Stephen Watson on Asset Allocation

Economic and market forecasting is always a fraught occupation, difficult and subject to behavioural biases, not least over-confidence. Looking at the past few years, analysts' forecasts for earnings on both sides of the Atlantic have proven to have been over optimistic and subject to downgrades. The Chinese have a curse 'May you live in interesting times'. That is certainly the case today.

The three main uncertainties facing investors and forecasters alike are the imponderables surrounding the UK's decision to Brexit and what that will mean for trade and movement of people, the impact of Trump assuming the presidency in the US and what that might mean for global trade and profitability for US corporates, and thirdly what geopolitical shocks may happen across Europe.

UK economic forecasts for the UK have been downgraded because of Brexit. This would have been much lower save for the stimulatory impact of last year's savage depreciation of sterling.

Forecasts for UK inflation are similarly quite diverse, and what seems sure is that real wage growth will fall if not disappear.

We must remember that 80% of UK earnings come from overseas and the melt-down in commodity and oil prices feared last January failed to materialise. Furthermore, monetary policy remains accommodative and borrowing costs are low.

Bull Points

Strong outlook for US corporate profits and financials

An improving backdrop for commodity and oil prices

Bear Points

Geopolitical situation in Europe

Tough times for exporters to the US

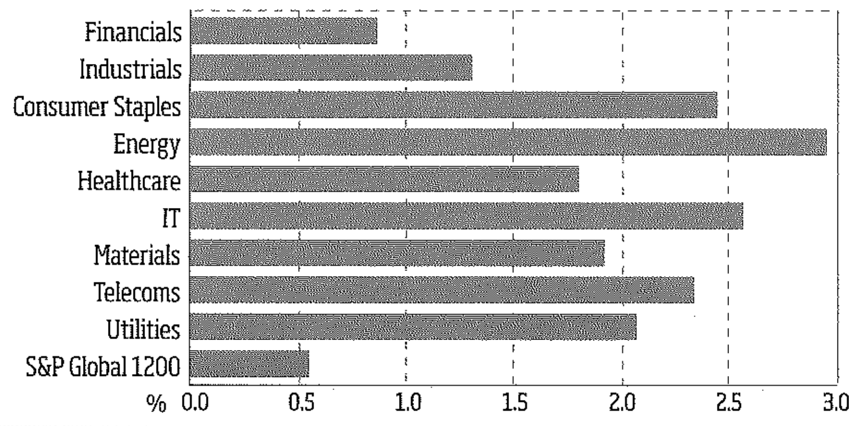
Will Trump's many promises fail to materialise? On the plus side for corporates he has promised lower taxes and increased infrastructure spending which should be stimulative. To counterbalance this, his rhetoric on global trade and import tariffs could damage world trade at a time when growth is not exactly robust. Historically, rising interest rates are positive for financial companies, particularly banks so US equities should do relatively well.

In Europe, will Marine Le Pen win the presidential race in France and result in a National Front leader? What will happen in Germany, the Netherlands and Italy?

As ever, equity markets will have to climb a 'wall of worry' but still look favourable relative to government bonds.

Stephen Watson is chief investment officer at Beaufort Investment Management.

S&P Global 1200 sector returns



2 January 2017 - 8 January 2017. Source: Morningstar

James Penn on Bonds

(IA) £ Corporate Bonds: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
Top 5					
F&C Institutional Lng Dated Corp	34.60	1	3.06	44.92	★★★★★
PIMCO GIS UK Long Term Corp Bd	33.83	2	2.81	462.89	★★★★★
Schroder Instl Long Dated Corp Bd	32.99	3	3.20	301.16	★★★★
Henderson Inst Long Dated Credit	31.88	4	3.37	472.33	★★★★
Fidelity Instl UK Long Corp Bd	31.18	5	2.61	523.88	★★★★★
Bottom 5					
Threadneedle Stlg SD Corp Bd	7.88	79		754.72	
M&G Short Dated Corp Bd	6.44	80	0.50	341.72	★
SVS Brown Shipley Sterling Bond	6.06	81	0.92	88.10	★★
AXA Sterling Credit Short Dur Bd	5.72	82	0.31	539.85	
Fidelity MB Inc Reduced Dur	4.34	83	1.02	63.33	★
SECTOR AVERAGE	**18.82**		**1.61**	**750.11**	

Performances calculated bid to bid, net income re-invested, GBP to 08/01/17. Source: © 2017 Morningstar.

Bond markets have sold off aggressively in the past few months.

The election of President-Elect Donald Trump is seen as an antidote to 'secular stagnation', that will provide a reflationary boost to both the US and the world economy.

Accordingly, a number of market participants are anticipating the end of the 30-year bond bull market. But is that judgement premature?

In truth, it has been a difficult time for bond market investors brought up with a certain number of precepts: be careful about long duration bonds, buy bonds below par, take profits because another interest rate cycle, or inflation, is always around the corner.

Those strategies have not worked so well over the past eight years. Yields have tended to fall to ever new lows, even though we are many years past the financial crisis, and central bankers are still very reluctant to raise interest rates.

Many of the same problems are still all too apparent around us. Private debt levels are high, and the appetite to take on more of it is low, while there are not enough credit worthy borrowers; personal incomes are still not rising fast enough.

It could be the three hikes the Federal Reserve mentioned at its December meeting are on the ambitious side, and it would not surprise if they ended up implementing two, or even just the one (perhaps in December, which would start to suggest a pattern for the next few years).

Bull Points

Bond markets continue to receive unparalleled support

Huge amounts of 'money printing' have had virtually no impact on inflation

Bear Points

With economic resilience in the face of several political shocks, yields may have bottomed

Most governments around the world are likely to add an element of fiscal stimulus in 2017

It is worth pointing out the voting composition of the Federal Reserve committee is due to change, with an influx of three new doves coming on to it. That suggests some value in US bond markets and scope for shorter-dated yields to rally over the next year.

In the UK, the likelihood is we get no rate rise in 2017. At the same time, the economy is unlikely to go into recession (the consensus figure for 1% GDP growth looks about right), so in all probability we will not see a further rate cut.

US bonds look the most attractive internationally, while in the UK, decent spreads mean that corporate bonds look a better bet than governments.

James Penn is a senior portfolio manager at Thomas Miller Investment