momentum

Viewpoint

Monthly market update

October 2016

global investment management

Contents

1. Market commentary 3

2. Market performance – Global 5

3. Market Performance – UK 7

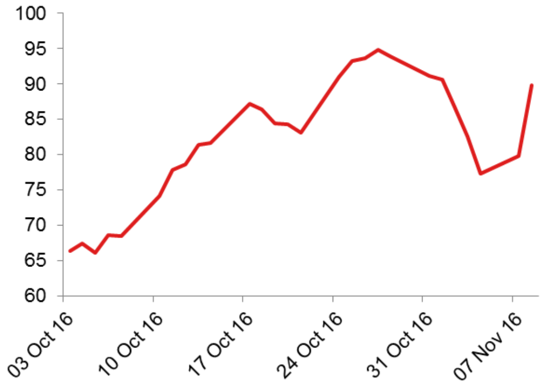
4. Asset allocation dashboard 9

Important notes 11

1. Market commentary

Throughout October, all eyes were on the build-up to the US election. Markets broadly followed the ebbs and flows of each candidate's campaign momentum. As such the announcement that the FBI was to re-open its investigation into then candidate Hillary Clinton's email account led to a wave of risk adverseness and portfolio hedging throughout global markets. The S&P 500 index lost 1.9% over the month, whilst European stocks lost 1.0%. The UK was an outlier, gaining 0.9% in sterling terms, although this was largely due to the pound depreciating by 5.6% versus the US dollar over the month. This happened after the UK Prime Minister Theresa May's announcement that Article 50 would be triggered before March next year, along with general mutterings of an inevitable 'hard' Brexit. Since then however, the UK High Court's ruling that parliament must vote in favour of triggering Article 50, as well as the surprising result of the aforementioned US election, has helped sterling recover from early month lows of USD 1.21 to USD 1.26 as of time of writing.

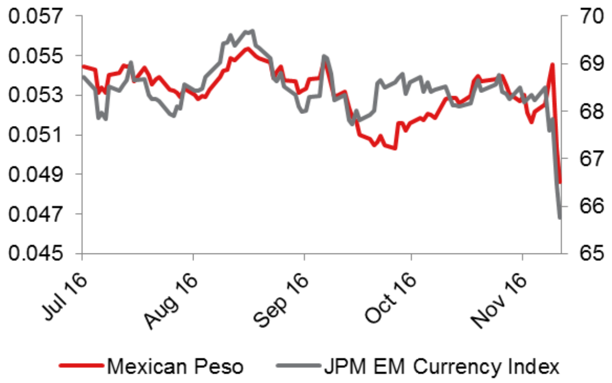
Figure 1: Trump defies polls and predictions.



The bounce in sterling has gone relatively unnoticed, however, with focus firmly on Donald Trump and his spectacular victory in the US election. He will likely benefit from both the House and Senate now having Republican majorities, too, with checks and balances in the US political system less constricting than if Congress was divided. President-elect Trump therefore has a better chance of implementing his policies, such as they are. However, many Republicans neither agree with nor like Trump, so passing legislation will not be plain sailing.

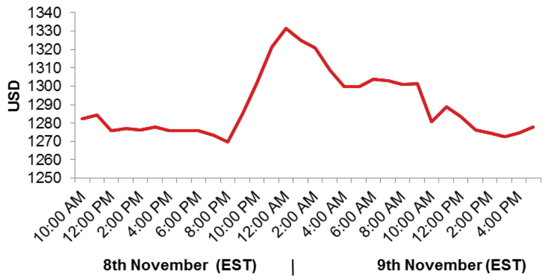
The strength of his mandate and his campaign rhetoric suggests that fiscal spending will be materially higher and policy more expansionary, underpinning growth in the US. His protectionist policies are likely to have a negative impact on growth longer term, both in the US and globally. However, as is invariably the case, overseas economies and markets are likely to be more vulnerable than the US. Emerging markets are especially at risk if protectionism results in increased tariffs and reduced trade. The Trans Pacific Partnership would appear to be dead. The net result of these policies is likely to be a steeper yield curve and higher inflation. The lows in both yields and inflation have almost certainly been reached in this cycle and the long 35-year global bond bull market is at an end.

Figure 2: EM currencies suffer, none more so than the Peso.



Given the heightened uncertainty and unpredictability of policy, the risk premium on equities is likely to move somewhat higher. However, it would be unwise to over-react and to make judgements prematurely. The prompt reversal of the initial falls in equities, and rises in safe-haven assets on Wednesday gives testament to this. General asset moves were typified by 10-year Treasury yields, which moved within a remarkable 37.4 basis point range, initially dropping to 1.7% before rising to 2.1%: the first time since January that the yield has been above 2%. Equity markets were just as volatile, the S&P 500 index closed up 1.1% with a high-to-low range of 2.1%, in Europe the Stoxx 600 closed +1.5%, with high-to-low moves of around 3.9% on the day.

Figure 3: Rush to safe haven assets fades as investors come to terms with Trump victory.



With regard to the markets' longer term reaction, much will depend on the key appointments that the President-elect will make in his new Administration. It is a reasonably safe assumption that he will drop some of his most radical policies and take a more measured approach as the reality and scale of his task will bring a degree of pragmatism. With inflation likely to move higher, government bonds appear over-valued, despite the rises in yields in the past month. Safe haven assets such as gold have increasing appeal. On balance we believe that markets will drift for a period, in the face of the uncertainty and the increased volatility we have seen in recent weeks will be a feature for the year ahead. However, the more extreme concerns about a Trump Presidency are almost certainly misplaced and we see no reason for taking a materially more defensive stance in portfolio construction than before the election.

A Trump victory is undoubtedly a shock for markets. Uncertainty surrounding the future direction of US policy is likely to result in heightened market volatility for some time to come. We would not recommend selling into this volatility. We are outcome based investment managers, constructing well diversified portfolios in order to minimise the potential detrimental impact that specific global events could have on returns in order to help clients to stay invested. While some asset classes will no doubt be adversely impacted by the global trend of political disaffection and anti-globalisation, other assets are likely to offer offsetting benefits. As always, we continuously aim to utilise opportunities to increase exposure to asset classes that are unfairly punished by risk events in striving to increase the long-term financial wellness of our clients, whilst making their journey to that outcome as palatable as possible.

Source: Bloomberg. Returns in US dollars unless otherwise stated. October 2016.

2. Market performance – Global (local returns)

		To 31 October 2016		
Asset class/region	**Index**	**Currency**	**1 month**	**Year-to-date**
Developed markets equities				
United States	S&P 500 NR	USD	-1.9%	5.3%
United Kingdom	MSCI UK NR	GBP	0.9%	15.4%
Continental Europe	MSCI Europe ex UK NR	EUR	0.0%	-3.7%
Japan	Topix TR	JPY	5.3%	-8.1% e
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-1.7%	10.4%
Global	MSCI World NR	USD	-1.9%	3.5%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	1.3%	16.2%
Emerging Asia	MSCI EM Asia NR	USD	-1.4%	11.4%
Emerging Latin America	MSCI EM Latin America NR	USD	9.9%	45.3%
BRICs	MSCI BRIC NR	USD	1.0%	17.8%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	0.2%	16.3%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-1.2%	4.1%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-0.5%	7.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.8%	8.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.4%	15.6%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-4.1%	10.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-3.5%	9.8%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-2.1%	4.1%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.7%	5.2%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	1.0%	8.1%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.3%	5.1%
Australian Government	JP Morgan Australia GBI TR	AUD	-2.0%	4.9%
Global Government Bonds	JP Morgan Global GBI	USD	-3.4%	6.9%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-2.6%	6.3%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-1.6%	1.5%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-2.0%	13.5%

Source: Bloomberg. e denotes estimate

		To 31 October 2016		
Asset class/region	Index	Currency	1 month	Year-to-date
Property				
US Property Securities	MSCI US REIT NR	USD	-5.7%	4.4%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-7.9%	1.9%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-1.3%	8.3%
Global Property Securities	S&P Global Property USD TR	USD	-5.0%	5.4%
Currencies				
Euro		USD	-2.3%	1.2%
UK Pound Sterling		USD	-5.6%	-16.9%
Japanese Yen		USD	-3.3%	14.7%
Australian Dollar		USD	-0.6%	4.4%
South African Rand		USD	1.9%	14.9%
Commodities & Alternatives				
Commodities	RICI TR	USD	-0.8%	8.4%
Agricultural Commodities	RICI Agriculture TR	USD	3.3%	3.0%
Oil	Brent Crude Oil	USD	-1.5%	29.6%
Gold	Gold Spot	USD	-2.9%	20.3%
Hedge funds	HFRX Global Hedge Fund	USD	-0.5% e	0.8% e
Interest rates				
United States		0.50%		
United Kingdom		0.25%		
Eurozone		0.00%		
Japan		-0.10%		
Australia		1.50%		
South Africa		7.00%		

Source: Bloomberg. e denotes estimate

3. Market performance – UK (all returns in GBP)

		To 31 October 2016		
Asset class/region	Index	Currency	1 month	Year-to-date
Equities				
UK - All Cap	MSCI UK NR	GBP	0.9%	15.4%
UK - Large Cap	MSCI UK Large Cap NR	GBP	1.8%	18.8%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	-2.5%	0.6%
UK - Small Cap	MSCI Small Cap NR	GBP	-1.7%	3.5%
United States	S&P 500 NR	USD	4.1%	26.9%
Continental Europe	MSCI Europe ex UK NR	EUR	3.5%	17.1%
Japan	Topix TR	JPY	7.9%	28.0% e
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	4.3%	33.0%
Global developed markets	MSCI World NR	GBP	4.0%	24.7%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	6.3%	40.1%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	-4.1%	10.1%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	-0.6%	2.1%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	-3.4%	7.1%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	-6.5%	17.9%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-0.5%	27.9%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	-0.2%	14.8%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	-0.7%	36.6%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-3.5%	9.8%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	4.8%	25.5%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	5.2%	30.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	6.5%	39.2%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.4%	26.6%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	2.8%	27.9%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	4.6%	31.4%
Global Government Bonds	JP Morgan Global GBI	GBP	2.4%	28.9%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	3.3%	28.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	4.4%	22.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	3.9%	36.7%

Source: Bloomberg. e denotes estimate

		To 31 October 2016		
Asset class/region	Index	Currency	1 month	Year-to-date
Property				
UK Direct Property	UK IPD All Property TR	GBP	0.0% e	0.1% e
Global Property Securities	S&P Global Property USD TR	GBP	0.8%	27.0%
Currencies				
Euro		GBP	3.5%	21.6%
US Dollar		GBP	6.0%	20.4%
Japanese Yen		GBP	2.5%	38.1%
Commodities & Alternatives				
Commodities	RICI TR	GBP	5.3%	30.6%
Agricultural Commodities	RICI Agriculture TR	GBP	9.6%	24.1%
Oil	Brent Crude Oil	GBP	4.4%	56.1%
Gold	Gold Spot	GBP	3.0%	45.0%
Interest rates				
United Kingdom		0.25%		
United States		0.50%		
Eurozone		0.00%		
Japan		-0.10%		

Source: Bloomberg. e denotes estimate

4. Asset allocation dashboard

Positive	Neutral	Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Neutral
European equities (relative to developed)	Positive
US equities (relative to developed)	Neutral
Japan equities (relative to developed)	Positive
Emerging market equities	Neutral
Fixed Income	
Government	Negative
Index-linked (relative to government)	Neutral
Investment grade (relative to government)	Neutral
High yield	Neutral
Loans	Neutral
Emerging market debt	Neutral
Convertible bonds	Positive
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Neutral
Yen	Negative

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