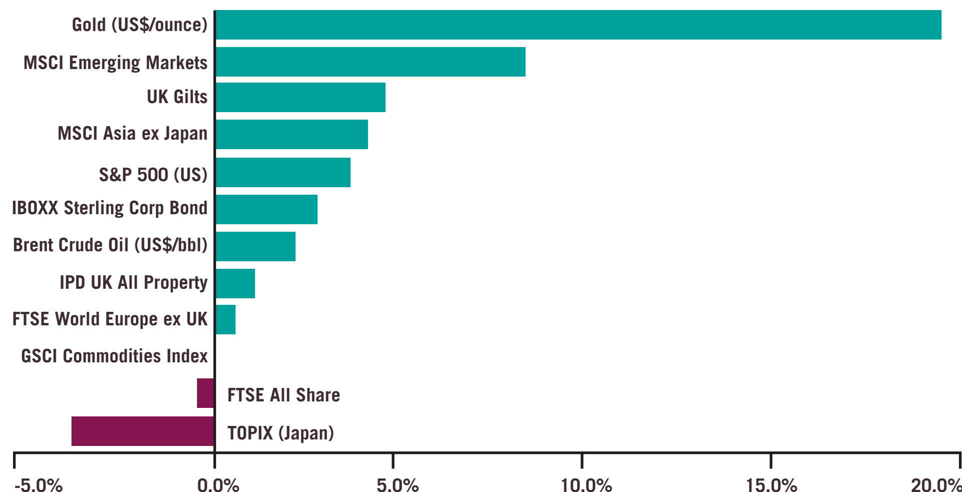
Asset Class Returns – Q1 2016



Data source: FE Analytics – rebased in Pounds Sterling

On 05 April, Christine Lagarde, the Managing Director of the International Monetary Fund (IMF) gave a speech in Frankfurt, Germany in which she warned, "the world economy is continuing to recover but it's still at a delicate stage. We have growth; we are not in a crisis. The not-so-good news is that the recovery remains too slow, too fragile, and risks to its durability are increasing... (because growth has been) too low for too long (too many people are) simply not feeling it''.

The level of consumption is one indicator of whether people are 'feeling the recovery' and in every major advanced economy over the past six months or so, consumption growth has slowed. This is despite the boost to real incomes from lower oil prices (caused by over-supply), with consumers in the US, the eurozone, Japan and the UK having saved an estimated $250bn of expenditure on motor fuel in 2015 compared with 2014, the equivalent of about 1% of household expenditure. But this benefit is diminishing and, according to economic research house Capital Economics, if oil prices remain around current levels the boost to incomes this year is estimated to be much smaller at around $50bn. Furthermore, recent surveys indicate that consumer confidence is in a decline, although this may simply reflect the turmoil in the global financial markets at the start of this year.

In the eurozone weaker employment growth is likely to be a drag on real incomes. In Japan, household spending has been flat since the 2014 sales tax hike and without a meaningful pick-up in wage growth a sustained recovery in consumption growth is unlikely. By contrast, the recent slowdown in US consumption is expected to be temporary because households could cut savings (given that they appear to have saved their entire windfall from lower oil prices), and wage growth is promising. In the UK the impact of further austerity measures alongside any possible uptick in inflation could be negative for consumption growth, although the labour market remains strong. So, overall, the outlook is for consumption growth in advanced economies to be weaker in 2016.

Last year predictions of global growth for 2016 were in the order of 3.5% but this has softened with Citigroup now forecasting about 2.5% – just above the 2% threshold generally defined as the break-point between growth and recession. So given that there was supposed to be a transfer of benefit from oil producers to oil consumers why hasn't the fall in oil prices since late 2014 been the tonic that the global economy was looking for? The possible reasons are complicated, but certainly include the surprise at how quickly China's economy has slowed down and perhaps an over-estimate of the strength of the global economy in 2014. Of course, the fall in the oil price may still turn out to be good for growth but it might be 2017 before we see it. (see chart, right).

Christine Lagarde also went on to say that "the world risks being trapped in a new mediocre of persistent low growth, with damaging effects on the social and political fabric of many countries". It is true that many people are losing confidence in their governments and institutions with populist political parties and extremist causes being the primary beneficiaries. So will the advanced economies be content with an annual growth rate of around 2% or will they execute measures to boost demand? The IMF has suggested that there should be a higher federal minimum wage in the US and active labour market policies in the eurozone, as these would give an immediate boost to demand, as well as supply.

Given the impact of the austerity measures introduced by some countries, the challenge of persuading governments that they should take action by engaging in higher public spending will be a challenge. Nevertheless, if the mainstream politicians are to regain the confidence of the voting public they will have to do more to stimulate growth. If they do not then global growth could slip to the wrong side of the cliff edge.

To this rather depressing scenario we must add a plethora of geo-political factors which includes the Brexit referendum on 23 June, November's US presidential election, the growing refugee crisis in Europe, and the conflict in the Middle East, to name but a few. Each of these issues has the capacity to generate increased volatility in 2016.

Given a backdrop of low global growth along with volatile markets we believe that it is important to avoid becoming too focused on the macro picture, maintain sufficient diversity through a broad range of asset classes, and adopt a selective approach to the markets.

This means that we will continue to focus on investment fund managers who are skilled at identifying those companies that have robust earnings, strong balance sheets, and are able to innovate or have niches where there are strong barriers to entry. It is such companies that are most likely to weather any storms and generate attractive rewards for investors over the long term.

Price of Oil

Brent crude, nominal prices, USD/barrel

Source: JP Morgan, Guide to the Markets – US, March 2016

Investment Views

Asset Class	Current View	Outlook	Comment
Equities	Positive	Deteriorating outlook	Equities continue to offer better potential long term returns than other asset classes, especially bonds. However, slow global growth and heightened volatility are likely to act as headwinds given present valuation levels.
Fixed Interest	Negative	No change in outlook	With current low yields and tightening monetary policy (albeit slow) return expectations continue to be poor. Corporate bonds are more attractive than sovereign debt other than as a safe-haven.
Property	Positive	Deteriorating outlook	Future rental yields in developed markets continue to offer attractive returns relative to developed market bonds. Returns are likely to reflect rental value growth rather than yield compression given high capital values.
Commodities	Negative	Improving outlook	Oil prices seem to have found a new floor but exhibit volatility as supply/demand news is released. Industrial metals remain exposed to China's economic rebalancing but improving data is likely to support prices.
Absolute Return	Positive	No change in outlook	This sector offers the potential for a positive return combined with some downside protection and this combination is attractive with heightened market volatility, supporting inclusion in our portfolios.
Cash	Negative	No change in outlook	With a rise in UK interest rates being pushed further out cash continues to offer an unattractive return, although the asset class holds defensive qualities.

Equity Regions	Current View	Outlook	Comment
UK	Neutral	Deteriorating outlook	The fall in sterling linked to concerns over Brexit and the outlook for interest rates should be supportive given the high dependence upon foreign earnings. However, uncertainty in the run up to the referendum is likely to act as a headwind.
US	Neutral	Deteriorating outlook	The strong dollar, commodity price weakness, and rising wage inflation is likely to depress earnings growth. Equity valuations are relatively high without a pick-up in economic growth.
Europe	Neutral	No change in outlook	The relatively early stage in the recovery phase is positive for the region, supported by the monetary backdrop as the ECB applies aggressive stimuli.
Japan	Neutral	No change in outlook	Earnings momentum has slowed given external headwinds (especially the strengthening of the yen because of its safe haven status) and poor domestic fundamentals. Further central bank support is expected and necessary.
Asia Pacific	Neutral	Improving outlook	Supportive domestic macro policies, a more benign Fed outlook, near-term growth stabilisation in China, and reduced currency risks are supportive for the region, with valuations relatively attractive.
Emerging Markets	Neutral	Improving outlook	For sterling investors valuations are attractive but only if highly selective on a country and company level. Asia EMs are favoured on a relative basis but volatility is expected as the Fed tightens and depending upon the pace of economic adjustment in China.

KEY

Current View: Positive | Neutral | Negative

Outlook: Improving outlook | No change in outlook | Deteriorating outlook

Portfolio Overview

Performance (%) for the period ending 31 March 2016

Portfolio	Descriptor	Quarter	1 Year	3 Years	Since Launch*
Parallel Multi Asset A	Defensive Growth	0.37	-0.8	5.49	12.21
Parallel Multi Asset B	Conservative Growth	-0.12	-0.96	10.00	21.47
Parallel Multi Asset C	Cautious Growth	-0.11	-0.70	13.08	28.09
Parallel Multi Asset D	Balanced Growth	-0.37	0.05	18.14	36.02
Parallel Multi Asset E	Adventurous Growth	0.12	-0.61	16.89	35.33
Parallel Multi Asset F	Global Opportunities	0.27	-1.83	15.03	31.77
Parallel Multi Asset B Income	Conservative Income	0.64	-0.19	7.01	16.19
Parallel Multi Asset D Income	Balanced Income	1.57	-0.52	12.06	29.05
Socially Responsible Growth		0.92	-2.08	16.30	33.96

Figures quoted net of management fee. Source: FE Analytics

*Inception date: 1 April 2012

Fund Selection: Contributing Funds

Legg Mason Japan – This was again the best performing fund in the Parallel portfolios. Its focus on the domestic economy lead the Fund to deliver positive returns over the quarter verses negative returns for the index.

First State Global Listed Infrastructure – This asset class demonstrated its defensive qualities by holding up well during the market turmoil experienced in the early part of the year, with the Fund delivering returns in excess of its benchmark index.

Stewart Investors Asia Pacific Leaders – Although this Fund suffered as a result of market volatility in January and February, it rallied strongly in March recouping its losses to end the quarter on a higher footing.

Fund Selection: Detracting Funds

Standard Life UK Equity Unconstrained – This Fund suffered as a result of its exposure to small and medium-sized companies in January and February, however the Fund fared better as market conditions moderated in March.

Woodford Equity Income – Exposure to the US biotech sector led to some underperformance against benchmark in the first quarter.

Standard Life GARS – Ongoing volatility in global equity markets has had negative consequences for several of the Fund's strategies resulting in a disappointing first quarter's performance.

Portfolio Activity

A summary of some of the main changes during the quarter:

Removal of currency hedging in Europe and Japan – We introduced currency hedging in Europe and Japan via hedged share classes early last year in anticipation of further weakening in the value of the euro and the yen relative to sterling. This worked well for our Portfolios throughout most of 2015; however, the spike in volatility since Q4 2015 has caused the euro and yen to rise relative to sterling, with the strength of the latter being compounded by its 'safe haven' status. Added to these effects, the uncertainty created by the forthcoming Brexit referendum has caused sterling to come under pressure. For these reasons, we believe the advantage of continuing to hold hedged share classes in both Europe and Japan has diminished. We therefore took the decision to remove all our currency hedging when we rebalanced our Portfolios in February. In both regions this also precipitated a change in some of our Fund holdings as we seek to focus on Funds that adopt an active 'bottom-up' approach which we believe is both suited and necessary give the current outlook.

Risk warnings

Investors should be aware that past performance is not a reliable indicator of future results and that the price of shares and other investments, and the income derived from them may fall as well as rise and the amount realised may be less than the original sum invested. The content of this newsletter is for your general information and use only, and it reflects the general market view of Parallel Investment Management Ltd., and should not be interpreted as recommendations or advice. The content should not be relied upon in its entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of the content. The value of your investments can go down as well as up and you may get back less than you invested.