Investment News

Monthly Bulletin from the Insurance & Investment Team

January 2017

Last Month in Brief

December saw the FTSE 100 reach an all-time high, closing the year at 7,142.83. This performance was in part driven by a rebound in mining and energy stocks, which have benefited from stronger commodities prices. The FTSE 250 (which is more domestically focused than the FTSE 100) also made modest gains over the month.

The UK service sector ended 2016 in a strong position according to the latest survey of purchasing managers, defying any fears of a post Brexit slump. In December the sector grew at its fastest rate since July 2015, with employment also increasing.

The most recent statistics published by the Office for National Statistics (ONS) show that house price growth for the year to October was slower than expected, with house prices rising by 6.9% on average, compared to the 7.3% that was previously forecast.

In Europe, the Italian government approved a bailout package of around €20bn, aimed at restoring liquidity to the country's banking system and avoiding a crash. The world's oldest bank and the third largest bank in Italy, Monte dei Paschi di Siena, is set to receive around €6.5bn of this package after its efforts to raise funds from private investors collapsed following months of talks.

Chart 1: Equity Indices

Equity markets were less volatile during December

Chart 2: Sterling Credit Spreads

Credit spreads were broadly steady over the month

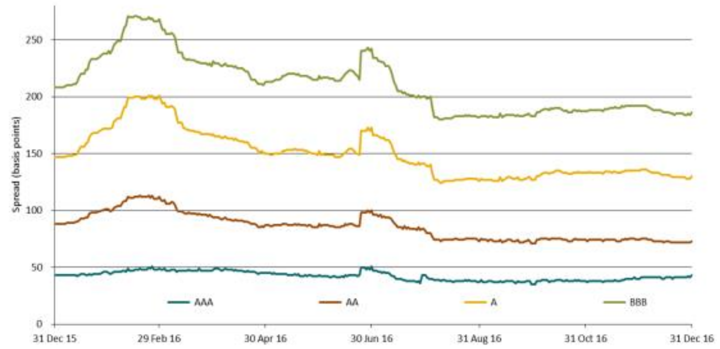


Chart 3: Gilt Yields

Long term gilt yields fell slightly during December

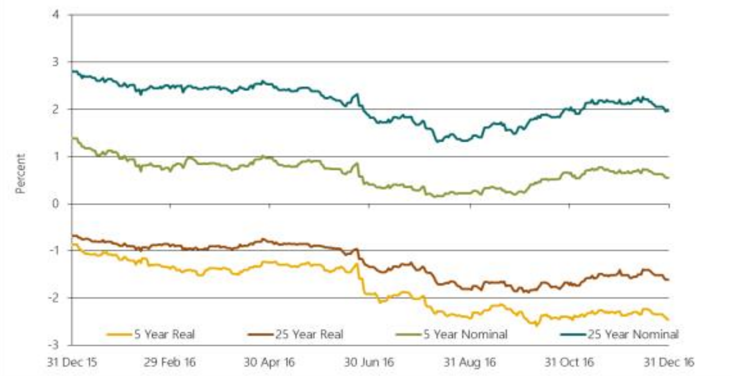
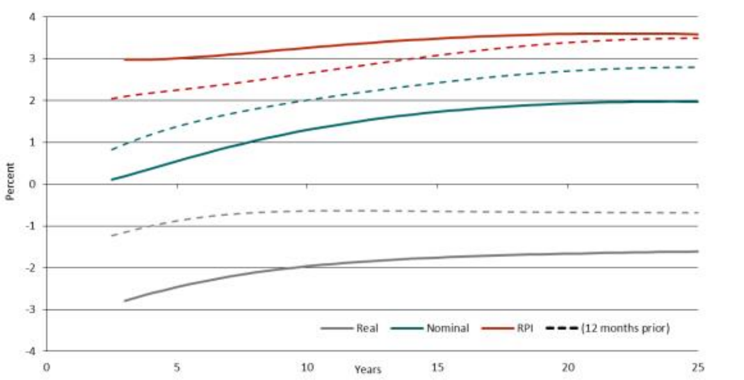


Chart 4: Gilt Spot Curves

Yield curves remained upward sloping



Source: Financial Times, MSCI, Merrill Lynch Bank of America, & Bank of England

	Latest	Previous		Latest	Previous
CPI increase (annual change)	1.2%	0.9%	**Base rate**	0.25%	0.25%
PPF 7800 funding ratio	88.1%	84.1%	**$/£ exchange rate**	1.23	1.25
Halifax house prices (monthly change)	+0.8%	+1.4%	**VIX (volatility) index**	14.04	13.33

For monthly published indices "Latest" and "Previous" refers to the two most recently published statistics, otherwise numbers are quoted as at the month end.

A look back on 2016

Early in 2016 equity markets fell as a result of a deteriorating economic outlook. However, as the year progressed, developed markets experienced a sustained rally despite significant macroeconomic uncertainty, ending on record highs. Stock prices also benefitted from President Elect Donald Trump's business friendly image.

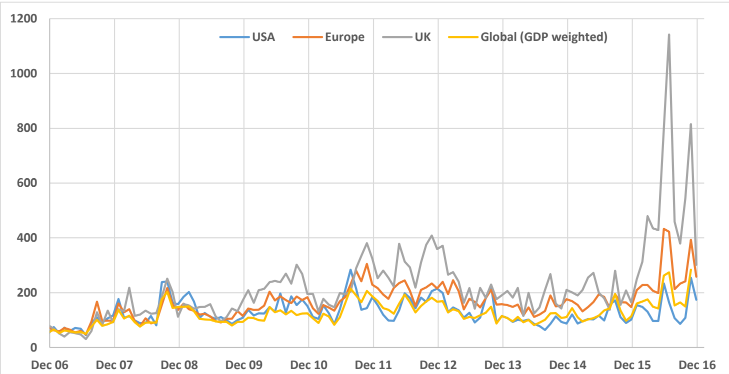
Towards the end of the year sovereign bond yields began to rise after a prolonged bull market since the financial crisis. Expected monetary and fiscal policy (especially in the US following the election) as well as higher expected inflation were key factors driving the sell-off.

Oil prices were less volatile than in 2015 as supply settled down although a potential impending OPEC decision to cut production may lead to price fluctuations in the coming year. Meanwhile, UK property price inflation continued to slow following the sharp increases over previous years. Worries over Brexit, in particular, dampened demand, although the subsequent weakened pound provided incentive for overseas investors to buy up 'cheap' properties.

The year ahead may test markets with further political turbulence in Europe with elections in key countries, as well as Brexit developments following the expected invocation of Article 50 and any developments in the US as Trump's position on key issues becomes clearer.

Economic Policy Uncertainty

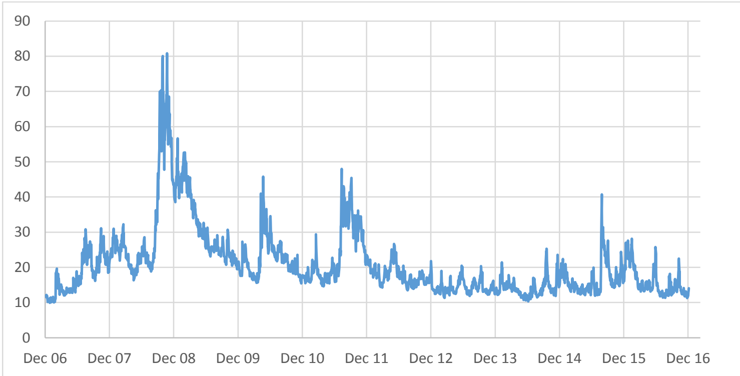
Index of frequency of articles discussing economic policy uncertainty



Source: http://www.policyuncertainty.com

Market volatility

VIX index of US (S&P 500) equity market uncertainty

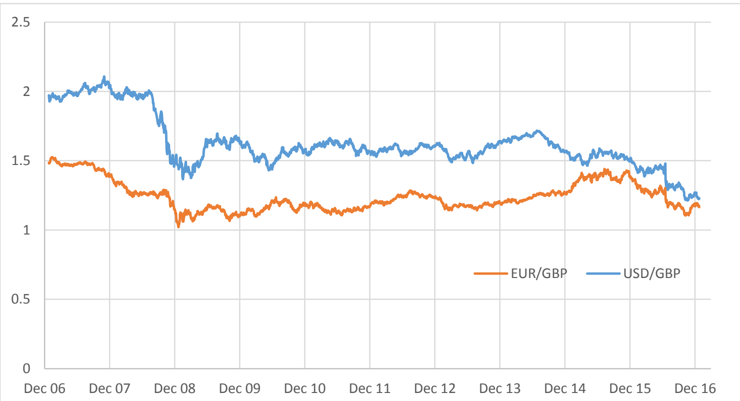


Source: Yahoo Finance

In 2016 the news was often associated with a few significant political events. In particular, the unexpected 'leave' vote in the UK's EU referendum and the US presidential election win for Trump dominated headlines. Many political and economic commentators expected strong market reaction to both events given the potential impact on the UK, US and global economies. In fact, major developed market equity indices were reasonably stable (the VIX often remained below its long term average) during the days and weeks after the events and saw a strong year of returns.

Exchange rates

Sterling exchange rates against the Euro and Dollar



Source: Bank of England

Sterling fell significantly against the majority of its peers following the Brexit vote, reflecting lower expected growth, higher expected inflation and lower expected interest rates that are being associated with the UK leaving the EU. Whilst this makes imports more expensive, it does make UK exports more competitive and GBP priced assets relatively cheap for foreign investors, boosting demand from foreign investors.

Forecasts

	2016	2017
GDP growth	2.1%	1.3%
CPI	1.2%	2.8%
RPI	2.2%	3.2%
Claimant unemployment	0.79 m	0.83 m
Current account	£-105.8 bn	£-81.1 bn
PSNB	£69.3 bn	£63.6 bn

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury December 2016

GDP forecasts have been revised lower, primarily driven by the expected impact of Brexit negotiations on confidence and output. CPI and RPI are predicted to rise faster than the recent historic lows as the weak pound contributes to imported inflation from overseas.

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