MELVILLE DOUGLAS

Quarterly Commentary

Minimum Disclosure Document as at 31 March 2017

Melville Douglas
USD Income Fund

Despite the numerous political anxieties, we continue to see a pattern of modest but global synchronised growth and reflation, suggestive of less accommodative central bank policies in the quarters ahead. The Federal Reserve has sanctioned its third interest rate increase and we forecast two, or possibly three more quarter-point hikes before the end of the year. Talk of interest rate rises in the Eurozone in our view is premature but we do expect the European Central Bank (ECB) to continue to ease off the quantitative easing pedal. In the UK, Brexit equals uncertainty but growth is likely to again exceed expectations in the coming quarter supported by consumer spending despite the ongoing inflation squeeze on wages. Ultimately, the backdrop of global growth and rising US government bond yields looks set to push global yields modestly higher and therefore, the Fund remains defensively positioned with a bias towards short and medium-dated issues.

US economic conditions remain consistent with the more hawkish monetary stance now in place at the Federal Reserve. Both inflation and unemployment are at or close to the Fed's dual mandate target levels whilst GDP trend's at acceptable levels for what is deemed the 'new norm'. President Trump inherited an economy with the wind in its sails but there is a growing sense of impatience over lack of clarity on proposed tax reforms and infrastructure spend, particularly given the recent Obamacare defeat. We expect some positive fiscal news in the coming months which may be sufficient to provide another economic and sentiment 'sugar rush' into 2018. Under this scenario, ten-year US government bond yields should move higher as part of the ongoing normalisation process and we retain our medium term yield target of 3%.

The US Dollar fell moderately in the quarter but the Fund remains overweight on the view that this short term weakness is unlikely to be the beginning of a sustained downturn, just yet. Without doubt, many of the supportive factors have been discounted such as favourable interest rate and yield differentials but we expect the Trump administrations pro-growth fiscal initiatives and some form of border adjustment tax (BAT), even if watered down, to provide another, and potentially final, lift for the US Dollar. We are poised to trim our overweight exposure in the Fund at more favourable levels in the year ahead.

There are real signs of an improving economic backdrop in the Eurozone and the 'long-term' outlook for the Euro appears more positive. However for now, the uncertain political landscape and negative interest rates and yields (even before adjusting for inflation) should be enough to keep the Euro pressured, particularly against the US Dollar. The odds of one or more member states exiting the Euro remain slim but those odds are not 'zero' and therefore, an overhanging concern. The Fund remains zero-weighted in the Euro, however, a push in the US Dollar/Euro rate towards the much hyped parity level may convince us to start adding some exposure.

Melville Douglas

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