

Mixed emotions

In short, there's a lot going on. From an international perspective, a lot of what's happened is down to the reversal in the strength of the US dollar resulting from a U-turn in Federal Reserve interest rate policy. This was borne of an overly hawkish Fed outlook not shared by the bond markets. Something had to give one way or another. The turn in the dollar immediately alleviated the pressure on US dollar indebted emerging and Asian markets, which had struggled last year, but shifted the problem to Europe and Japan, both of whom seek a weaker currency to stimulate their economies. This feels like a currency war, albeit a cold one. We haven't really seen the central banks gloves come off yet. But there are straws in the wind warning us that negative interest rates and QE have further to go. The UK is, of course, in the same boat as everyone else except with the additional uncertainty of the Brexit debate which has seen Sterling weaken this year as the polling drew closer to 50/50. From a Sterling perspective, the US dollar has strengthened which is great for a lot of the FTSE100 but hampers the domestic economy where things could and should be a lot brighter than they are. The picture is one of economics mixed up with politics and unpredictable central bank policy which made the

first quarter a difficult, almost impossible, one to invest and position for.

All hat and no cattle

As President Obama got up to poke a finger in the eye of the Brexit campaign last weekend, the word was that he was going to utter only a few well chosen words to help convince undecided Brits that they would all be better off staying "In" when they vote in the EU referendum on 23rd June. As it was he spoke for over 10 minutes and appeared to do a proper job for Project Fear. His use of the phrase "back of the queue" instead of the American word "line" with reference to a future trade pact was a nice one for the conspiracy theorists seeing the hand of Prime Minister Cameron in the writing of the speech. We have no reason to doubt his sincerity but whether or not this was true, it appeared to have the desired effect for David Cameron by turning the tide of opinion with polls and bookmakers showing a swing back towards the UK remaining in the EU.

Obama bounce

When the currency markets opened on Monday, the "Obama bounce" lifted Sterling from $1.43 against the US dollar and by day three was well on its way to $1.46 with similar gains against the Euro. This in turn had a profound effect on the FTSE 100 Index containing as it does a number of companies who make their profits abroad and, therefore, in foreign currencies. Indeed, 70% of the FTSE100 constituent profits are in US dollars alone and so, rather predictably, shares in those companies were sold heavily. Mining, which was recovering on the back of China not looking quite as bad as originally feared, got hit. Oil stocks would normally have been taken to the woodshed along with mining but, despite a comical OPEC meeting where nothing was agreed let alone production cuts, the oil price just seems to want to go higher now that everyone is waking up to what oil rig closures mean in the longer term.

Small or large?

This is one reason the FTSE100 has beaten the FTSE250 index of mid-sized companies but the sustained outperformance from mid-February is also indicative of the way stock markets incline more towards big caps during periods of volatility and uncertainty. With so much hinging on Brexit or central bank policy, and with the behind the doors decision making it difficult to analyse, we expect uncertainty to linger a while yet because the situation in less of an investment decision than it is a gamble. So while we are asking whether there is something more fundamental going on to explain the shift from mid to large cap, the case for selling out of mid-caps has not been made, in our view. We believe the merits of staying invested in stock picking investments in equities are sufficient to retain long term successful investments but will, as we have before, made shorter term opportunistic investments, where appropriate, in large caps where the short term flows are more evident.

Sticking to the 2016 script

With so much going on in global stock and bond markets this year and, from an investment perspective, you would think it would've been quite easy to be on the wrong side of Obama's utterances and the effect it had on Sterling, shares and bonds. But we find that thanks to the strategies that we invest in, very

few fund managers owned many shares in those sectors that fell hard.

The reason is that it's been a tough quarter for a majority of fund managers running what, to their minds, are perfectly sensible investment strategies with portfolios of shares in well-researched, well-run companies with sustainable profit growth. By and large, this approach has not included shares in companies exposed to emerging markets, oil and mining. Emerging markets are typically saddled with US dollar debt and so struggle to finance it when the US dollar is strong. The collapse in the price of oil did it for shares in the energy sector worldwide and mining has been out of favour owing to the slowdown in demand from China.

Fed U-turn – The EM buyer strikes back

All of this changed when the Federal Reserve did a U-turn on their 2016 outlook for interest rates, abandoning their objective of four hikes throughout 2016. In a way, considering stock markets ended 2015 in fine fettle, further hikes seemed reasonable given the US economic data was all broadly pointing in the right direction. Even the side issue of a lack of inflation could be conveniently dismissed as a result of falling oil prices. But the Fed's four hikes forecast seemed more than a bit punchy and the bond markets didn't bite. At best they priced for two hikes and, at times, nothing at all until 2017, which was a brave call. After all, they do say "Don't fight the Fed". However, this battle was won by markets and as the Fed retreated from the notion of a return to normality via a nicely scripted series of well-flagged interest rate hikes, the US dollar fell. The reversal of the US dollar also coincided with signs of a turn in the slowing Chinese economy. Emerging markets also stormed back at the expense of Europe and Japan where markets were waiting patiently for their central banks to ease further. Such are the far reaching effects of a change in Fed policy. And so January in particular was a bad month for anyone invested with a cautiously optimistic portfolio having taken the central banks broadly at their word yet still cognisant of the risks of investing in risky markets.

Brexit - Clinging to nurse for fear of something worse

The chances of the UK leaving the EU have faded in just a few days and the partisan points scoring carries on in what is proving to be a rather unelevated debate full of sneering, smears and half-truths. It's well within the capability of some members of the Brexit debate to conjure up an articulate and compelling reason why the UK would be better off going it alone. But one gets the feeling that they lack the firepower and media presence to overcome the Government's position and their basic assertion one's personal finances would be worse off out of Europe because the word "uncertainty" is repeated continually in a way that conflates the word with job prospects. Why put one's job on the line in the name of democracy and sovereignty, or any number of the bigger issues, when the status quo, with all of its faults is at least known. The silent masses may come out far stronger than polls suggest, as they did for the Scottish referendum and the general election (it's amazing the same polls are still worthy of newsprint) but if this week's move in the FTSE and Sterling is telling us anything, it looks like the UK will vote for nurse for fear of something worse.

Inflation and interest rates – It's the journey, not the destination

There are several factors influencing inflation, or the lack of it, and the fall in the price of oil is again the culprit partly to blame. Leaving aside whether cheaper petrol represents inflation of a good kind or bad, the headline figures do influence bonds and we had expected inflation figures to start picking up in the US and UK thanks to the mathematical base effect of the big fall in 2014 falling out of the year-on-year figures. However, the second lurch down from October last year put paid to that and we will have to wait a while to get this free boost to the headline figures even if oil prices continue to rise at the pace they have been over the last few weeks. Regarding UK, we believe a vote to stay in the EU would, amongst other things, strengthen Sterling, limit inflation from imported goods and give the Bank of England enough elbow room to raise rates by 0.25% at year end. In the US, a June hike is now on the table and one suspects that it has to be June or nothing because a September hike would be perilously close to the US Presidential election.

Oily business

During periods of relative calm, the fortunes of oil have in the past been largely influenced by fluctuations in the US dollar. This makes sense because, apart from the occasional geopolitical effort to price in Euros, it is priced in US dollars the world over. The health of the global economy also has an effect on demand. But the biggest shock to markets was the collapse in oil prices since the summer of 2014 resulting from excess capacity and over supply. Although most developed countries strip out oil from their core inflation figures, it's not hard to imagine how a 75% drop in the price of oil to below $27 a barrel can ultimately lead to lower goods prices. Of course, this does wonderful things for the cash in the consumer's pocket and you would think the markets would see that as a good thing for consumption and the economy as a whole. However, economists largely brushed this notion aside and the greater concern of falling oil being a bad omen for global demand prevailed instead. As oil sank below $30, some of the City's most respected institutions, who shall remain nameless, threw in the towel forecasting $20 oil by year end. Of course, this didn't happen and we are now looking at $47 and daily increases. Our energy purchase in more adventurous portfolios has risen significantly and other TAM portfolios participate through the rise in FTSE ETFs whose performance is driven indirectly through the large exposure to oil and gas. Again, a bit like the financial, mining and retail sectors, the oil sector is one area of the market where the problems, whilst legion, are at least well understood and one doesn't have to believe that oil will return to $100 a barrel for shares in the sector, some of which were undeniably priced for failure, to stage a major rally. But it has been a volatile round trip and the fact that the price action in oil went against the direction of other economic indicators, confounded economists and traders alike.

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When the Federal Reserve finally hiked rates at the end of 2015, it was tempting to believe that the merry dance between the central bank and the markets and the whole will-they-won't-they had come to an end and we could all get back to the business of investment rather than speculation. Unfortunately, whilst the Fed wrote a script, the main actors didn't follow it and the U-turn, when it came, was both confusing and annoying not just for markets but for the central banks in Europe and Japan who, it seems, were relying on a stronger US dollar to give them a chance to stimulate their own economies with currency weakness.

In amongst all of this were the usual list of dreads like China, Middle East, South America, Grexit, oil and

other commodities plus a raft of new ones in the shape of the US election and Brexit. Any market be it stocks, bonds, property and currencies are driven by fundamentals that can be reasonably forecast. Other factors, like close referendums, elections and central bank policy are prone to the relative unpredictability of human decision making and overall sentiment which can at times remain irrational longer than rational investors can stay with losing trades.

For this reason, we believe it is important to run well diversified portfolios across asset classes in shares, bonds cash and property as well as specific strategies that aim to achieve modest returns with minimal risk. In our strategic deliberations our emphasis today is on avoiding investing in areas which appear calm but have the capacity for significant loss and where the outcome is almost impossible to predict.

In doing so we aim to continue to deliver steady investment returns but by taking less risk than the markets and so avoid a financial and emotional roller coaster of volatile returns.

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