Parallel
Investment Management

Quarterly Update – April 2017

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Market Backdrop

Global equity markets got off to a strong start as the post-election 'Trump rally' continued into 2017. However, this proved relatively short-lived and soon investors cooled-off as they paused to reflect on the wider impact of the new US President's policy proposals. The widely welcomed proposal to reduce taxes and regulations was somewhat over-shadowed by the potential impact of increased tariffs and harsher immigration policies. Despite this, encouraging economic data and strengthening commodity prices meant that the MSCI World index managed to hold on to record a positive return for the first month of the year.

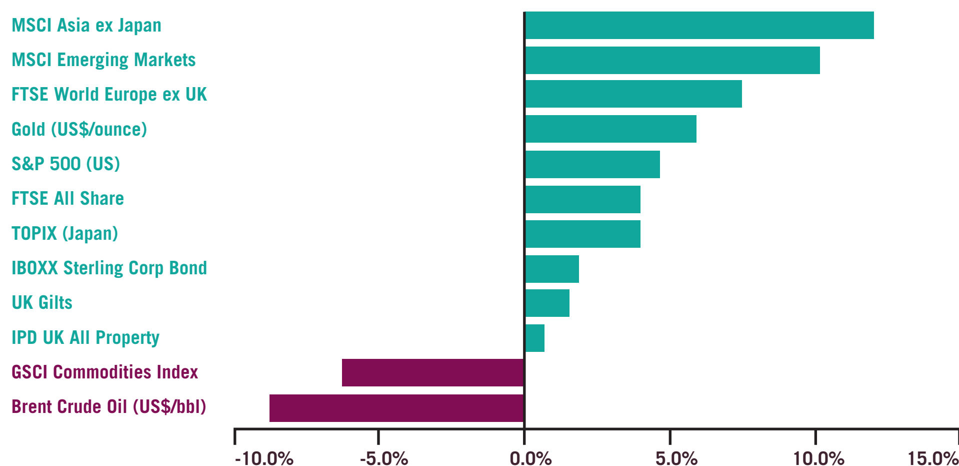
February saw none of this 'see-saw', with stronger momentum in the US markets spilling over to create a general mood of investor optimism across global equity markets. The spur for this was hope for faster economic growth based on strengthening economic data, improving manufacturing conditions and strong consumer demand. However, this seemed to mask an underlying nervousness among investors, evidenced by the relative strength of 'defensive' sectors when compared with relative weakness in the more economically-sensitive sectors, such as energy and industrials.

Although not yet seen in the returns of the Eurozone (ex-UK) equity markets, February saw the release of economic data which pointed to both the resilience and breadth of the region's economic recovery. The composite of private sector surveys covering the construction, manufacturing and services sectors was the most positive since 2011, and employment data showed job creation to be the best for nine and a half years. This apparent strengthening was also reflected in the results of European companies, where the majority beat 2016's Q4 earnings expectations and recorded positive earnings growth relative to the previous year.

The strong start to the year for global stocks continued in the first half of March but a mood of caution permeated investors as the quarter drew to a close. This partly reflected President Trump's inability to drive through his healthcare policy reforms, thereby creating uncertainty as to the likelihood of him being able to successfully land his tax reform, deregulation and infrastructure spending policies.

Global stocks have enjoyed one of the strongest starts to the year since 2012 although ended the quarter in a more measured fashion. It is perhaps a relief that markets seem to be acknowledging that they cannot continue an inexorable rise based on hope and expectation rather than the underlying fundamentals.

Asset Class Returns – Q1 2017



Data source: FE Analytics – rebased in Pounds Sterling

What a difference a bit of warm weather makes? It seems that it doesn't take much for the signs of spring to burst into life with trees now in blossom and lambs playing in pastures. It all helps to create a sense of well-being and optimism for the future.

And so it is with the global economy – spring has arrived! By the time you read this the finance ministers and central bankers from the International Monetary Fund's 189 member countries will have met for the organisation's spring meeting. As they assess the state of the global economy they will acknowledge that for advanced economies the outlook has improved with stronger manufacturing activity evident across a broad-base of countries, including Europe, although here some countries still face high debt and weaknesses in certain banks. The prospects for emerging and developing countries also bode well for global growth with an expectation that they will contribute more than three-quarters of global GDP in 2017. Somewhat in contrast, and despite the relief brought by higher commodity prices, some low-income countries still face a number of challenges.

Of course, actual data always lags behind surveys of business and consumer confidence, but the consensus is that there is substance to the improvements leading to the opinion that this is not simply a blip.

This rosy picture is not without risks: political uncertainty, especially in Europe; the possibility of protectionist policies hampering global trade; tighter global financial conditions (higher interest rates) triggering disruptive capital outflows from emerging and developing economies. Not to be ignored is the weak productivity trend that permeates advanced economies and which acts as a drag on strong growth – this reflects ageing populations, the slowdown in trade and weak private investment since the financial crisis.

Central banks should be credited with having run a sensible race in addressing the challenges of the last 8 years even though some, notably the European Central Bank and the Bank of Japan, were slow out of the blocks. But there is no room for complacency if the recovery is to be sustained, and this will require policies which support growth through an appropriate mix of fiscal, monetary and structural measures, the balance of which needs to be tailored to individual country needs.

Today, according to the IMF, public sector debt in advanced economies is at a post-war high – 108% of GDP. If you add to this the amount of private sector debt the numbers are worrying. Debt, demographics and disruption (technological innovation) are deflationary forces and with wage pressures subdued in major advanced economies, save for the US, it is likely that we will need to identify other means than simply expecting inflation to erode the value of the debt.

Despite the world economy being in better health than for some time a myriad of reasons could unsettle this fragile upswing, and now we have the additional uncertainty of a general election in the UK to contend with. So, as an investor, you may be wondering if the transition from spring to summer will be far from smooth? In truth, no-one knows, and so the only way to protect your capital is by diversifying your portfolio and periodically swapping expensive markets for better valued ones – exactly the approach we adopt in managing our clients' portfolios.

Fixed Interest In Focus

Fixed interest investments (bonds) have generally been seen as relatively predictable and carrying low risk. This predictability changed following the financial crisis of 2008 as Central Banks around the world pushed down the cost of borrowing (interest rates) to artificial lows in order to stimulate economic growth, by making it easier for companies to obtain finance via debt. They achieved this by buying up large swathes of their own government (and latterly corporate) debt markets, thereby reducing the amount of bonds in circulation causing prices to rise and consequently yields to fall.

However, global economic growth is no longer as fragile, particularly in the US. There we have seen interest rates on the rise causing bond prices to fall. If the global economic recovery takes hold other Central Banks will no doubt follow the US lead and begin to raise interest rates. Whilst economic prospects tend to lag on this side of the Atlantic, and interest rate rises may not arrive in the UK and Europe this year, the prospect makes us cautious of holding a larger weighting to fixed interest within our portfolios just yet, given the virtual surety of capital loss.

Given this outlook, and as we seek to dampen equity volatility within our portfolios we continue to make use of alternative investments such as inflation-linked bonds, property and infrastructure. Where we have retained exposure to fixed interest this has largely been via strategic bond funds. These investments typically enjoy a much more flexible mandate than traditional fixed interest funds, and can often hold assets in niche areas not generally accessible to those large mainstream funds. In theory, this should allow the managers to adapt their debt holdings to changes in the economy, avoid the more troubled parts of the debt market, and provide a greater chance of preserving capital.

We do not see ourselves adding to the more traditional fixed interest investments until the market has begun to adjust to a higher interest rate environment in the UK, which may still be some time off. In the meantime we will continue to look for innovative ways to reduce investment risk.

Investment Views

Asset Class	Current View	Comment
Equities	Positive	Equities continue to look attractive against a backdrop of improving global growth. Global corporate earnings could be further supported by any US fiscal stimulus as long as revised US trade policies or geopolitical issues do not interfere with markets.
Fixed Interest	Negative	With interest rates on the rise the outlook for government debt is poor. Better relative value is to be found in corporate debt, especially selected higher yielding paper, but we are entering a higher risk period. We remain focused on defensive qualities in the corporate bond and inflation-protected sectors.
Property	Neutral	Whilst property is supported by real yields and sterling weakness may present an attractive return point for overseas investors, the asset class is expected to face headwinds in a rising interest rate environment.
Commodities	Negative	Following a sustained recovery in prices in 2016, and despite an accelerating global economy, we now expect supply to be more of a driver of returns than demand. Opportunities exist as commodity companies focus more on returns than volume growth, but a selective approach is demanded.
Absolute Return	Positive	Absolute Returns funds should provide a useful diversifying tool to reduce portfolio risk as well as 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 solely as a tactical holding given its defensive qualities, though this is tempered with a vulnerability to inflation.

Equity Regions	Current View	Comment
UK	Neutral	Positive consumer and business surveys, sterling weakness and poor yields from other assets are all supportive of UK equities. However, headwinds are expected to strengthen as Brexit uncertainty grows and inflation picks up.
US	Positive	The US economic recovery that emerged last year has built up momentum, and interest rate increases signal confidence in the strength of that recovery. Tax cuts and increased spending would improve growth prospects further for US companies but are dependent on greater political consensus. We are mindful of current valuations and the room for disappointment.
Europe	Positive	With healthier European growth and employment levels now being realised, the ECB has confirmed it sees a diminishing need to apply further stimulus. If European equity markets turn out to be less sensitive to political upheaval than feared, then they may provide an attractive investment opportunity.
Japan	Neutral	With the Japanese labour market still tightening at the margin, there are encouraging pointers to economic growth. However, the Japanese economy's reliance on exports makes the equity market vulnerable to any US dollar weakness against the yen.
Asia Pacific and Emerging Markets	Positive	Despite geopolitical tensions, some of the fears of US protectionism are receding, US dollar exchange rates are also more supportive, Chinese growth is resilient, and more upbeat surveys all point to stronger regional growth.

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 March 2017

Portfolio	Descriptor	Quarter	1 Year	3 Years	Since Launch*
Parallel Multi Asset A	Defensive Growth	2.74%	7.41%	12.46%	20.54%
Parallel Multi Asset B	Conservative Growth	3.10%	8.39%	16.30%	31.73%
Parallel Multi Asset C	Cautious Growth	3.64%	11.71%	22.60%	43.17%
Parallel Multi Asset D	Balanced Growth	3.93%	14.01%	28.50%	55.17%
Parallel Multi Asset E	Adventurous Growth	4.41%	16.51%	30.89%	57.77%
Parallel Multi Asset F	Global Opportunities	5.19%	21.16%	35.02%	59.76%
Parallel Multi Asset B Income	Conservative Income	3.55%	10.11%	17.60%	28.04%
Parallel Multi Asset D Income	Balanced Income	4.32%	14.46%	26.19%	47.86%
Socially Responsible Growth		4.33%	19.35%	29.42%	59.99%

Figures quoted net of management fee. Source: FE Analytics

*Inception date: 1 April 2012

Fund Selection: Contributing Funds

Evenlode Income – The Fund experienced a strong first quarter as a result of its broadening exposure to healthcare and digital analytics, and as defensive stocks came back into favour following the previous rotation to cyclicals. The managers seek to invest in sustainable, asset-light businesses with the ability to generate healthy, growing free cash flow and dividends over time. The Fund currently has a bias to large-cap stocks.

Lazard Global Listed Infrastructure – Infrastructure (energy, transportation, water-sanitation and telecoms) is a growing asset class in both developed and emerging markets, and has been one of the main beneficiaries following the US presidential election result. The Fund focuses on companies which typically are regulated monopolies that have the ability to translate consistent revenues into relatively stable returns over the long term.

Fund Selection: Detracting Funds

Investec UK Total Return – The Fund underperformed the FTSE-All Share Index in the period reflecting its contrarian, value approach and focus on out-of-favour stocks, as well as the defensive benefits attained through its current weighting in cash and bonds. The Fund is currently subject to a review to determine its continued inclusion within our exposure to the UK equity market.

Man GLG Continental European Growth – Despite posting positive returns in the quarter the Fund lagged the index because of stock specific issues. Whilst a fund running a concentrated portfolio always carries such risk the better economic news emanating from the region bode well for the outlook and the manager is confident of the potential offered by the stocks held.

Portfolio Activity

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

Reduction of property exposure – We have decreased our exposure to this asset class as we are concerned for the volatility that could arise in the UK property sector as the UK negotiates its exit from the EU. Even though the income opportunities presented by the sector are attractive, we do not envisage meaningful capital appreciation in the short term.

Increase of allocation to US equities – We have increased our allocation to this region as part of a short-term momentum play. We believe there is an attractive opportunity to capture a proportion of the upside generated from investor optimism surrounding President Trump's proposed fiscal stimulus. We anticipate that our exposure will be reduced in the forthcoming months as rotation into other geographical regions offering better value commences.

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.