Six Funds for 2017 – Psigma's Investment Outlook

At the start of 2016 we outlined a number of key themes that we believed could power returns for our clients through the rest of this decade, at a time when we felt that certain asset markets offered the best potential for returns since 2011 and, in some cases, all the way back to 2008. The recovery that we have seen this year in some of the previously mistrusted asset classes, such as US high yield credit and resources equities, has been so strong that we have been forced to temper our enthusiasm and take profits as the year has progressed. A decent number of the investments that we classified as 'contrarian' have become much more "consensual" as the year has progressed. There is obviously the potential for higher levels of volatility in the year ahead, but the key themes we identified a year ago still hold plenty of potential for 2017 and beyond. These themes are "Long Term Equity", "Equity Recovery", "Emerging Market Growth", "Inflation Protection", "Hunt for Yield" and "Defence".

Before we reveal our latest list of some of the most interesting components of our clients' portfolios, we should first outline how we see the economic and market path ahead developing through next year. To be frank, it is hard to remember a time through all the combined years that the Psigma Investment Team have been working when the number of potential outcomes were so high, which is a problem when most asset markets to us look 'fair value' to 'expensive'. At Psigma we pride ourselves on thinking differently to our peers and casting our nets very wide to find an optimal balance between opportunity and risk and such philosophies will be vital in the uncertain times ahead.

Our key views for the year ahead are:

- Markets have immediately assumed that President Trump is successful in engineering a break out for the US economy from the "dull but not disastrous" period post-Great Financial Crisis. We believe there are risks to this assumption and feel many routes are still possible for the global economy.

- The best way to avoid the economic and ever-present political uncertainty is to focus on tangible investment themes that should be rewarding, such as Japanese corporate change and Asian consumption, and decent each way "bets", such as short duration credit.

- Having a clear view of markets, such as that we had at the start of 2016, when we felt that many asset markets were undeservedly cheap, is now perilously difficult. That being said, we have a high degree of confidence in our positioning and strategy and are excited by the investments that we hold.

Long Term Equity - The "I'm a Believer" Investor - RWC Nissay Japan Focus

The Japanese equity market has been a relative underperformer in 2016, which we believe is undeserved. Investors have slavishly obsessed with the direction of the yen, whilst ignoring positive long-term corporate fundamentals, which have transformed Japanese equities from "uninvestable" a decade ago to an exciting opportunity now. Improving corporate dynamics remain in place and it is becoming clear that many companies are changing; dividends and buybacks are soaring and many company managements are pursuing governance changes that are vital to changing investors' perceptions of the Japanese equity market. RWC directly play this theme by working with their concentrated list of investments to ensure improving shareholder value with company managements. Having just come back from Japan and seen first-hand the changes that are taking place, we are increasingly bullish on this fund's prospects and enthused by how cheap Japanese equities are compared to their global peers.

Equity Recovery - The Contrarian Investor - *Polar Capital Healthcare Blue Chip*

One of the best long-term themes we can find in global financial markets is in healthcare, particularly after the poor performance of the sector in 2016 and we believe we are potentially entering into a golden age of healthcare investing. By 2050, 1 in 5 members of the global population will be over the age of sixty. This demographic tailwind alone does not make the investment case, as pleasingly there are at present major structural changes taking place in the industry which are creating opportunities in pharmaceutical and healthcare service companies. Government indebtedness is well known, likely to deteriorate further and means that future governments who are strapped for cash will do all they can to keep patients out of hospital. We have looked to exploit this theme by working with Polar Capital to create a specific strategy where the fund will focus on the opportunities in the pharmaceutical industry, healthcare services and medical technology companies. The team are highly experienced and specialists in healthcare investing with over sixty year's industry experience and currently have the opportunity to buy great companies, with healthy profits growth at historically reasonable valuations.

Emerging Market Growth - The Forward-Thinking Investor - *Macquarie Asian All Stars*

Since the inception of our business in the early years of this century, we have been more optimistic than most on the outlook for Asia and this has helped shape our asset allocation decisions. Our client portfolios benefitted enormously from our emerging market assets and resources investments in the last decade and in 2015 we once again took the view that such assets were cheap and discounted too miserly an outlook for Asian growth. Although undoubtedly premature, this view has paid off well for the last ten months and we have started to reshape our emerging market investments. In particular, we want to focus strongly on the Asian consumption theme and intra-Asian tourism, both of which we feel will continue to grow strongly in the coming years. The exponential growth in Chinese outbound tourism, in particular, offers investors sensational growth in a low growth world. The good news is that such investments have lagged badly in 2016, as regional banks, materials and industrial companies have soared. We believe that now is a great time to be buying into an exciting growth theme at sensible valuations, which the excellent Macquarie team will be doing on our clients' behalf. A big surprise next year could be that Asia outperforms and investors flock back to the region, as China continues to rebalance its economy and Donald Trump doesn't derail the Asian economic juggernaut.

Hunt for Yield - The Income-Starved Investor - *Airlie Strategic Focus High Yield*

Perhaps the most commonly held view at the start of this year was that US high yield credit was to be avoided; the commodity sector was collapsing and the collateral damage would be sufficient to trigger another poor year for the whole asset class. We disagreed and thought the "blow-out" in spreads suffered by high yield bonds, generally, in 2015 offered patient investors both a capital recovery and healthy income opportunity. In particular, we felt that the excess yields that could be found on lower-rated bonds were only realistic if we were to see a tsunami of corporate defaults, which we felt was an unlikely scenario. Fortunately, our view turned out to be correct and our position in the Airlie Strategic Focus High Yield fund has provided a return in excess of 20% this year. Looking forward, we still feel that in both the US and European markets you are still being compensated for taking credit and liquidity risk in smaller and lower rated bonds, as spreads on such bonds are still extremely wide when compared to higher rated and liquid corporate debt issues. The Airlie fund that we own has a specific structure that only invests in bonds that mature before a set date three years out, so we have some predictability over returns, as long as the companies that the managers select do not default. Given Airlie's expertise in the sector and the quality of their credit research, we expect them to be able to continue to avoid defaults and envisage attractive income returns of around 8% in the coming years, which will come in handy in a world where interest rates will remain low by historical standards and higher quality bond yields seem set to be very volatile.

Inflation Protection -The Investor who's "Keepin' it Real" - Fidelity Global Inflation Linked (currency hedged version)

It is obvious that by this time next year inflation rates are going to be significantly higher in the UK and US than they are now. After the last few years of disinflation, governments will surely welcome this trend to help them stealthily whittle down existing debt piles (let's pretend that they aren't going to grow more in the coming year). Investors should be more worried and recognise that inflation is a sure-fire way to erode your purchasing power. Inflation protection is always vital, particularly to those like us that see inflation as a clients' real benchmark, but arguably it is now more important than it has been this decade. The problem is that most ways of protecting against inflation are either very expensive, volatile or, in the case of inflation-linked bonds, currently very inefficient. Our favoured way of providing some effective and moderately priced inflation protection is through inflation breakevens* and the Fidelity fund does that on our behalf, in particular by exploiting more efficiently insurance in the US market and avoiding the structurally-expensive UK market.

Defence - The Scared Investor - *Odey Odyssey*

With defensive assets becoming ever scarcer, as evidenced by ballooning yields in Treasury bond markets in the last three months, we have opted to add protection in the form of a go anywhere multi-strategy fund. The managers of the fund, Tim Bond and Dip Shewaram, have strong opinions that asset markets are broadly overvalued and that stalling economic growth, lofty valuations and rising bond yields are large obstacles that markets will struggle to overcome. While markets have broadly disagreed with the managers' view since the inception of our position in Q1 2016, they remain net short equities, short credit and with a very negative view on government bonds. Basically they are bearish on everything. In buoyant markets, we would expect to see some capital loss in the fund, but during periods of uncertainty the fund has the potential to achieve a reasonable level of upside. Despite the fund being down since the inception of our position, we feel that there are very few true alternatives available in the market and the Odey fund allows us to diversify and reduce risks we have elsewhere, particularly in markets that are presently highly correlated.

Tom Becket
Chief Investment Officer
December 2016

* The breakeven inflation rate is a market-based measure of expected inflation. It is the difference between the yield of a nominal bond and an inflation-linked bond of the same maturity.

Important Information

The investments contained in this document may not be suitable for all investors. Prospective investors should consider carefully whether any of the investments contained in this publication are suitable for them in light of their circumstances and financial resources. If you are in any doubt whether any of the investments contained in this publication are suitable, you should speak to your Investment Director, or take appropriate advice from an accountant, lawyer or independent financial adviser authorised and regulated by the Financial Conduct Authority.

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Notes for Editors:

Psigma Investment Management

Psigma Investment Management was established in 2002 by a team of highly experienced investment managers. The business has expanded rapidly and has been extremely successful in attracting assets under management of £2.59 billion (as at October 2016) from Private Clients, Charities and Pension Schemes. Much of this success is due to Psigma Investment Management being positioned to utilise the skills of the consulting businesses within the Punter Southall Group, to help it design specific solutions for its respected clients rather than shoe-horning them into inflexible standard products.

Drawing on the shared intellectual capital and expertise of the different businesses within the Punter Southall Group umbrella, the group provides innovative, integrated, liability-led, client-focused investment and financial planning solutions.

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