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REVOLUTIONARY THINKING

2017 INVESTMENT THEMES

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The past twelve months have been extraordinary in many ways and the geopolitical landscape has shifted in a new direction.

Change can initially be unsettling to investors, but after more than eight years of below trend growth and pension breaking low savings rates, the time for new policy initiatives is overdue.

The vote to leave the European Union and the election of Donald Trump reflect the deep frustrations with the political establishment felt by many people in the UK and US. The shift to the political right has taken many by surprise, but this trend is likely to continue on the continent with the upcoming elections in the Netherlands, France and Germany. A sustainable transition to a world comprised of higher productivity, economic growth, inflation and interest rates has begun.

The journey will present numerous challenges, but also contain investment opportunities along the way. Risk management and portfolio diversification will be more important than ever.

The key investment themes and my expectations for 2017 are as follows:

BONDS

The thirty-five year bull market in government and investment grade corporate bonds is over. Returns will be negative and yields will trend significantly higher in the coming twelve months. The powerful combination of increased gilt and corporate bond issuance, and the return of inflation above the Bank of England's target rate of 2% will steepen bond curves and drive ten-year gilt yields above 2.25%. The US Federal Reserve has already begun raising rates to fight off inflation and the Bank of England will have no choice but to follow given that it is even further behind the inflation curve.

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EQUITIES

The FTSE 100 and FTSE 250 are poised to make modest gains in the region of 5-10% in 2017. Strong corporate earnings in the first half of the year will be required to sustain the current bull market. The UK economy has proven to be resilient in the aftermath of the Brexit vote and there is no material evidence to suggest that this will change. Global GDP has recovered to the long-term average of 4% and this will form the basis for higher valuations. The outlook for global developed and emerging market equities remains positive and returns will range from 5-15% in the coming year.

COMMODITIES

The outlook for commodities is positive and increased demand from the US and China will drive prices higher by 10-20%. The OPEC agreement to restrict production appears to be holding and the price of oil will likely trade in the range of $50-$75 per barrel. Both the mining and energy sectors have significantly reduced the level of investment since the last recession that began in 2008, which means that even a small resurgence in demand will have a disproportionate impact on prices to the upside. Inventories have been depleted and it will take many months for supply to come back online. The demand for base metals is also set to rise with Trump's plans for large-scale infrastructure projects in the US and to meet the ongoing needs of the Chinese and emerging market economies.

STERLING

The fall in sterling is overdone and the pessimism surrounding the post-Brexit economy is even more exaggerated. Countries such as the US, China and Australia are queuing up to negotiate separate trade agreements with the UK that will eventually increase the demand for sterling in the long run. Logic suggests that the UK will retain the vast majority of its trade flow with the EU, given its geographic proximity and that it imports more goods than it exports to the continent. Once the speed and trajectory of the Brexit timeline have been defined, sterling can easily recover much of the 15-20% that it has lost versus the US dollar and euro in the last eighteen months. Following a successful "hard exit" from the EU and the formal establishment of additional trading partners, sterling is likely to adopt many of the same robust qualities that have made the Swiss franc one of the most stable and strongest currencies in the world over the last quarter of a century.

COMMERCIAL PROPERTY

The commercial property market in the UK remains overvalued and prices are set to fall irrespective of the Brexit negotiations and the return of inflation. The cost of operating any business in the London area has become prohibitively expensive and a further fall of 10-15% in the sector will ultimately boost economic activity in the years to come. Technology has changed the manner in which many businesses operate and the requirement for large amounts of expensive office space has become increasingly diminished. Away from the UK, commercial property valuations in the US, Europe and in parts of Asia are much more attractive.

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The global economy has finally recovered from the ravages of the recession that stemmed from the irresponsible and reckless bank lending policies in the US and Europe.

Lessons have been learned, but can easily be forgotten during periods of economic prosperity. The effectiveness of the quantitative easing policies pursued by the Bank of England, European Central Bank and the US Federal Reserve are unclear, but fortunately they are coming to an end with the return of **higher growth and inflation**.

Government and investment grade corporate bond yields will rise and the savings community that has suffered greatly during this prolonged period of low interest rates will slowly recover. **Risk assets** such as equities, commodities and non-UK commercial property **will drive returns** in 2017 and partially offset losses from the further sell-off in the bond markets. Brexit and US President Donald Trump will dominate the press headlines over the coming months, but investors tend to ignore politicians during periods of increased economic growth. It will be **crucial to remain patient, disciplined and diversified.** Crystal balls always tend to be hazy, but one thing is very clear; democracies have spoken clearly on both sides of the Atlantic.

It will be important to remember during bouts of political “white noise” that the **“sky is not falling”.**

In summary, investment returns are expected to be positive in 2017, but marginally lower than in the previous year. The future remains bright.

Happy New Year!

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