Psigma
Investment Management

FOR PROFESSIONAL ADVISERS ONLY

Psigma Market Commentary

10 January 2019

At the start of this New Year and after a huge amount of market-changing newsflow and volatility over the last year, we thought it would be useful to outline our core views on the global political, economic and financial market outlook for the year ahead. We have also included some of our latest views on the outlook for asset market returns and our current flexible investment strategy. These views are not "exhaustive" so we would be delighted, as always, to field any questions either you or your clients might have at this particularly unpredictable time.

Tom Becket
Chief Investment Officer

- **2018 was a challenging time for all major asset markets,** with volatility significantly higher than the relaxed environment we enjoyed in 2017. Positive returns were almost impossible to come by and we believe that the challenges are here to stay as we head deeper into 2019.
- **Many commentators were surprised** by the change in market behaviour, as it came at a time when the global economy was expanding and corporate profits grew at a healthy pace. However, our view was that **the global outlook had become more uncertain** and when this was combined with high valuations and creeping complacency, it spelt trouble for investors.
- Our early expectations this year are that **we expect a year of around trend growth** from the global economy, but that the chances are that we have seen the best of the growth for this particular economic cycle and that **downside risks certainly exist.** We constantly stress that **we need to keep an "open-mind"** about any economic projections, as there remain a confluence of major factors providing a genuinely uncertain short-term future. However, **we now expect a slowdown in global growth** in 2019 as this economic cycle comes towards an end, before a possible recession in 2020.
- Whilst we are starting to think about an end to this business cycle, loose fiscal policies in the US and continued "pent-up" economic demand could potentially lengthen the cycle further. On the negative side, the positive "credit impulse" from China has slowed and **liquidity in the global economy is tightening.** Any concrete signs of a change in either of those dynamics could be supportive of economic output and market direction.
- The key factors behind the recent market oscillations have been concerns over global trade, rising market interest rates and signs of a return of inflation. Global trade grew impressively in 2017, but with the opening salvo of a mutually-impairing trade war between the US and China having been fired, obstacles to free trade have been raised and this is undoubtedly a key concern we need to monitor as 2019 progresses. **It could well be that a deal emerges between the US and China, but we are sceptical that it will be particularly impressive over the long run.**
- The biggest change over the last 18 months, in our opinion, has been the change in central bank mind-set from "loosening" to "tightening". The US Federal Reserve (Fed) has been raising interest rates and reducing their balance sheet through quantitative tightening, ensuring a tighter

liquidity environment for investors. Interestingly investors have now switched their projections for the Federal Reserve raising interest rates further to join us in a view that **the Fed will struggle to raise rates this year**. If the Fed were to confirm an end to their tightening bias then markets could well rejoice in the short term.

- Bond yields and borrowing costs were also given added upward pressure last year from the spending intentions of the US government, which has decided to pursue an extremely loose approach to its finances to spur further growth. When combined with the tax cuts afforded to US companies and consumers at the end of 2017, **the cost could well be extremely high to the future generations with question marks hanging over the efficiency of the spending**. It could also lead to a further structural shift lower in the US dollar over the next decade.
- Another by-product of the US government's splurge could well be a **further inflationary push**. Certainly, the days of disinflation and deflationary fears appear to be behind us and inflation uncertainty has risen. Notably **nobody is now worried about inflation and this is something that should therefore concern us**. Certainly wage growth seems to have some long overdue upward pressure and this could feed through into inflation rates.
- In the UK, the Monetary Policy Committee (MPC) raised rates in August 2018, although we are not convinced by this decision and recognise that their own forecasting powers are not strong and they are prone to change their minds. **We are sceptical about the merits of the MPC's change in policy towards a moderate tightening bias**, with the UK economy still lingering under a fog of political and economic uncertainty.
- In Europe, there finally seems to be a commitment to bring to an end the insanely loose monetary policy that has been in place for the last few years and notably the European Central Bank stopped further asset purchases at the end of 2018. This is a dynamic that might have **major consequences for investors** and we might start to discover what price certain assets should be without indiscriminate purchases from central banks distorting financial markets.
- Our asset class forecasts are predicting that **future returns from equity and fixed interest markets will be lower than they have been through history**, although after the recent sell-off we now expect **higher returns from developed world equities in the years ahead** than we previously expected. Returns will still likely be lower in the future than they have been in the past, but **we believe that "realism" is appropriate** at a time when asset valuations are not cheap and the economic potential of the developed world, in particular, is lower than it has been for the last 50 years.
- Our portfolios are positioned with a **"neutral with a hint of caution"** stance, with high levels of diversification and a healthy cash buffer. This helped to partially protect against the volatility of all major asset markets last year, particularly in the early and late months of this year. In recent months we have been moderating our risk allocations tactically and have **temporarily had more of a "risk on" approach**, although this is more of a short term call to reflect oversold markets. There had been a shift in the underlying components of our portfolios to **allow us to benefit from the improvement in market sentiment** over the last few weeks. However, we are **continuing to operate with a flexible mind-set** as to our next strategy moves, as we head deeper into this New Year.
- We are alert to **take advantage of selective opportunities** as they present themselves with emerging market assets chief amongst the investments that we are reviewing for possible increases. Other investments that have performed badly could also be ripe for an increase, despite our core view that the there is a "new regime" for the global economy and financial markets and we need to be more respectful of growing volatility and rising risks, while remaining alert to any opportunities that come our way. The key advice we can have for all investors at this time is to be very "open-minded" about one's ongoing investment strategy.

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Psigma Core Strategies

December 2018 (Including ARC Estimates for October to December 2018)

	PSIGMA CORE CAUTIOUS	ARC STERLING CAUTIOUS PCI	DIFFERENCE	PSIGMA CORE BALANCED	ARC STERLING BALANCED ASSET PCI	DIFFERENCE	PSIGMA CORE GROWTH	ARC STERLING STEADY GROWTH PCI	DIFFERENCE
1m	-0.80%	-1.30%	0.50%	-2.19%	-2.60%	0.41%	-2.72%	-3.70%	0.98%
3m	-1.96%	-3.66%	1.70%	-4.30%	-5.90%	1.60%	-5.37%	-7.64%	2.27%
6m	-2.45%	-3.28%	0.83%	-4.24%	-5.14%	0.90%	-5.47%	-6.44%	0.97%
1yr	-2.30%	-3.78%	1.48%	-3.70%	-5.14%	1.44%	-5.03%	-5.71%	0.68%
3yr	10.95%	6.08%	4.87%	15.25%	9.95%	5.30%	18.75%	15.09%	3.66%
5yr	14.15%	11.69%	2.46%	18.76%	17.06%	1.70%	23.29%	23.19%	0.10%
7yr	31.35%	24.00%	7.35%	44.44%	37.77%	6.67%	53.24%	50.88%	2.36%
10yr	54.72%	41.76%	12.96%	75.10%	65.60%	9.50%	92.31%	89.56%	2.75%
12yr	54.39%	43.66%	10.73%	68.36%	53.61%	14.75%	73.96%	64.78%	9.18%
ITD	96.61%	73.00%	23.61%	126.08%	101.99%	24.09%	139.01%	130.10%	8.91%

Past performance is not a guide to future performance.

Source: Interactive Data as at 31st December 2018 and ARC PCI Report 30th September 2018. Please note that from October to December 2018 ARC data are estimates.

The data above represents the performance of the Psigma Managed Portfolio Service (MPS). All performance figures above are shown net of underlying fund charges and net of Psigma Investment Management fees applicable at the time. Currently the Psigma MPS AMC is 0.40% plus VAT (charged pro rata on a quarterly basis) and 0.12% custody, settlement and execution (charged pro rata on a monthly basis).

Psigma
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client.services@psigma.com
businessdevelopment@psigma.com
www.psigma.com

@PsigmaIM

company/psigma-investment-management

London

11 Strand,
London,
WC2N 5HR

+44 (0)20 3327 5450

Birmingham

1 Colmore Row,
Birmingham,
B3 2BJ

+44 (0)121 230 1937

Edinburgh

The Capital Building,
12/13 St Andrew Square,
Edinburgh, EH2 2AF

+44 (0)330 094 0090

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3D 2018 PSIGMA INVESTMENT MANAGEMENT AWARDED BY ARC

Psigma Bespoke and Managed Portfolio Services have been awarded 5 Star Defaqto ratings for six consecutive years.

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Investment Risks:

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