What can be expected from investment markets in 2017?

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January 2016 saw investors pricing in the first rate rise in the US for years and a consolidation of the oil price following the falls in 2015. Bond and equity markets had stabilised after the continued political angst of Greece and the Chinese devaluation of the Yuan in September 2015.

Substitute the Greek crisis for the political events this year and you have a similar situation. This backdrop of economic and political uncertainty had a major impact on all asset classes for the first seven weeks of last year. Significant losses were made across most markets as investors flocked to 'safe haven' assets. Many were troubled with the currency situation, the rate rise path in the US, low growth political events and rising inflation. Not much has changed in twelve months as the same market situation is present now. This to us highlights one question……..will the markets react similarly to 2016?

In terms of risks and opportunities, we expect 2017 to be very similar to 2016. There will be much volatility; however, risk will reward investors with longer term investment time horizons. The difference will be in how those returns are generated. This year will see a more 'risk on' opportunity than 2016 with equities providing the bulk of returns. This is a significant difference to 2016 which saw Gilts and Bonds providing investors with equity type returns for most of the year.

For 2017 we see the following for each of the main asset classes:

Sovereign & Investment Grade Bonds:

Last year was a very positive for sovereign bond holders as yields fell globally for most of the year. The fundamental reasons for this were; the political back drop experienced in UK and Europe and the Fed holding interest rates at 0.50bp-0.75bp through to December when there was the one rate rise of the year.

This year will be different for Sovereign and Investment Grade bonds. A more proactive Fed has indicated at least two possible rate rises. The economic back drop in the UK and Europe shows good signs that the 'Brexit storm' may pass without potential tapering of QE, yields should continue to climb as inflation expectations continue to increase. We anticipate yields to rise across most areas of Investment grade bonds. However, one area that will continue to provide an opportunity for investors is Emerging Market Bonds. This area has been impacted significantly in recent years by the flight to safety. With more 'normal' economic conditions and investors needing higher yield for income purposes, we see the emerging market bond sector both dollar denominated and local currency being quite a productive area for investors albeit with more volatility than conventional Investment grade bonds.

A further area in the Investment Grade bond area that will be quite productive is Index Linkers both UK and Global. Inflation is being seen in most global economies following a period of deflation or very low inflation. Even though linkers will not benefit from higher yields in conventional yields, the pace of inflation in early part of the year should provide a good opportunity for this area. The only issue is the 'Break-even levels' which may shorten from the current attractive levels if inflation does not come at the pace that markets expect.

Corporate Bonds / Credit:

Through the last quarter of 2016 the portfolios have rotated out of Sovereign and Investment grade into Corporate Bond and Credit. This will be the main component of the bond content for 2017 with areas such as ABS and MBS being well utilised. In credit, areas of favour are banking, financial and insurance bonds. Like their equity counterparts, it has been an area that has been out of favour for several years with only Coco bonds being used. These areas clearly bring further volatility so to have an area like Banking and Financials as a full option to utilise helps with increasing diversification in the lower risk areas of a portfolio.

Another factor that we believe will be significant in 2017 is duration. With longer dated bonds under serious pressure from rising yields, it will be important to keep the bond content duration to no more than 7 years. This will limit the potential for higher returns as have been seen but with shorter duration, there is good protection which is what should be looked for from the bond content.

Despite the additional volatility high yield brings there should be continued opportunity in this area. Issues that affected this space especially in the US through the energy sector have now subsided and investors in this sector are now being correctly rewarded both in terms of income and growth for the risk that they are taking. This sector shows to be a good global opportunity allowing plenty of diversification which in turn helps to reduce the volatility.

Property:

Following Brexit nearly all UK property funds were forced to either suspend or move to an active price. Apart from these few months of turmoil, the sector provided good capital growth along with an excellent income stream. The pricing movement was only short term and nearly all funds in the sector are now back to pre-July pricing levels. For 2017 the same type of opportunity should be present for investors with both income and capital growth levels moving forward with the only exception being property in London which may continue to struggle as it has done since the Brexit vote.

REITs had a positive 2016 with the sector having another good year. Like most other sectors, globally the returns have been made through the sector and have not just come from one or two areas. The same is expected for 2017 with all areas offering investors good return opportunities which should be similar in terms of sector average as 2016 which was 17%. A good quality Global REIT fund which allows the manager to allocate into the individual areas will be the ideal.

Bricks and Mortar property funds provided solid growth and income in 2016 and will continue throughout 2017. With the UK economy showing signs of improvement, rental incomes have continued to rise with the average yield also increasing. What has slowed down has been capital value growth which has slowed considerably quicker post the vote.

With Sterling also falling there is still a lot of purchase activity that should keep capital values positive for the next 12 to 18 months. The activity in property purchases is not just beneficial for London and the South East but other areas such as Leeds, Manchester and Birmingham with a number of top quality companies looking to move Head Offices into these regions. This allows Property managers to look away from London and the South East to gain exposure into Property that not only matches previous capital values it also provides (in most cases) better rental income. For investors, this means there is more diversification which is not limited to a few Managers who own properties in London and the South East. During 2016 the portfolios were changed to utilise smaller funds where the manager has exposure across the UK. This rotation will continue through 2017 to ensure the maximum opportunities are gained from this sector.

Absolute Return:

This area was a substantial part of the portfolio allocation for 2016 as it acts as an excellent volatility reducer. Many of the funds look to protect on the downside so returns can be made in flat or negative markets which helps protect portfolios through all market conditions.

These funds also provide good diversification from bond and equity markets. With both economic and political risks looking very similar in 2017 to what was experienced in 2016 this area will be a significant element of the portfolios. Several European countries will have elections this year and the results of which could have a significant bearing on how both bond and equity markets perform. Having this protection in place will be hugely beneficial before during and after these political events unfold no matter what the result. This area will be very much in focus in the percentage held within the funds as well as new opportunities for potential use in the future.

Commodity & Energy Sector:

This sector was at the heart of the issues experienced at the start of 2016 with oil prices plummeting to below $25 dollars a barrel. At the end of 2016 commodities as a whole were producing good returns. Prices have continued to increase which is a lesson that has been learn to ‘never discount any opportunities however bleak the short term outcome’. The main element of the returns for 2016 came from metals and this area will continue to play a part in 2017 but supplemented by oil and other energy areas.

Oil is a difficult commodity to predict, in terms of pricing, but the price has stabilised in the last three months of 2016 and it now seems to be working between levels of $45 to $60 a barrel. With the OPEC agreement to cut supply being ratified by the main OPEC countries as well as areas such as Russia and Mexico, the perceived reality for the next couple of years is that the price will only move upwards. However, it will not be at the rate in which we saw the fall in the price during 2015 and 2016. There will also be times when prices will fall but this agreement and the cuts proposed should allow prices to remain reasonably static during 2017.

That said, commodities will still provide an excellent opportunity for investors and although the fund opportunities for retail investors are very limited, there are opportunities to provide both growth and diversification through certain strategies which will only increase further during 2017.

Equity Sector:

Despite the difficult start to the year and the political issues that the markets faced, 2016 ended up being a good year for equities with all the major sectors showing reasonable levels of growth. Looking at the sector figures below, at first glance it may look surprising to what sectors performed well. It was due to these sectors being undersold during 2015 and the early part of 2016, so these areas were better investment options because despite the

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volatility that was present all year, the opportunity for growth was enormous. The question for many investors is 'will there be the same opportunity for equities in 2017 as experienced in 2016?' The same rationale for opportunity can be applied with several areas still undervalued and the core areas of 2016 Latin America, Emerging Markets and Asia Pacific still offering good risk to return opportunities.

Other areas favoured include Europe, UK smaller companies and Global value/recovery based funds. With all these areas having good quality fund opportunities available to investors, 'risk on' once again should be the route taken by investors.

It will not be all plain sailing with the global political backdrop. There will be much volatility and, as we saw in 2016, when markets experience negative sentiment, losses will be quite heavy. However, in the better times, the reward for taking risk will be prominent.

There are areas where valuations are currently far too high and even though there will not be an outright correction certain equities may struggle to move forward. The three main areas that will be watched closely in 2017 are Japan, US Large Cap Growth and UK Large Cap Growth. There will be investment in all three of these areas but there will be a conscious decision as to how much we allocate to each. At the first sign that the individual market is not providing adequate reward for the risk we are taking we will either reduce our allocation to a minimal amount or pull out totally from the sector. At this stage things look likely to follow on from the pattern of what we saw in 2016, so all three of the areas remain a key part of our asset allocation.

UK All Companies

There are areas of this sector that are significantly overvalued mainly defensive stocks which have performed well with the fall experienced in Sterling following the Brexit result. The area that should offer the best opportunity is the value/recovery sector which has performed well in the last three months of 2016 and is an area where there are a lot of depressed valuations linked to very good business opportunities. The portfolios will continue to be overweight in the UK in general but 2017 highlighting the difference between a good stock picking manager and a bad one.

UK Smaller Companies

Following the sectors excellent performance in 2015, 2016 was a difficult year for most funds in the sector. This was due to period following the Brexit vote as it was the larger defensive companies that benefited the most from the falls seen in Sterling. Many smaller companies who rely heavily on importing have seen the role reversal of the fall in sterling with many seeing profits hit quite heavily. This in turn has reflected on their share price. With Sterling now reasonably stable, the selloff experienced in the last 6 months should provide an excellent entry point for long term investors who will look through the short term risk of the triggering of Article 50 and the UK finally looking to leave the EU.

Europe

Despite a number of high profile elections in 2017, this area should provide some good risk to reward opportunities for investors. The main reason for this is the valuations seen for most European companies lag significantly behind their counterparts in the UK and US. As it becomes more apparent that the European economy is stabilising, investors will benefit from investing in companies with scope for growth. Europe could provide investors with excellent growth as very low company valuations will provide good pricing points for long term investors.

Japan

This area for the last 20 years has blown 'hot and cold' for investors with most of the positives coming when investors believe the Japanese economy has finally turned a corner. In the past there have all so many false dawns rapidly failing meaning the economy has not shown any signs of growth since the 1990s. There are small signs that things are changing with the Yen especially with it falling against most major currencies over the last three months. However, more needs to be delivered in terms of 'Fiscal Policies' to move the economy forward. With the right fund though, investors will be able to makes some headway from investing in this sector. We will continue to have a reasonable allocation in this area but it will be via a fund we have not changed since it was introduced into the portfolios 4 years ago. The portfolios look to utilise the hedged version of the fund as the Yen continues to fall against sterling, this will provide additional growth for investors.

North America

Similar to the UK there are certain areas of this sector that are now significantly overvalued and even though there will not be a major falls in the price of these stocks, the opportunity for growth will be limited. An area that will continue to move forward in 2017 will be the financial sector with Banks providing investors with an excellent growth. As the interest rate environment moves towards the potential for at least two rate rises in 2017. This move forward with interest rates will also make the Dollar stronger. This will provide major assistance to US based companies which are mainly based in the smaller companies sector. This area will also be a focus for our research as we go through 2017.

Asia Pacific/ Latin America/ Emerging Markets

The movements seen in these sectors are similar due to the three areas relying very heavily on the US Economy and the strength of the dollar. During 2015 and the first half of 2016, the sluggish global economy resulted in large outflows of investor monies from all these areas. With the pick-up in the US Economy during 2016 (which did not result in an over strengthen dollar) all three areas benefited from the better global economic conditions which led to investors moving to more 'risk on' basis. This led to positive inflows into the sectors and the largest gains made from all equity market regions. There was also positive news from individual economies in the three sectors; the political resolution in Brazil; the economic stability in many of the Asia Pacific economies and an upturn in the Russian economy following the recent increase in oil prices. This has provided investors with much more diversification and options where there is a significant reward for the risk being taken. With valuations' still on the lower side in these three sectors 2017 should provide the same sorts of opportunity for growth with volatility as experienced during 2016.