

Review of the First Quarter 2016

The year started with a number of new statistical records, not least of which was the US stock market suffering its worst start to the year since 2001. Of course, as is almost always the case in today's globalised world, the concerns stretched further afield and, in this case, China was held up as the culprit with their central bank being accused of indulging in the new cold war of currency manipulation. Coming so soon after the admission of the Renminbi to the global SDR basket of trading currencies, this was an unsettling time for stock and bond markets and the Chinese authorities PR machine seemed to have trouble conveying their various reassurances to nervous markets.

Central Banks change tack

However, in the wake of the Federal Reserve finally hiking interest rates in December, all the main central banks appeared to have been unprepared for the reality of it all and were hastily indulging in their own form of PR. First up was Bank of England Governor, Mark Carney, who sent an uncharacteristically clear message to markets that the Bank would not be raising rates in 2016. This was much more than just a knee jerk reaction to weak UK manufacturing data and confounded those expecting the Bank of England

to dutifully follow where the Federal Reserve had led. Indeed, it was completely at odds with the subsequent message from Janet Yellen, Federal Reserve Chair, warning of a further four hikes by year end. Sterling fell as a result and kept falling throughout the quarter although, by the end of it, the market was blaming the continued weakness on the Brexit debate which had narrowed far closer to 50/50 than the bookmakers odds of around 9/1 at the start of the year.

Navigating 'Brexit'

It was a tough quarter for Prime Minister, David Cameron, whose party and cabinet fractured over Brexit and the debate started to look more like a circular firing squad. The issue of Scottish independence, should the UK leave the EU, resurfaced which can only have added another layer of complexity and uncertainty for foreign investors in Sterling investments. It was an unedifying debate right across the UK and both sides were variously accused of sneering, smears and half-truths which made it all the more difficult for the public to get a more objective assessment of what the real issues were. Even the FTSE was split with two distinctive camps emerging; the "remainers" (in europe) being largely big cap FTSE 100 companies vs the small and medium sized enterprise "outers" already struggling with EU red tape.

Geopolitical risks were not just contained to the UK; even though the US Presidential election is seven months away the political risk is already being felt by financial markets. In what has become referred to as one of the most "polarising and populist" campaigns in recent memory, investors weigh up every new sound bite (of which there are many thanks to Mr. Trump) to ascertain its possible implication for the economy, financial markets and global trade.

Europe battling headwinds

It wasn't all plain sailing in the EU, however. President of the ECB, Mario Draghi, made it clear in January that he wasn't going to let markets push him into further monetary easing only to say the very next day that maybe more was on offer. When eurozone year-on-year inflation came in at minus -0.2% a month later, markets decided not to wait and immediately priced in more easing which obligingly came in March with an interest rate cut to minus -0.4% and an expansion of the existing bond buying program which was broader, bigger and for longer. Just to show that the tail can wag the dog on both sides of the Atlantic, the Fed's Janet Yellen rowed back on her "four hikes in 2016" motif to bring the official stance back to where the bond markets were already pricing it; somewhere between two and never.

This back and forth shifting was quite unsettling because, after all, there was nothing wrong with the economic data coming out of the USA. Even the Fed, on the last day of the quarter could only cite weakness in global demand and an uncertain outlook for inflation as the main factors to justify taking a more dovish stance.

Gold was a beacon in the gloom

After years of annual decline gold enjoyed one of its strongest quarters rallying over $160 (or 15%). A weaker dollar and renewed investor interest in safe-haven investments resulted in its strongest start to a year since 1980. Even crude oil prices recovered to near $ 40/barrel after falling as low as $26/barrel.

However hope that any deal to reduce output by the main producing nations looks tenuous and the outlook for the oil price remains uncertain.

Equity markets ran aground in January

It was a volatile quarter for the stock markets. In every year since 2008 the FTSE has experienced a plus 10% sell off at some point during the year. Something that TAM has repeatedly taken advantage of to buy equities opportunistically. In 2016, a bit like the daffodils, this year's came early. Whilst the US and UK markets recovered by quarter end European and Japanese markets stayed rooted firmly in the red.

The turnaround in US interest rate forecasts and the subsequent turn in the US dollar, from strength to weakness, is what really did for stocks in the developed markets of UK, Europe and Japan, each of whom seeking, one way or another, a weaker currency of their own. The turn also highlighted the current balance of the global risk-on risk-off trade because as developed stocks got hit, emerging markets, mostly saddled with US debt, staged a recovery. But all these moves, hinging on the various utterances of central banks made it dangerous for those trying to time the market and, broadly speaking, Government bonds in the US, UK and Europe lived up to their popular status as any port in a storm despite the low or negative yields on offer.

We maintained a mild overweight in equities which are mostly invested in selective strategies but with a good spread of risk, volatility and geographical exposure. We shifted TAM client portfolios during this period by taking profits in some property investments in favour of absolute return strategies and, again, maintained an underweight to the bond markets, in particular government debt where we have not altered our longer term view that this sector of the market is simply too risky to invest given the extraordinarily small returns on offer.

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