Quarterly Commentary

Minimum Disclosure Document as at 31 March 2017

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Global Growth Fund

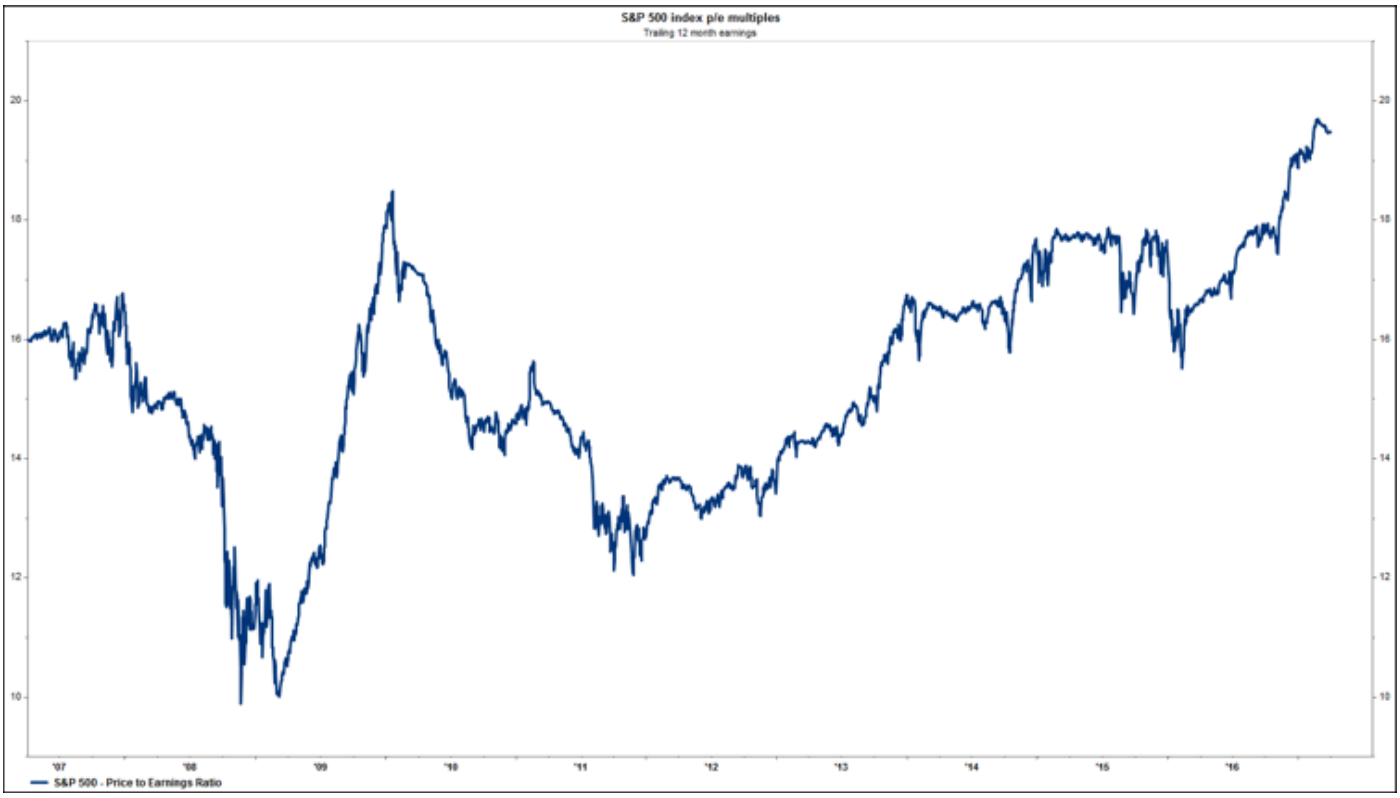
Investment Environment

Equity markets were mostly quite strong in the first quarter, and many indices globally were at or close to new highs. The key drivers were strong economic data and strengthening corporate earnings. The data showed that developed economies continue to strengthen, and that a more synchronized growth phase is under way: Europe and Japan are no longer lagging the US as much as they were. In addition, some expected deterioration did not happen: the UK economy, for example, has come through the first post-Brexit months much stronger than estimated, even though there remains considerable doubt as to what the exit process will mean for the economy. Uncertainty is not usually good for economies, but it hasn't bitten in the UK as yet. This may be partly because of the cushion provided by a weaker currency, but also because no actual change has taken place as yet – for companies reviewing investment and employment plans, there is a long way to go to implementation.

Importantly, economic robustness is helping to reduce fears of deflation. While inflation is a clear threat in the US and the UK, and the central banks are already taking note, it is not yet an issue in Europe or Japan. This means the world may go through a phase where monetary policy can remain accommodative overall, and rising US dollar interest rates will not be disruptive. That of course would be the best possible outcome. Nevertheless, it is not clear that all markets are convinced, and in spite of reasonable growth, the yield on US government 10-year bonds fell in March even though it is now clear that the Federal Reserve expects to continue raising rates and that the inflation rate is close to the target. The resulting narrowing of the gap between short term and long term interest rates can be interpreted in several ways, but the fact that it involves a decrease in the long term yield at least suggests that the bond market believes there is no significant risk that inflation will be allowed to overshoot.

That doesn't mitigate the risk that long bond yields can rise further: a 2.4% 10-year yield is not historically consistent with inflation levels at or close to 2%, and higher yields may yet be a necessary adjustment to more "normal" financial conditions. The most likely trigger for such a move would be rising bond yields elsewhere: at present, the weight of funds seeking higher yields will still find US rates attractive, as rates in other developed markets are even lower than in the US. As growth improves elsewhere, and the deflation threat recedes (as it did in the US), rates will rise.

For equity markets, good economic fundamentals are now backed by a strong turn in the corporate earnings cycle, particularly but not only in the US. This has persuaded investors that it is reasonable to pay more for each unit of earnings, so multiples have expanded.



As the chart shows, this means investors are now paying the highest prices for delivered earnings since the financial crisis - in fact it's almost 20 years since current multiples previously occurred, in the early 2000s. At the very least that means markets are very confident that earnings forecasts will be delivered, but it is also historically the case that such enthusiastic anticipation of earnings growth can lead to very dull returns. Overpaying is not a good strategy. Even assuming that this is because markets are anticipating a significant downward adjustment to US corporate taxation, it's a large adjustment that appears to fully anticipate the possible change, and there is significant room for disappointment. Elsewhere, multiples have also risen sharply even though the immediate outlook is more mixed, even where there may be a less clear path for earnings and additional macro risks (in Europe for example). Economic growth in Europe is no longer as far behind the US as is often assumed – and has not been for some time.

This at least partly explains the central bank's willingness to contemplate adjusting and ending its monetary stimulus in the foreseeable future. It is entering a phase where growth appears sustainable and is supporting some of the peripheral economies that were so devastated following the financial crisis. There are undoubtedly still stresses. Italy, a large component of the Eurozone, has a weak banking system and is overindebted; the central bank has to battle with the fiscal and growth inconsistencies across the region; and the banking system is still not as robust as it should be. In addition, the coming year is full of electoral events that will highlight the political pressures on incumbent governments to deal with employment and migration issues. The Dutch election passed with more or less smoothly, but elections in France, Germany and perhaps Italy are still to come. So there are unquestionably risks, but equally opportunities. As the world develops into a more synchronized growth phase, the importance of the US is likely to be reduced and it makes sense for investors to look more widely for opportunities, especially given historically high multiples in many markets.

PERFORMANCE

Over the quarter, the fund returned +4.56% compared to a benchmark return of +4.74%.

ACTIONS TAKEN

Given a favourable global economic backdrop and improved corporate earnings cycle, the allocation to equity was increased at the expense of fixed interest over the quarter. Our fixed income strategy remains defensively positioned in short to medium-dated issues. We expect some clarity on fiscal reforms from President Trump to provide another fillip for sentiment and the economy, driving yields higher.

CONCLUSION

Bob Dylan's "The Times They Are A-changin'" has never been more fitting than now, as the winds of political change are being felt in many countries. The rise in protectionism and anti-establishment sentiments have resulted in two very unexpected outcomes during 2016. There are significant unknowns and risks that will affect the longevity of the European Union and global trade in an 'America First' and Brexit world, with implications for China and the rest of the Emerging Markets universe. Geopolitical uncertainty globally, will remain a material source of volatility this year.

We do not pretend to know how it all plays out and what lies ahead in the coming year. Opportunities will present themselves as the year unfolds and our relentless focus on long term valuations will stand the fund in good stead. Diversification is the name of the game for success and will assist us in navigating through what is expected to be another year full of surprises. For now, we remain overweight Equity.