Parallel
Investment Management

Money Wise Portfolios Quarterly Update – January 2017

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Market Backdrop

The first half of last quarter was dominated by heightened volatility around the US election as markets came to terms with an unexpected result and the prospect of protectionism, seen as damaging to corporate earnings. In contrast, the second half saw a calming of markets, with investors looking to the impact of tax cuts and spending plans suggested in the then President-elect's proposed economic policies. The prospect of US interest rates rising has increased as a result and the US dollar has strengthened.

The new US administration's proposed changes have been viewed as positive for not just the US but for global growth, corporate earnings and developed market equities. Apparently undaunted by the political, monetary and fiscal uncertainty in Europe, most developed equity markets have subsequently claimed new all-time highs. Even the Japanese market finished the year ahead, despite a poor early start to the year, though more as a consequence of further Yen weakness against the US dollar, which benefits Japanese exporters.

Funds investing in Global Emerging Markets (GEM) equities or debt (fixed interest) have suffered outflows of around US$14bn* following the US election, as exporting businesses anticipate headwinds from the new administration and a strong dollar makes the US a more attractive home for investment than domestic GEM currencies. However, as the year drew to a close the rise in the US dollar's value slowed and investors began to take a more sanguine view of the likely timescale and impact of any threatened trading arrangements.

In December, as the outlook for US growth improved, the Federal Reserve resumed hiking US interest rates with the prospect of further increases during 2017. This resulted in weakness in the US Treasury market, and had a knock-on effect in global fixed interest markets where we had already adopted a cautious approach. This 'game of two halves' was of course reflected in the performance of our portfolios, with the higher risk components languishing at the start, before recovering towards the end of the quarter.

We believe that valuations in many parts of the market remain stretched and political risk remains an issue, but they are now better supported over the short term by the prospect of fiscal stimulus and, as such, present opportunities, although remain susceptible to disappointment.

* The Financial Times, 29 Dec 2016

Asset Class Returns – Q4 2016

Data source: FE Analytics – rebased in Pounds Sterling

The big questions for 2017 might be whether Donald Trump can deliver on his taxation and spending pledges and, if successful, does this reinvent the current business cycle or simply postpone its end?

Whilst global growth appears to have caught up with the current supply of oil, supportive monetary policy continues in Japan and also, for the moment, in Europe. Leading indicators in Japan appear to be signalling the emergence of domestic growth, which should supplement the prospects of exporters boosted by the recently more favourable exchange rate.

With the prospect of fiscal stimulus and the penalty-free (?) repatriation of capital boosting the earning potential of many businesses in the world's largest economy, we are now more comfortable with the outlook for equities over the next twelve months. We currently favour US equities over other global markets as, whilst we believe that demand in the global economy will grow by way of the 'trickle-through' from the US stimulus, the potential for downside risks outside of the US is greater, particularly if de-liberalisation of trade creeps in.

At present, this threat makes us a little more cautious of global emerging markets (GEMs) ahead of clarification on the direction of travel. Prospects of a significant Chinese currency devaluation, already flagged by state officials, may also limit the upside from the region as a whole, as would any restriction on access to the US market in retaliation to such a move.

That said, the relatively attractive valuations on GEM stocks with exposure to domestic growth prospects may provide an opportunity, as would the traditional GEM exporters if the strong US dollar allows America to continue consuming cheap imported goods without penalty.

With improving US growth prospects and an already tight labour market it is now expected that the Federal Reserve will hike US interest rates three more times during 2017, rather than the twice anticipated prior to the election.

The efficacy of US fiscal stimulus, through rewriting the US corporate tax code, personal tax give-aways and increased government spending, and how this compares with market expectations will not be known for some time. This suggests that we have a window of opportunity to benefit from the Trump-rally, whether expectations are met or not, though given the myriad of challenges in 2017 we expect a number of 'bumps in the road'.

Japan In Focus

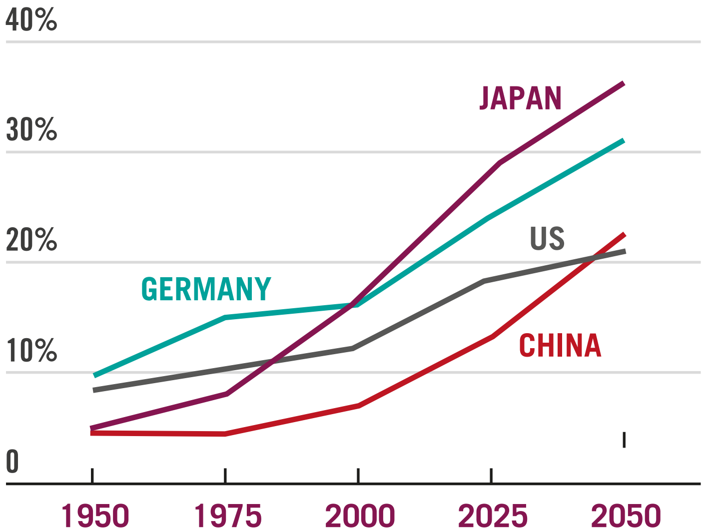
For a very long time the Japanese economy has been a manufacturing economy which has relied heavily upon exports. Companies in this sector always do well when the currency is weak and recent gains in the Japanese stockmarket reflect this.

However, the Japanese economy is going through a structural change from a regulated to a deregulated economy and from a manufacturing to a service-oriented economy. There are three primary areas which are driving this change: the increasing medical and long-term care needs of an ageing population, changing consumer lifestyles, and the rise of the internet as a consumer sales channel.

Although the change is somewhat akin to a super-tanker altering course and so will take time, we believe that the best long-term investment opportunities in Japan are to be found in domestically-focused companies that seek to exploit and benefit from these changes.

In some of our portfolios we provide exposure to such companies through the AXA Framlington Japan Fund and the Legg Mason Japan Equity Fund. Chisako Hardie, the manager of the AXA Framlington Japan Fund recently stated, "although this (currency led) trend is still continuing we believe it will change soon and small long-term growth businesses will start attracting investors' attention".

Japan's percentage of population over 65 is growing faster than any other nation:



Source: Population Division, DESA, United Nations

Investment Views

Asset Class	Current View	Comment
Equities	Positive	The promise of fiscal stimulus in the US should prove supportive for both US and global corporate earnings, and push out the likelihood of recession into 2018. Given the potential for equity gains over the next 12 months we are encouraged to add selectively but remain conscious of the downside risks & uncertainty, particularly further out.
Fixed Interest	Negative	With the rising interest rates in the US and inflationary pressures growing in the UK we see little upside in either US Treasuries or UK Gilts. We continue to focus on defensive qualities in the corporate bond sector and an opportunity to add to the asset class once rates approach a new equilibrium.
Property	Positive	Whilst property has already signalled late cycle characteristics, extending the business cycle should protect capital values. The asset class is well supported by real yields and Sterling weakness may present an attractive return point for overseas investors, boosting demand.
Commodities	Negative	Hard industrial commodities have seen a speculative rally on the prospect of US and Chinese stimulus after producers closed much of the previous overcapacity. Oil has rallied as increasing global demand has reduced the effect of oversupply supported by the OPEC agreement on limiting production.
Absolute Return	Positive	Absolute Returns funds should provide a useful diversifying tool to reduce portfolio risk but also the opportunity to achieve positive returns in what may prove to be a ‘bumpy’ period over the next 18 months should the new US proposition disappoint.
Cash	Negative	With a negligible return on cash we see the asset class as a tactical holding given its defensive qualities ahead of potential politically-driven volatility in asset markets.

Equity Regions	Current View	Comment
UK	Neutral	Ongoing Sterling weakness should provide a further fillip to companies with overseas earnings and encourage M&A activity by overseas buyers, scenarios that lend themselves to further upside. However, that same risk of Sterling weakness also highlights the relative attraction of overseas equities to UK-based investors.
US	Positive	Tax cuts and increased spending may improve growth prospects and with them both interest rate expectations and strength of the US dollar. Whilst this should present an opportunity we are cognisant of downside risk and believe it would only pay to add selectively and ensure that we are well diversified by investment style.
Europe	Neutral	The ECB has signalled it will tighten monetary policy as Europe begins to emerge from its economic malaise, whilst recent questions over bank solvency also appear to have been addressed. However, political uncertainties continue and we therefore remain cautious despite the low relative valuations.
Japan	Neutral	A reduction in spare capacity and nascent signs of growth in wages suggest that the Japanese labour market may be tightening as the economy begins to grow, but we remain cautious based on the impact of Yen weakness on Sterling returns.
Asia Pacific and Emerging Markets	Neutral	Strength in the region’s service sector and evolving domestic consumption still suggest opportunities, and whilst the EM ‘world factory’ may also benefit from fiscally stimulated US demand it also faces the risk of US protectionism.

KEY:
Positive Neutral Negative

NOTE: The opinions expressed in this document do not constitute investment advice or a recommendation nor investment research

Portfolio Overview

Performance (%) for the period ending 31 December 2016

Portfolio	Quarter	1 Year	3 Years	5 Years
Money Wise Cautious	1.29%	9.40%	15.59%	35.34%
Money Wise Balanced	1.92%	12.70%	20.70%	50.16%
Money Wise Adventurous	0.35%	12.95%	25.59%	60.92%
Money Wise Income	1.56%	10.56%	16.32%	42.03%
Money Wise Higher Income	2.22%	12.08%	18.58%	49.62%

Figures quoted net of management fee. Source: FE Analytics

Fund Selection: Contributing Funds

Fidelity American Special Situations – This Fund benefitted from its exposure to IT, Financial, Industrial and Healthcare stocks following Donald Trump's victory in the US Presidential election. The Fund is relatively concentrated and seeks to invest in companies that are undervalued with a strong balance sheet or resilient business model.

Schroder European Alpha Income – This Fund was one of the top performers over the quarter, taking advantage of the market's rotation from defensive to cyclical stocks, as inflation expectations move higher. The Fund provides a concentrated portfolio of European equities and adopts a business cycle approach, currently holding a preference for value-orientated stocks.

Fund Selection: Detracting Funds

Newton Real Return – This Fund continues to be cautiously positioned, focusing on investing in companies with solid fundamentals and in areas where structural tailwinds and/or 'haven-like' qualities are present. Performance has recently lagged the benchmark due to its defensive properties, which is to be expected when equity markets rally, however this Fund will provide investors with an element of downside protection during periods of increased volatility and market uncertainty.

Premier Pan European Property – There remains considerable negative sentiment towards UK real estate, particularly in London, since the aftermath of the Brexit referendum in June. Continental European property securities have also recently experienced weakness as a result of higher bond yields and inflation expectations. We remain confident that the Fund's approach of investing in the shares of quality real-estate companies in markets that are supported by supply and demand fundamentals will reward investors over the long-term.

Portfolio Activity

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

Increase in exposure to infrastructure – We have increased our exposure to this sector in the belief that governments across the global economy will deploy fiscal stimulus in order to boost economic growth. We introduced the Lazard Global Listed Infrastructure Fund which is a defensive, low-volatility strategy that invests in a global range of 'preferred infrastructure' companies that are regulated monopolies.

Introduction of Gold – We took the opportunity to introduce exposure to gold in the portfolios in order to provide an element of insurance in light of a number of global macroeconomic and market risks given the geo-political uncertainty in the forthcoming year. Although short-term performance has been disappointing gold carries 'safe-haven' qualities and will enable investors to preserve real value over time given its negative correlation with risk assets.