

Markets climb a wall of worry

The global market rally that started during the second half of 2016 gained further traction in first quarter of 2017. Supportive policies within the US, inflation surprises, alongside improving global fundamentals provided the start of a global recovery in investor confidence.

Newly elected US President Donald Trump's promises of infrastructure investment, corporate tax reform, and the loosening of regulation also provided an upward lift to equity markets, which have gained strongly since his election in November.

The US central bank raised interest rates for only the third time since the financial crisis, stepping up the pace of tightening as policymakers grew increasingly confident on America's enduring recovery. China's central bank later followed the Federal Reserve by raising their domestic money market rates.

Politically investors were reassured by central bank action and the lack of political upheaval. The US Federal Reserve, Bank of Japan, and the Bank of England all conformed to market expectations in terms of monetary policy, whilst the populist surprise of recent elections came to a halt as the Netherlands rejected the right-wing Geert Wilders' PVV party. The rise of populism appears the largest threat to the recovery and continues to march across the globe.

The US reflation trade

In the US, Donald Trump's inauguration was enacted on 20th January, and his "twitter" approach to policies has provided both concern and a level of light entertainment. The belief remains that he will reflate the global economy and markets have certainly moved ahead on that assumption. Some of this was misplaced as the new President delivered on some of his protectionist policies with Mexico and immigration in the firing line.

There is a real contradiction in Trump's policies as he wants to put America first by delivering jobs and growth through fiscal spending and tax cuts. This would ultimately strengthen the dollar which is where the dilemma exists. America already has low unemployment and there is a desire to make multi-national companies competitive through keeping the dollar lower. Getting the right balance will be difficult. For now, equity markets will likely trade higher but the risk of protectionism and trade wars remain at the forefront of investors' minds.

More recently President Trump had to pull his revised policies on healthcare as he failed to gain support from Congress. Markets reacted negatively believing

that he will now struggle to implement the all-important tax cuts and infrastructure spending programmes.

Overall, confidence remains high in the US, with a pro-business Trump administration, which continues to drive the bullish sentiment. Federal Reserve Chair Janet Yellen, raised interest rates acknowledging the rise of inflationary pressures and a strong labour market. Waiting too long could potentially require policy makers to eventually raise rates rapidly, which could risk disrupting financial markets and push the economy into recession.

Boost from commodities

Since the end of last year key exporters, such as Russia and Brazil, have demonstrated a strong pick-up in economic growth. Other major commodity importers, such as China, are also faring well, highlighting the positive effect of other key themes at play in the emerging world.

Russia agreed, in December, to join OPEC in cutting oil production to reduce inventories and bolster prices in the first joint supply deal since 2001. The ensuing price rebound has stoked a US shale oil resurgence, prompting worries over increased supply once again.

The rise of populism

The rise of populism has increasingly appeared fully entrenched in today's society. This upset to the political status quo results from the disenfranchisement of significant elements of the electorate. It has created headwinds for investors, one example being Marie Le Pen of the French far right where there was genuine concern that she could follow successfully in the "populist" footsteps of Donald Trump and Brexit. Le Pen's intention if she had won was to eject France from the euro and call a referendum on EU membership, which would have created yet more political uncertainty for Europe.

However, the Dutch electorate witnessed a victory over the far-right populist challenger Geert Wilders. The Dutch election was a precursor to the subsequent election in France and the German election will follow later this year. It revived hope that the populist movement may not have reached as far as the core European countries.

The European Central Bank (ECB), agreed to keep interest rates at a record low, but Mario Draghi, President of the ECB, said the Bank no longer had a sense of urgency to take further action on monetary stimulus. The ECB shift came as Eurozone inflation

rose above its target of just under 2 percent for the first time in four years.

Ultimately, the European economy has been improving markedly, and has only been held back by the threat of politics. Corporate profitability is also gaining momentum with many companies delivering solid earnings growth.

Brexit negotiations

Prime Minister Theresa May indicated she would move towards a hard Brexit, and pledged to seek a separate trade agreement with Europe. Finally, Theresa May signed the historic letter to start proceedings, starting the formal process to initiate Article 50. The two sides now face two problematic years of negotiation, and questions will rise over their ability to achieve an adequate solution.

May's EU counterparts have warned that access to the single market would require the UK sticking to the free movement of goods, services, capital and labour. But with May's intention to focus on controlling the country's borders, it looks like this will be a drawn out and difficult affair.

So far, Brexit has caused a fall in the pound which although is starting to have an impact on import costs, these have not yet really been passed onto the UK consumer. This may be about to change. Fundamentally these increased costs cannot be absorbed, leaving companies little choice but to pass the burden onto the consumer. By the end of the year price inflation looks set to outstrip wage growth, which will squeeze household budgets over the medium term.

Entering the summer lull

A wave of populism continues to surge through Western societies. The Brexit vote was followed by the dramatic election of Donald Trump to the White House and the rejection of constitutional change by Italian voters, yet equity markets reacted favourably. Economic data is improving and company earnings are witnessing upgrades. The interest rate rise pushed through by the US Federal Reserve shows that confidence in the US economy is building and this is likely to ripple through to the global economy.

Markets have recently taken a pause, questioning, and assessing the ability of the Trump administration to create the fundamental changes promised during the election period. This may continue as we start to enter the traditional summer lull. Ultimately, positive change is occurring across the globe and growth is likely to improve from here.

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APPENDICES

IA Sector Returns

Sector	3 Month %	6 Month %	1 Year %	3 Years %	5 Years %
Cash & Near Cash					
Money Facts 90 Day Notice Account (£10K)	0.08	0.27	0.65	2.16	4.22
IA Money Market	0.06	0.09	0.25	0.39	0.82
UK Fixed Interest					
IA Sterling Corporate Bond	1.94	-0.60	8.88	19.20	34.32
IA Sterling High Yield Bond	1.86	3.70	10.61	10.34	32.42
IA Sterling Strategic Bond	1.95	1.12	7.99	13.37	29.51
IA UK Gilts	1.57	-3.56	7.35	26.24	27.32
Commercial Property					
IA Property	1.29	1.24	6.81	28.41	46.94
UK Equities					
IA UK All Companies	4.53	8.41	17.95	21.75	63.14
IA UK Equity Income	4.22	6.69	15.14	23.31	66.57
IA UK Smaller Companies	7.29	11.39	18.69	25.72	92.99
International Equities					
IA Asia Pacific Excluding Japan	11.59	10.49	35.08	48.24	60.07
IA Europe Excluding UK	6.20	11.47	23.72	29.84	81.86
IA European Smaller Companies	7.54	9.13	22.08	37.51	100.15
IA Global	5.52	11.53	28.56	43.23	75.76
IA Global Equity Income	4.91	10.71	25.42	38.69	75.79
IA Global Emerging Markets	11.03	11.06	35.27	37.98	32.42
IA Japan	4.26	8.72	32.37	60.36	81.64
IA North America	4.67	14.80	33.20	65.86	113.58
Important Notes:					
<ul style="list-style-type: none"> • Source: Financial Express Analytics • Bid to bid pricing • Total return basis • Returns shown in local currency (Sterling) • Time period ends at end of last quarter (31/03/2017) 					