



CAERUS Market Commentary – December 2016

Market overview

Last year will be remembered as the year the UK voted to abandon its 40 year relationship with Europe. A seismic shock, which was not expected by many. This was quickly followed by the election of Donald Trump, perhaps an even greater surprise given the rhetoric of his campaign. Both results have been described as a 'populist' revolt against the ruling elites, a rejection of globalisation by those who have not benefitted. Will 2016 be remembered as a historic year? Perhaps that is a question for future historians but, from an Investment point of view, the political changes could potentially have important economic implications.

But first, who were the winners and losers in 2016? Emerging Markets and commodities both recovered strongly after spending four years in the doldrums, rising by 35% in sterling terms. Stock market returns bettered bonds (global bonds were up a mere 3%), with the US rising by 35% (sterling terms) and both Japan (up 25%) and Europe (up 19%) posting decent returns. The UK lagged with a still respectable rise of 16%. It should be remembered that the overseas market returns were flattered by the 10% fall in sterling during the second half of the year.

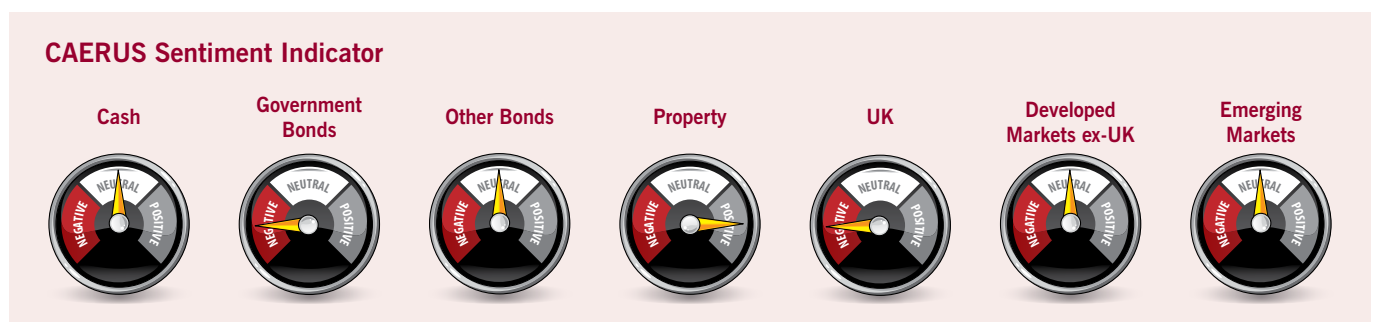
A significant outcome of the Brexit and Trump votes has been a change from an austerity agenda to one of fiscal expansion. For many, it appears that central banks have done as much as they can with record low interest rates and now it is the turn of governments to intervene using the fiscal tools available. Trump has promised a growth agenda that includes tax cuts, new trade agreements, large spending on infrastructure and perhaps relaxation of regulation on the activities of banks. For the UK, a change of Prime Minister and a new Chancellor has resulted in the abandonment of a goal budget surplus by 2020, giving the government more scope to deal with the economic uncertainties post the Brexit vote.

Another feature of these votes has been the expectation of a rise in inflation. In the US the Federal Reserve did raise rates in

December to 0.75% as a sign of confidence in the economy. With a strong pro-growth rhetoric from the new President, Investors should perhaps expect more rises in 2017. The rises are in contrast to the UK where rates were lowered to 0.25% post the Brexit vote. However, with the fall in sterling, which raises the price of imports, inflation will likely rise to nearer 3% this year. Despite the forecasts of economic gloom by the IMF and OECD for the UK economy following Brexit, to date this has not been the case. Consumer confidence and spending have held up well, employment continues to increase, as do wages.

Another source of inflation may be a sustained rise in the oil price. The agreement between OPEC and non OPEC countries led by Russia to limit production in the first half of 2017 means stocks of oil may be run down, allowing the fundamentals of demand and supply to reassert themselves. And if Trump does match his rhetoric and spend big on infrastructure, demand for commodities as a whole may rise and, with that, prices. For economies, the talk will be more of growth rather than recession, and inflation rather than deflation.

Overall, the 2017 outlook is uncertain. There are just too many unknowns to make predictions with great confidence. Will the year be driven by politics rather than the economics? Certainly, the elections in France and Germany will loom large for Investors, their outcomes perhaps a reflection of relevant populations' continued appetite for the EU. As for the UK, the government have stated that Article 50, by which we formally start the timetable of leaving the EU, will be invoked by the end of March. The flavour of Brexit, whether hard or soft, may become clearer as the year progresses. And then who knows if the experience of Presidential office will moderate Mr Trump's approach? 2017 may be a challenge, but it will not be dull.



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