WISE INVESTMENT
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Quarterly Market Review, Q4 2017

Global equity markets delivered just over 4.6% in the last 3 months of 2017. Equity returns were led by Asian and Emerging Markets with the Japanese market at the forefront of these returns providing 7.6% in sterling terms and offsetting some weakening in the yen against the UK pound. Strong returns in Japan were broadly based across the various sectors but the weakening Japanese currency saw marginal outperformance amongst the exporters. Since mid-2016, the performance of Japanese equities has been strong relative to other regions and appears unsustainable given the weakening trend in some market fundamentals such as corporate revenues. Conversely, other Asian and Emerging Markets continue to show some value, particularly when compared to developed markets. However, as share prices have marched on globally to the end of the quarter we are becoming ever more sensitive to the potential for positive correlation (prices moving in the same direction at the same time) and beta (the greater degree that higher risk emerging market assets move relative to lower risk developed market assets) in the event of any pull back led by equity markets in developed economies. These relationships can be particularly acute when macroeconomic events are driving investor behaviour.

At the beginning of November, the Bank of England raised overnight UK interest rates by 0.25% to 0.5%. However, this move had been more than fully anticipated by Gilt markets in the prior September. Consequently, for the final quarter of 2017, yields in UK fixed interest markets settled back to lower levels sending bond prices higher. Within the spectrum of issuers of UK debt, longer dated government bonds provided the highest returns. Corporate bonds (particularly high yield) lagged as, on average, they tend to have shorter maturities which creates less price sensitivity to interest rate moves.

Annual inflation, as measured by the Consumer Prices Index has steadily increased from marginal deflation in mid-2015 to around 3%. This has been spurred by the fall in the pound after the EU referendum result was announced and the subsequent rise in sterling terms of the cost of imported goods. Although the impact of the currency devaluation on year-on-year inflation is transitory, other associated effects of higher prices, such as wage inflation, can become entrenched. This is especially pertinent now when the unemployment rate is at a 45 year low. Despite some question marks over the 'quality' of this employment, it may become a focus for the UK Monetary Policy Committee in setting rate policy and pre-empting an inflation measure getting too far away from their 2% target.

UK Commercial Property made steady gains over the final quarter of the year with momentum building in monthly capital returns. Capital gains continue to outpace rental growth which has led to further compression of the yield available on this asset class. Should interest rate policy begin to decisively take a new tack then the continued grind of yield compression becomes questionable and a period of rebalance may be in order.

As ever, we are seeking to apply our investment expertise to your money with us by identifying the most attractive opportunities. This is combined with maintaining a sensible level of diversification to manage the overall risk in your portfolio. However, no matter how diversified a portfolio is, the value of investments can fall as well as rise. Moreover, diversification becomes a less effective tool when single factors (such as changes in interest rates) can have a similar impact across asset classes. Managing against this risk is a key consideration for us in delivering our service to you going forward.