Lincoln Private
Investment Office
London

31 March 2017

Investment Letter – Q1 2017

The year started on a firm footing as the FTSE 100 hit an all-time high and the Dow Jones Industrial Average saw new peaks for 12 consecutive trading days. This may be something of a surprise when set against the backdrop of the inauguration of President Trump and the triggering of Article 50 by the UK government. So why did equity markets manage to rally to higher levels? Much of the move has been attributed to the 'Trump bump', which refers to investor confidence and the associated market strength on the back of optimism for his stance on taxation, infrastructure spending and reduced regulation. However, we believe the recent strength in some fundamental data, that had begun prior to Trump's election victory, was also a major feature. Most notable being the US job market, where headline data remained strong, with unemployment rates continuing to fall and positive wage growth. This, coupled with respectable corporate earnings results, helped support consumer and investor confidence.

Whilst from an economic standpoint the first months of the new US administration have passed relatively smoothly, it has, however, become increasingly apparent that Trump's ability to implement policy commitments may be somewhat constrained. Early evidence of this was the failure to repeal Obamacare. His views on protectionism and immigration, which many believe could hinder international trade and lead to increased tariffs globally, has raised concerns, in the short term at least, that the pro-growth story may have fed too far into market expectations and that there is more implementation risk than anticipated.

In the UK, equity markets have performed well, both in the aftermath of the referendum result, and more recently in the run-up to the triggering of Article 50. To a large extent this is due to the 10-15% depreciation of sterling. That said, now the official communication of the UK's exit from the EU has been delivered, we move into a period of uncertainty as the exit negotiations take place. The implications for UK asset prices remain unclear although it seems likely that this will continue to weigh on both sterling and sterling denominated assets.

After the political turmoil in 2016, we have to consider if there are further possible shocks on the horizon that could disrupt markets or cause a sudden change in investor, market or business sentiment. There has been much talk that the European election cycle is the next hurdle for markets to overcome. With the Netherlands, there was a potential precursor to another year of drama, but their election came and went with little noise. It also appears that the market is developing confidence that in France, Marine Le Pen will be unable to keep the populist success story on track. German and Italian elections loom, and whilst these could destabilise markets and alter allegiances, particularly within Europe, they seem unlikely to lead to the break-up of the European Union in the short term.

We have discussed interest rates and their impact on markets in these letters on a number of occasions. We have also highlighted our concerns about the unpredictability of Central Banks. This quarter was no different, as expectations that the Federal Reserve would increase US interest rates waxed and waned. This uncertainty is not unplanned; the intention is to make a market and ensure that the direction is known, but perhaps not the exact timing or destination. In the end, the Fed did raise rates a further 25 basis points in March and has indicated that further increases are on the horizon this year, but it has also incorporated comments about the need to shrink the size of its balance sheet. These actions, we believe, have led to the end of the bull market in fixed income securities. Although it will not be a straight line, it reinforces our conviction around a cautious approach to fixed income and leads us to seek out alternative investment approaches to add value. There is a meaningful risk that newer appointments to the Federal Reserve Board will want to pursue a more Trump-friendly agenda of faster rises to interest rates or even policy changes. An environment of rates moving much higher while GDP growth remains lacklustre is a combination that could weigh heavily on risk assets. It is this factor that we feel is likely to have more of an impact on both bond and equity markets than the inevitably watered down "deals" that President Trump can effect.

Interest rate expectations are inextricably linked with inflation. President Trump's proposed policies of tax cuts, increased spending on infrastructure, and the possible repealing of Dodd-Frank are all pro-business, but crucially are all also inflationary. The potential change of US trading relationships with major economies due to the protectionist policies suggested by the new administration will push up the price of goods and services in the US. With the unprecedented economic experiment of quantitative easing coming to a close, it is not clear how inflation will respond. We believe Central Banks will need to be extremely vigilant as the risk of them being behind the curve if inflation picks up in earnest could have a dramatic impact on financial assets.

This document has been prepared and distributed for information by Lincoln Private Investment Office LLP ("LPIO") and is a marketing communication. LPIO is authorised and regulated by the Financial Conduct Authority. The information in this document does not constitute an offer by LPIO to enter into a contract/agreement, nor is it a solicitation to buy or sell any investment. Nothing in this document should be deemed to constitute the provision of financial,
investment or other professional advice in any way.

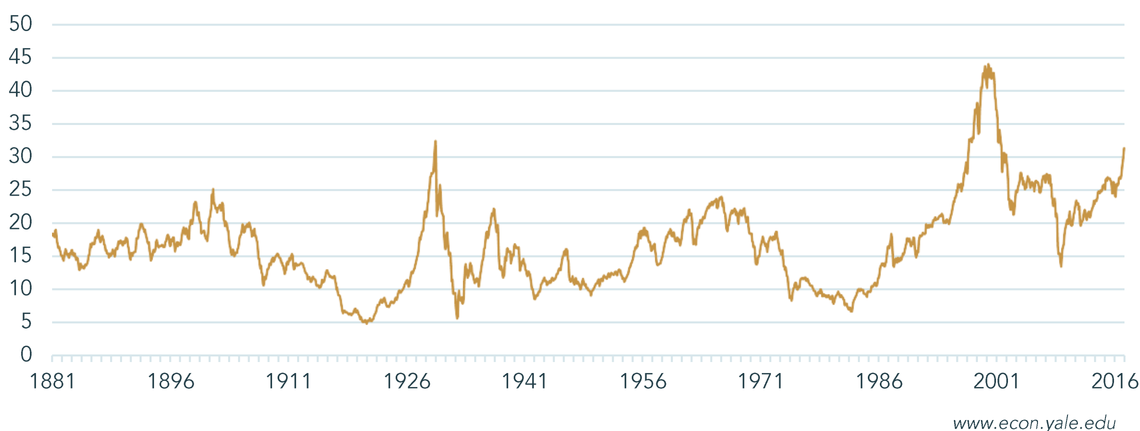
Lincoln Private
Investment Office

London

31 March 2017

With new highs being seen across US equity markets, valuations are looking particularly stretched. We spend a lot of time analysing historical valuations and the Cyclically Adjusted Price Earnings Ratio (one of the most widely accepted measure of equity market valuations) demonstrates that the US equity market has only been more expensive than it is now twice in the last 135 years, as shown in the chart below. This is not to say that it will not get more expensive in the short term, but on a comparative basis we prefer the risk return characteristics of other markets. Asian and Emerging equity markets are trading at a significant discount in both absolute and relative price terms. The continued growth in the middle class in those regions and associated increase in consumer spending are themes that will continue to develop. We see better opportunities in these parts of the world where we anticipate further reform and have positioned portfolios accordingly.

CAPE Shiller price/earnings ratio



As we have commented previously, we believe Central Bank policies over the last 9 years have driven inefficient capital allocation. One result of this has been the strong outperformance of growth stocks over value stocks. Growth stocks are companies whose earnings are expected to grow at a much faster pace than the industry average, such as certain technology companies. Value stocks, on the other hand, are companies with sound fundamentals, who are currently unloved by markets and as a result trade at a lower price/earnings ratio, therefore offering greater value. With markets stretched we prefer the relative safety offered by these types of companies and believe value stocks will begin to outperform going forward.

In a time where a tweet can have the power to move markets, and fake news has become news, it remains difficult to filter through the noise. For a number of years, politics and fundamentals have played second fiddle to Central Banks, however, are we now moving back into a world where these factors begin to drive markets again and geopolitical risk will impact markets? Against this backdrop, we continue to maintain a cautious view of the world and have positioned ourselves to participate in as much of the upside as possible, but without exposing portfolios to excessive risk. We hold investments that provide protection for portfolios and will look for opportunities where the balance of risk and return is appropriate.

Fred Hervey
Chief Investment Officer

This document has been prepared and distributed for information by Lincoln Private Investment Office LLP ("LPIO") and is a marketing communication. LPIO is authorised and regulated by the Financial Conduct Authority. The information in this document does not constitute an offer by LPIO to enter into a contract/agreement, nor is it a solicitation to buy or sell any investment. Nothing in this document should be deemed to constitute the provision of financial,
investment or other professional advice in any way.