‘The Times, they are a-changin’ – Bob Dylan, 1964

2016 has been a momentous year politically and economically. Below we highlight key events over the last 12 months and assess their impact on stock markets before turning our attention to what might await us in 2017

Politics drives sentiment

More than most years, politics has dominated news flow in 2016. Firstly, Brexit, when the UK voted in June to leave the EU after more than 40 years’ membership. Secondly, and *most importantly*, the election of Donald Trump as the 45th US President in November following a bruising campaign against Hillary Clinton. Both results reflect growing populism among voters as well as distrust of globalisation and disdain for ruling political establishments.

In the UK, Brexit led to political fall-out with David Cameron’s resignation as Prime Minister and disarray among Labour politicians. Theresa May quickly succeeded as the new Prime Minister, filling the political vacuum, but her Government is now tasked with preparing the ground for the UK’s exit from the EU through triggering Article 50 of the Lisbon Treaty. Negotiations are likely to be long and difficult with EU politicians, keen to maintain the 'four freedoms', underpinning the Union and Single Market: ***freedom of movement of goods, people, services and capital over borders***. Moreover, EU politicians are unlikely to concede much ground, wary of populist movements in the Eurozone which are likely to make headway in forthcoming political elections in 2017 in Holland, Germany and France, potentially triggering similar ‘Brexit’ referenda in those countries.

‘Making America Great’

It is events in the world’s largest economy, America, which are most relevant to us all. Together with achieving Republican majorities in the Senate and Congress, Donald Trump was elected US President on a ticket to ‘pump prime’ the economy through a policy of fiscal expansion, estimated at $1trillion, consisting of tax cuts for ordinary people and companies plus increased expenditure on infrastructure (roads, bridges etc) and defence. Trump’s policies are undoubtedly ‘pro-growth’, but there is still precious little detail, which, along with pre-election promises of protectionist tariffs on imports, is not helpful. As President-elect Trump assembles his team, we must ‘wait and see’ how he acts after inauguration.

Central Banks running out of fire power

Ever since the financial crisis of 2008, Central Banks have been at the forefront of reviving the global economy through their policy of Quantitative Easing (QE), whereby interest rates are suppressed to encourage bank lending, investment across economic assets and, ultimately, economic growth. QE has been most successfully employed in the US, where the Federal Reserve has engineered economic recovery such that it is now able to *raise* interest rates – its latest hike this month – unlike the rest of the developed world. Elsewhere, implementation of QE has been mixed: in the UK, it has been moderately successful, but for Japan and the Eurozone, both regions remain mired in sluggish economies. Indeed, economic growth rates in developed economies generally remain below pre-2008 levels, and with interest rates also extremely low - in some cases below zero – QE’s effectiveness looks exhausted. In its place, Governments are turning to the ‘Keynesian’ model, combining tax cuts with public expenditure on infrastructure and defence to boost economic growth, whilst abandoning budget austerity.

The US will lead fiscal expansion, followed by the UK, where the Government’s recent announcement to increase public expenditure is expected to add 0.4% annually to economic growth. However, substantial injections of cash into economies will, in all probability, have inflationary consequences, which, in turn, may result in higher interest rates. The Federal Reserve is already pencilling in further rate hikes in 2017 in anticipation of higher prices.

Stock Markets end volatile year on a high

Against a backdrop of heightened political risk, global stock markets proved resilient, reaching record levels in America and the UK.

UK investors enjoyed a particularly strong year, both from domestic and overseas markets, with returns significantly enhanced by sterling's sharp depreciation post-Brexit. In the first six months, so-called 'bond proxy' shares in dividend paying sectors like utilities, telecoms and pharmaceuticals, performed well ahead of the uncertainty surrounding the Brexit referendum. In the second half of 2016, the tide turned against these shares in favour of cyclical areas like banks, insurance, construction and media as markets started to price in the likely effect of expansionary Government policies.

For most of 2016, government and corporate debt markets rose in unison with equities, but again, this trend has come to an end, at least temporarily, as investors have started to sell down debt after taking account of the probable inflationary consequences of sterling's fall, high levels of employment and expanding public expenditure. Elsewhere, the price of oil staged a dramatic recovery. In January it fell to a generational low, but has since risen over 48% in dollar terms, thanks in part to OPEC's agreement to cut production. Amid the political uncertainty ahead of Brexit and the US election, gold rallied.

Asset Performance Table - 2016	
Equities [1]	
United Kingdom	**17.0%**
North America	**33.3%**
Europe ex UK	**15.7%**
Japan	**22.3%**
Pacific ex Japan	**27.0%**
Emerging Markets	**30.6%**
Government Debt	
UK Gilts [2]	**7.5%**
US Treasury (US$) [3]	**1.7%**
Commodities	
Brent Crude (US$)	**48.2%**
Gold (US$)	**7.3%**
Currency Markets - Sterling vs Major Currencies	
Sterling	**0.0%**
Dollar	**18.6%**
Euro	**13.6%**
Yen	**20.5%**
[1] MSCI Indices, [2] FTSE Actuaries UK Conventional Gilt All Stocks Index, [3] US 10 Year Treasury	
All figures - cumulative total return, sterling adjusted unless stated, for period 31 December 2015 to 16 December 2016	
Source - FE Analytics	

2017: Time to Deliver

Next year promises continued geopolitical risk, particularly in the Eurozone. On the one hand, the UK intends to trigger Article 50 by end of March so that it can start negotiating in earnest Britain's exit from the EU, while, on the other, Holland, Germany and France are due to hold elections which could see significant gains for populist, Eurosceptic parties, putting further strain on the Union.

From an economic perspective, all eyes will be on Donald Trump's fiscal stimulus measures, designed to accelerate economic growth and, thereby, boost the health of US businesses and households. Observers will also be keen to see the extent to which Trump applies campaign views on protectionism and reducing the burden of regulation. The proposed scale of stimulus, along with the Federal Reserve's interest rate hikes, serve to underline divergent economic policies between the US and the rest of the developed world.

On a valuation basis, we regard equities as more attractive than bonds and expect to retain this position across our portfolios for the foreseeable future. We, nevertheless, anticipate periods of volatility, either for political or economic reasons, which may favour one asset class over another.

Season's Greetings! And best wishes for a happy and healthy New Year!