QUARTERLY MARKET COMMENTARY

The results are in but we are out! That is the majority decision of the UK populace in the June referendum on Britain retaining membership of the European Union (EU).

As one would expect on such an announcement being made, stockmarkets fell significantly and £ weakened against most developed currencies by 15% in one day. David Cameron resigned as Prime Minister, whilst the SNP tried to re-negotiate continued membership of the EU!

Two months on from the referendum result, some form of political stability has ensued with Teresa May having been appointed as Prime Minister. Her Conservative Cabinet is now in place with at least some sort of a directional plan. However, irrespective of your political persuasion, it would be useful if the Labour party, as the ruling opposition, could find some meaningful agreement within their own ranks.

There is, of course, continued disagreement between Great Britain (GB) and the EU on when GB should invoke Article 50 of the Lisbon Treaty and start the 2 year window for negotiations and the ultimate exit from the EU. The only thing that is clear is that GB has not yet left the EU and there is no template for such a process. The debates continue, not just on the economic impact of such a decision but whether or not the whole process will be seen through. We have some who believe a second referendum could be held; Britain remains part of a reformed EU to those who believe the process is so complex that many of us will not witness Britain out of the EU in our lifetimes. At this stage we simply do not know how this will develop but without question, the quick political resolution and swift action by the Bank of England (BoE) settled markets to some degree at the appropriate time.

Away from the political aspect, we must now try to assess the economic impact on our potential new future, which at this stage, is impossible to determine. What we do know is that soon after the result, the BoE revised down their economic growth forecast for 2017 from 2.3% to 0.8% and suggested the Unemployment Rate could increase from 5% to 5.6%, resulting in the loss of 250,000 jobs. Data around that time suggested that mortgage approvals and retail sales were falling, whilst the UK Construction industry was already in recession in the lead up to the referendum. These were some of the key reasons why interest rates were reduced by 0.25% and the Quantitative Easing (QE) programme was restarted, with the BoE looking to expand their Bond buying programme by £70bn to try to restore some form of confidence to the UK consumer. The BoE also instigated the 'Term Funding Scheme' which essentially made £100bn available to UK Banks to continue lending.

However, data released in August showed that mortgage approvals may have dipped but lending to consumers expanded at its fastest pace in 11 years, whilst retail sales rose 1.4%, the strongest rise in 6 months. The Manufacturing and Services sectors posted strong rises with their respective Purchasing Managers Indices (PMIs) rising from around 47-48 to 52-53 (a figure above 50 indicates growth in the sector). Nationwide also reported that house prices increased by 0.6% in August, following on from the 0.5% rise seen in July. The UK Unemployment Rate fell to 4.9%, its lowest level since 2005, whilst the Employment Rate hit its highest level since 1971.

It is far too early to tell what impact the referendum decision will have on GB. It will be interesting to see how the negotiations with the EU unfold and what Trade Agreements GB can reach. The EUs decision to apply a retrospective back tax on Apple Inc. for €13bn for their operations in Ireland and the recent failed discussions between the US and EU on free trade deals as part of the Transatlantic Trade & Investment Partnership (TTIP), perhaps provides some insight into the EUs stance going forward. However, the fact that Australia, India and Brazil have already sought trade discussions provides some comfort that other trading partners wish to continue with GB Plc.

Stockmarkets have been rather resilient and supportive over the summer months, despite BREXIT. Indeed, UK stockmarkets have performed reasonably well, largely due to the fact that many of the leading companies report their earnings in US$ and £ weakness has been beneficial. This includes the likes of BP and Shell, which have also benefitted from an improving oil price. However, exposure to UK Banks and Housebuilders has hampered performance on many UK funds.

UK Commercial Property has witnessed some liquidity issues with a clear 'run' on the asset class as overseas investors unwind their tangible asset position to the UK. This led to a number of fund suspensions and exit penalties being applied. As a firm, we reduced our exposure to this asset class across our model portfolios towards the end of last year, given the strong returns previously made in recent years.

Despite the above, reasonable investment returns have been made. This, in large part, is due to the fact that despite BREXIT, the likes of the US and China play a much more important role to the overall direction of global economic growth.

The US economy appears to be in a relatively strong position. US non-farm payrolls has added 697,000 jobs in the last quarter to the US economy, the housing market remains buoyant and inflation is picking up. The Unemployment Rate in the US is at 4.9% with many suggesting that the US economy is at or near full capacity in terms of labour and job creation. We cannot ignore consumer sentiment readings in the US that suggest that most Americans do not feel 'better off' as a result of improving economic fundamentals. What is becoming clear is that the tone and sentiment of the US elections is having a negative effect on US consumer confidence. If history is anything to go by, sentiment weakens and stockmarkets become volatile in any period leading up to a US Presidential election. It will be very interesting to see who will be the new US President come November! This is viewed by many as the main reason why the Federal Reserve is unlikely to increase Interest Rates in the US this side of the election.

Elsewhere, in China, the authorities continue to rebalance their economy from a manufacturing and export led basis to a service driven and domestic consumption one. The belief that an economic 'hard-landing' would be witnessed appears to have dissipated as the Chinese authorities continue to take action, such as domestic lending rate cuts and reducing the reserve ratio requirements, so that bank lending is more available. In addition, the fact that we have not witnessed a surge in strength of the US $ has been supportive to the 'commodity' sector, which has been partly beneficial to China as the leading importer of raw materials. This is one of the main reasons why emerging market and raw material exporters such as Brazil have witnessed strong rises this year in their stockmarkets.

Japan and Europe have continued with their economic reforms and QE programmes with some limited success. However, it is clear, certainly in Japan, that further Monetary and Fiscal policies are required before these regions witness the economic recoveries experienced by the US and UK several years ago.

In summary, despite the good gains made by most stockmarkets in recent months, significant political and economic headwinds prevail. Central Banks appear ready to intervene and provide stimulus if they feel it is necessary but in a world where 36% of all Government Bonds are on negative rates, the results of their action and the longer term impact of such action is becoming more difficult to comprehend. Accordingly, in our view, it is more important than ever for medium to long-term investors to maintain a diversified portfolio in order to benefit from market rises when they happen and to dilute volatility in the event stockmarkets fall. It is impossible to predict when markets will fall and rise but, in general terms, a sensible investment strategy involves riding out market volatility.

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