



McLAREN CAPITAL
MANAGING WEALTH

Market Update

January 2017

McLaren Capital Limited is authorised and regulated by the Financial Conduct Authority.

Prepared in commercial confidence

This report contains reference to past performance of certain investments. Past performance is not a guide to the future, and unless a capital guarantee has been specifically mentioned, all investments may fall as well as rise and you may not get back the full amount invested especially on early encashment.

. All data provided is protected under the terms of the Data Protection Act and confidential in accordance with the terms of the UK Financial Services Act.

McLAREN CAPITAL Ltd | MANAGING WEALTH

Tel no: 0845 123 3804 **Fax no:** 0845 123 3805 **Web address:** www.mclarencapital.co.uk

Registered in England No. 06586342 Registered office: The Old Forge, Shackstead Lane, Godalming, GU7 1RJ Trading address: The Old Forge, Shackstead Lane, Godalming, GU7 1RJ

Introduction

As we look back on the final quarter of 2016, it is hard not to concentrate on Donald Trump's victory in the US Presidential elections. The result has clearly divided opinions (both in the US and abroad) in much the same way that the EU referendum did in the UK but as we noted in our last update, the race to the White House had become almost too close to call and so perhaps the result was not as surprising as many analysts (and indeed the dreaded polls) had suggested.

This particular election will no doubt be dissected by political commentators for years to come but as it's seemingly becoming clear, there are huge sections of democratic populations around the globe that appear to have had enough of the status quo in their countries and are now seeking change. For many of these nations there seems to be an underlying feeling that after years of global quantitative easing, the real winners have been those who were already wealthy and hence the gap between the 'haves' and 'have nots' has only grown further. This point was reinforced by Mark Carney, the governor of the Bank of England, who during one of his recent speeches referred to the last 10 years as 'a lost decade' due to the lack of real wage growth for the majority of the UK's population.

At home the debate continues over the structure of the BREXIT deal that the UK will be able to make with the EU, but there is no doubt that the EU also has further huge concerns over other members of the Union. At the forefront of this is the rise of support for populist parties across Europe and when we review the figures, they are quite startling. In Italy, the 'Movimento 5 Stelle' party now has in the region of 25-30% of the public's backing and the same situation can be found in Spain where 'Podemos' now has support in the region of 20%. These figures are particularly important when we factor in the number of EU countries that will have general elections (Netherlands, France, Germany and potentially now Italy) in 2017, as well as the huge number of people who wish to leave the Euro across the continent.

Politics therefore seems to have been more important in 2016 than it has been in recent years, and the world markets will continue to be affected by political decisions across the globe. The ECB recently extended its bond buying programme until the end of 2017, but it is believed that there are growing differences between the ECB's 'hawks and doves' over how the programme continues to be rolled out, and this adds further weight to concerns over how bond markets in general (both in the UK and abroad) will fare in 2017.

Returning to Donald Trump, questions of course remain over what he will end up doing with some of his early policy decisions. What is clear is that he very much wants to put America first and has indicated that he would like to spend \$1 trillion to help 'America's crumbling infrastructure'. He has already talked about potential penalties on imports (from the likes of China) and again, such political decisions are likely to have significant ramifications for the global markets.

In the UK, the government's new chancellor Philip Hammond has already hinted that the country needs to change its economic plans and targets. Once again, improved infrastructure is high on the agenda in an attempt to make the UK more competitive and productive, especially given the referendum result.

Taking all the above into consideration, it may therefore come as something of a surprise to see that markets have, on the whole, held their own during the quarter and as always, we will discuss these in the individual sections within the remainder of this report.

USA

As the dust settles on Trump's victory, the US markets have had a strong finish to 2016. The S&P 500 rallied to an all-time high of 2,271.72 whilst the Russell 2000 saw its biggest jump since 2011.

US economic data has continued to be steady, PMIs (purchasing managers' indices) remain acceptable rather than spectacular but the revised 3rd quarter US GDP figure came in at an annualised rate of 3.2% which was 0.3% up on previous estimates, and indicates that the US economy expanded at the fastest rate in 2 years over Q3 2016.

Against that, corporate earnings were mixed, which again brings US stocks' high valuations under the spotlight, although Trump's promise of both de-regulation and corporate tax reductions may both benefit US stock market investors. As alluded to in the introduction of this report, much now depends on the direction in which the now labelled 'Trumponomics' proceeds, and only time will tell as to how the markets react to such fiscal stimulus (if indeed it happens).

As expected, US interest rates were raised in December and decisions by the FED remain vitally important both in the US and around the globe, but the difference going forward, may well be a general change in the way policymakers attempt to stimulate their respective economies.

Despite the huge political change in the US, our investment committee's general view of the US remains relatively similar to previous updates. We continue to see opportunities for our clients in the vast US markets but we also fully appreciate the fact that current market valuations remain on the high side.

Our investment committee therefore recommends that our clients continue to have broad US exposure via sector / geographic specific funds, as well as global equity mandates that have greater flexibility in terms of where they can invest. Through the combined use of such strategies investors can maintain holdings in both domestically focused US stocks alongside US stocks that are huge global powerhouses.

UK

A lot of the focus in the UK (in Q4 2016) has continued to be centred around when Article 50 will be invoked and the subsequent timetable for the UK's exit from the European Union. There has been all manner of legal challenges to the exit but at the time of writing, it still looks like the UK will indeed leave the union and this has of course prompted all sorts of doomsday scenarios to be rolled out by various commentators.

However, against this backdrop the FTSE 100 (new record high), FTSE 250 and FTSE AIM have all had a strong end to the year. This has been especially important for the FTSE 250 as it was this index's underlying UK centric stocks that bore the brunt of investors' concerns after the UK referendum.

Investing in 2016 in the UK (and indeed across the globe) has shown how important currency swings can be, as significant parts of the overall returns have been due to the large swings in sterling, which has in turn benefited the big global exporters. This rollercoaster ride for sterling may well continue in 2017 as if/when Article 50 is invoked, the likes of Morgan Stanley and Deutsche Bank have predicted that sterling could tumble a further 5% versus the likes of the dollar and the euro.

As mentioned in the introduction to this report, the UK government has recently declared its desire to boost economic growth in a different manner to that employed over the past 5 years. Much of this is centred around infrastructure improvements and an overall aim to hike UK productivity growth, which has lagged a lot of other developed nations since the financial crisis and in theory, this can only be a good thing for the UK in general.

The investment committee continues to have faith in the UK markets but acknowledges that a tricky road lies ahead in terms of continued European negotiations. As such, we retain our view that whilst diversity is key within our portfolios' UK holdings, there should currently be a slight bias towards larger, more global facing UK companies within our clients' portfolios.

Europe

Many believed that a Donald Trump victory in the US would create a situation in which global equity markets would falter and there would be a further rush to asset classes / equity sectors which have historically been safer havens for investors. However, this proved to be anything but the case and in Europe, as elsewhere, investors continued to move away from these safe areas and into cyclical, such as financials and basic materials.

Alongside steady market performance there has also been some encouraging economic data from the region as a whole. Eurozone headline inflation continued to rise (November's figure of 0.60% was a 0.10% increase from the month before), the manufacturing PMI hit a 34-month high, whilst the unemployment figure fell to 9.8% which is the lowest level for over 7 years.

As with the FED in the US, analysts and commentators keep a very close eye on Mario Draghi and the actions of the ECB, and in their most recent meeting, they voted to keep interest rates at their current record low position, whilst they decided to taper their bond purchasing programme to 60 billion euros a month with effect from April 2017.

There is much still to do to keep the zone moving in the right direction and the ECB face the same issue as other economies, in that QE programmes such as these cannot go on forever and sooner or later, economic growth needs to be stimulated by other sources that are not dependent on centralised monetary policy.

As mentioned in the introduction of this report, Europe and the EU face significant political challenges in 2017 and this is why the region remains something of a conundrum for our investment committee. Compared to many of the other developed nations, European stock market valuations look generally attractive and dividend yields also look appealing. However, it is very difficult to remove the political risk from our general overview of the region. The recent defeat of Matteo Renzi's Constitutional Reforms Referendum in Italy was much wider than expected, and although Europe sighed a breath of relief when a pro-European leader managed to win the Austrian Presidential election, we believe that there are far bigger hurdles for the EU to overcome in 2017.

However, if markets have taught us anything it is that investment opportunities can often be found in countries and sectors which are unfancied by the masses and as such, we continue to see both value and opportunities in Europe but remain convinced that skilful stock picking will be crucial.

Japan

With much of the focus on other developed economies (and principally their political situations), Japan has perhaps fallen away from investors' radars over the latter stages of 2016. However, the Japanese markets have generally performed well over the calendar year, although currency fluctuations have of course played their part and the difference in performance for local currency investors is marked, compared to those who invested around the world via their own currencies.

Much of our recent commentary on Japan has been centred around PM Abe's Abenomics and the perceived failure of a lot of the policies that have been implemented thus far, but 3rd quarter economic data has at least provided Japan's somewhat beleaguered policymakers with some cheer. The CPI (consumer price index) rose by 0.10% which although not staggering, was at least the first year on year rise in 8 months, and alongside this GDP grew by 2.2% which was greater than analysts' estimates.

Alongside these statistics, stock valuations continue to look attractive versus other developed nations and as part of the corporate governance reforms, the potential for companies to focus more on the long-term outlook for their investors (especially those from abroad), may well make such stocks more attractive from a global perspective.

Our investment committee retains a relatively positive outlook for the Japanese markets as we approach 2017. The combination of both economic and corporate governance reforms at home may well continue to benefit investors, whilst the potential for further rate rises in the US may help keep the Yen in check and stave off further appreciation.

We have previously commented on the emergence of a 'new Japan' which is more open to foreign investment, and whilst this is of course very much an ongoing project, our investment committee continues to see potential in the Japanese markets and hence we feel that investors with a suitable risk appetite should retain their exposure via their multi region (global) funds but as ever must be aware that it is likely to be a volatile ride and should only be seen as a long term investment.

Asia and Emerging Markets

UK investors have enjoyed strong returns from both these sectors in 2016, although the weakness of sterling has again aided overall performance. In part, the returns have been driven by the general recovery in commodity prices alongside lower concerns over the state of the Chinese economy.

However, the market rallies were checked in Q4 by Donald Trump's victory as investors became nervous over the potential revision of trade agreements, talk of levies on imports (especially from China) and the fact that the dollar could strengthen further in 2017, which would not be beneficial to many of the economies in these two sectors.

Chinese economic data released in Q4 2016 has been mixed, with lower than expected consumption growth figures; although against this, most Chinese companies announced better than expected quarterly earnings. As noted, concerns over China's 'hard landing' were perhaps exaggerated at the start of 2016 but when one considers the nation's level of debt (alongside other ongoing issues) there is no doubt that the Chinese administration still have a huge job on their hands in terms of the transitioning of the Chinese economy.

Indian PM Modi surprised a lot of analysts with his decision to demonetise high denomination banks notes, and whilst this should, in theory, be a positive step forward for the country, such changes do need time to bed in and take effect and as such, the markets did subsequently suffer a downturn during Q4.

Potential Trump policies which may centre on the reversal of globalisation, alongside changes in immigration legislation also affected several South American countries in Q4. Mexico has been the target of a lot of Trump's dialogue and in an attempt to stop the devaluation of their currency, the Mexican Central Bank raised interest rates by a further 0.50% (to 5.25%).

As with most sectors, our investment committee must again balance off these potential political issues versus potential opportunities in these two huge sectors. In line with previous updates, we still believe that the long-term story remains compelling in both these sectors and hence, we still believe that they warrant our clients' attention.

However, as has already been alluded to, the regions require certain economic / political conditions to prosper and given that the situation can change quickly (especially with Trump's arrival) there is likely to be significant ongoing volatility in both Asia and Emerging Markets. As with Japan, we therefore believe that any investment in both sectors needs to be viewed as a long time call rather than a short-term opportunity.

Fixed Income

The fixed income markets have enjoyed a long run of favourable conditions over the past few years. Record low interest rates across the globe, alongside a succession of political concerns, have helped many of the debt sub sectors produce excellent returns as investors have flocked to supposedly 'safe' assets. This run however has been halted in Q4 2016 with most of these sub sectors (based on IMA averages) having a reversal in fortunes.

We have discussed the 'bond bubble' in several of our recent market updates, and whilst we believe that it is too early to say that the bubble will be burst, there is no doubt that any increases in inflation may well dampen enthusiasm for fixed income further.

Government decision making will also play an important part in the debt markets' future and a case in point was Philip Hammond's recent announcement concerning increased government borrowing as this added further pressure to the sovereign debt market at home.

The investment committee is concerned by these increases in inflation as well as the scope for further government and central bank intervention. That said, we believe that there is still a market for fixed income vehicles although the pockets of value are becoming more niche and harder to find.

Property

As we have reported on in our previous updates UK commercial property was one of the asset classes that took the biggest hit from the 'surprise' result of the EU referendum. Investor sentiment nosedived and in turn this created a somewhat artificial panic scenario in which investors flocked to redeem their money, fearing that they may become trapped in suspended funds.

The picture has now changed somewhat as most (open ended) managers have lifted their trading suspensions, 'fair market value adjustments' and in some cases, have reverted their pricing basis so that the net effect is that a lot of these funds are now in positive territory for the calendar year 2016. This does not negate the liquidity risk of physical property funds but it does again highlight why time in the market, rather than attempting to time the market, is more often than not crucial.

Flows into UK property vehicles have once again turned positive over recent months and the McLaren Capital's investment committee's view remains the same as per our Q3 2016 update. We continue to see value, especially so given the sector's attractive yields versus other asset classes such as fixed income and hence believe that commercial property should retain its place in our portfolios.

Absolute Return

As we have commented on in the past Absolute / Targeted Return sector contains all manner of different investment strategies which take varying degrees of risk and given these huge variations it is therefore unsurprising that some strategies suit certain market conditions better than others and 2016 as a whole has proven to be a difficult year in which to manage these types of investments.

The different fund management teams typically attempt to make various domestic or global plays within their strategies but various economic and political events during the calendar year have made this task significantly harder and this has affected the performance of funds like Standard Life GARS and other funds across the risk spectrum of this wide and varied sector. Our investment committee continues to meet with the teams of these funds on a regular basis to understand why they have performed in the manner that they have and post our most recent meetings we continue to have faith in the managers' abilities that we utilise in the portfolios.

The McLaren Capital investment committee therefore still believes that some of these lower risk strategies continue to offer strong diversification benefits within our clients' portfolios and hence we are happy to retain our current exposure to the absolute / targeted return funds in the McLaren Capital portfolios. That said we do now prefer smaller, more nimble strategies and have therefore decided to remove the mammoth Standard Life GARS from our portfolios.

Commodities

The main story during the latter stages of 2016 has, from a commodities perspective, been the steady increase in the price of oil and no doubt all our clients have begun to notice this at petrol stations across the UK.

Both OPEC and non-OPEC members agreed to cut oil production (the first joint output cut since 2001) during a series of meetings during the final quarter of 2016. Initially OPEC members agreed to a cut of 1.2 million barrels a day whilst non-members followed with an agreement to cut 558,000 barrels per day for a 6-month period starting on January 1st 2017.

The effect of these cuts is likely to be good news for economic growth in several regions (such as the US and Russia) but against this it will, as previously mentioned, hit consumer spending and does add further fuel to the fire (no pun intended!) in terms of potential inflationary rises across the globe during 2017.

Other natural resources have also performed well through Q3, and this has been mainly due to a combination of successful corporate restructuring throughout 2016 (which had been needed for some time) as well as increased demand for certain raw materials. The main question for the sector now centres around whether this run can continue and as ever much will depend on the ongoing demand for these products.

In recent years, much of the demand has come from manufacturing in China but as we have already noted, in this report there appears to be a genuine desire to change the way in which policymakers want to inject stimulus into their economies, and if significant spending in infrastructure occurs, then demand may well remain high for the foreseeable future.

Our investment committee does indeed see potential in this varied sector but as ever, believes that there will be significant associated ongoing volatility. We will therefore continue to trust our multi asset and multi region managers to make the decisions over whether to invest in precious metals and / or natural raw materials.

Conclusion

Political events across the globe have been hugely important throughout the course of 2016 and looking ahead to 2017, there is every chance that politics could again play a vital role in the developing macroeconomic picture.

We will learn more about Donald Trump's plans once he is sworn into office in January, whilst general election results across Europe will answer the question over whether populist parties can uphold their current support and turn it into electoral success and if they do, there could be further upheaval for the EU in general.

All of this will most likely have a direct impact on how the markets perform through 2017. The fixed income markets are coming under increased inflationary pressure (their natural enemy) whilst 'value' rather than 'growth' strategies in the equity markets may well come into favour again.

In line with these observations we will, as ever, continue to monitor global economic developments carefully to ensure that our clients' portfolios remain invested in suitable fund selections and asset allocations that match both their investment objectives and their attitudes to investment risk.

IMPORTANT NOTES

This market overview contains the opinions of the McLaren Capital IMC and a variety of external analysts. The report does not represent a recommendation of any particular sectors or products. The information contained in the report is for information only and should not be considered investment advice. And the information within the report has been obtained from sources which although we believe to be reliable cannot be guaranteed. This is not a promotion of McLaren Capital's services.

The information in this market report is provided in good faith, and whilst every care has been taken in its preparation, no responsibility is accepted for any errors or omissions which, despite all precautions, it may contain. The investment consulting services referred to may not be suitable for all investors. The information in this report is limited to general information and does not constitute individual investment advice. Should you wish to discuss your specific financial circumstances, please contact us at info@mclarencapital.co.uk.

Certain products and services mentioned in this report are subject to the legal requirements and regulations of the relevant jurisdiction. This report is not intended to solicit an offer to buy or sell investments in any jurisdiction (including without limitation the United States of America).

This report is provided on an "as is" and "as available" basis. McLaren Capital makes no representations or warranties of any kind, whether express or implied. By using this report, you assume any and all risks that this report and any content in it may be incomplete, inaccurate, out of date or not meet your requirements. In no circumstances whatsoever can McLaren Capital be liable for any direct, indirect, punitive, incidental, special or consequential damages arising out of or in any way connected with the use of this report or any information that it contains.

Please do not reproduce wholly or in part, distribute or publish this document without the consent of McLaren Capital.