Market Commentary for the Period 1st October 2017 – 31st December 2017

Global equity markets were strong over the quarterly period, in broad terms. In the US, President Trump passed substantial tax cuts benefiting businesses and the majority of the American people at the expense of widening the budget deficit. The UK made further progress with Brexit negotiations although the divorce bill was much higher than planned. Political tension rose in Spain following the Catalonian vote on independence, while in Japan there was a solid victory for the incumbent Prime Minister in a snap election. Fixed income markets varied following rising interest rates and a general reduction in stimulus from the major developed economy central banks.

US equity markets performed well with the market grinding higher consistently over the period. Senators passed President Trump's tax cuts bill, marking the largest tax overhaul since the 1980s. The changes saw a sharp cut in corporation tax which the Senate committee expected would add around $1 trillion to the budget deficit. The Democrats were quick to criticise stating the cuts only benefited big businesses and the wealthy.

The Federal Reserve raised interest rates by a further 0.25% in their December meeting. This marked the fourth and final interest rate rise over the year and the central bank forecasted a further 3 interest rate hikes over 2018. Multiple improvements in the economic backdrop were mentioned in their statement including; a strengthening labour market, rising economic activity, expansion in household spending and growth in business investment. US third quarter GDP rose to 3.2% q/q (annualised), the highest growth rate in over 2 years, with government spending revised much higher than expected. Inflation rose to 2.2% y/y in November led partly by rising energy prices. Unemployment was unchanged at 4.1% in November, remaining the lowest jobless rate since early 2001.

UK equity markets produced attractive returns, with the market particularly gaining traction over the month of December. Prime Minister May and the European Commission agreed in principle on a "divorce bill" of between €40 billion and €60 billion, significantly higher than the original €20 billion stated by the Prime Minister in September. It was also agreed that EU citizens living in the UK (and vice versa) would have their rights to live, work and study protected. UK Brexit Secretary David Davis announced that MPs would get to vote on the final deal before the UK leaves the European Union, meaning that the terms of exit would need to become law via new legislation.

The Bank of England raised interest rates by 0.25% in their November meeting, marking the first rise in over 10 years. This adjustment was widely anticipated by the market following earlier comments from the Governor around the risk of building inflation pressures. The bank noted that the decision to leave the EU was having a noticeable impact on economic growth and that this would be taken into consideration with future decisions from the central bank. UK third quarter GDP rose to 0.4% q/q following a boost in household consumption. Inflation rose to 3.1% y/y in November marking the highest rate since March 2012. This was driven mainly by rising prices for transport, leisure activities, restaurants, hotels, housing and food. Unemployment was unchanged at 4.3% in October remaining at a 42 year low.

European equity markets were broadly flat over the period following disruption in the Spanish region of Catalonia and elections in Germany. In Spain, around 2.3 million people voted illegitimately on the independence of Catalonia with around 90% voting in favour. The Catalan President was eager to work towards a unilateral declaration of independence shortly following the vote, however the Spanish Prime Minister Rajoy triggered article 155. This allowed the Spanish government to assume direct rule over any of the country's autonomous regions in a crisis scenario. A number of regional ministers were held in custody for rebellion, sedition and misuse of public funds. Catalonia then held regional elections where 3 separatist parties won a slim majority vote causing further disruption. In Germany, Chancellor Merkel failed to secure a coalition government following a breakdown in negotiations with the Free Democratic Party due to disagreements on policy. A coalition government is yet to be formed.

In their October meeting, the European Central Bank agreed to reduce the level of monthly stimulus from January 2018 and to continue at the new level until at least September. The Central Bank President Mario Draghi commented that this was a reflection of their growing confidence that inflation was returning to their target and took into account broad based economic expansion. European third quarter GDP fell to 0.6% q/q, held relatively steady by household consumption, fixed investment and exports. Inflation rose to 1.5% y/y in November, with energy costs rising at a faster rate. Unemployment fell to 8.8% in October marking the lowest rate since January 2009.

Japanese equity markets were strong driven in part by political stability following a favourable election result. Shinzo Abe won a large majority on behalf of the Liberal Democratic Party in the general election, allowing him to proceed with aggressive economic policy measures. In their latest meeting, the Bank of Japan maintained interest rates and existing levels of stimulus. In their statement they re-iterated the expectation of a moderate expansion in growth, as well as an increase in inflation towards their 2% target. Japanese third quarter GDP fell to 0.6% q/q. This was the seventh straight quarter of growth buoyed by exports and increasing business spending. Inflation rose to 0.6% y/y in November driven largely by an increase in transport costs. Unemployment fell to 2.7% in November marking the lowest rate since late 1993.

Emerging markets performed well following a large rise in the oil price and a number of changes implemented by central banks. OPEC agreed to extend the existing 1.2 million barrels a day of production cuts until the end of 2018. The decision was expected to further tighten the oil market and is seen as an upside factor for oil prices generally. Chinese third quarter GDP fell to 6.8% y/y dragged lower by a much weaker rise in fixed asset investment. Multiple central banks across emerging economies altered interest rates. Rates were cut by 1.25% and 0.75% respectively in Brazil and Russia in order to combat low inflation and support their economies. Conversely, rates were hiked in Mexico by 0.25% given a rise in inflation to a near 16 year high.

In fixed income markets, both the UK and US central banks increased interest rates over the period, although bond yields shifted in opposite directions, falling in the UK and rising in the US albeit only marginally. There was however some disparity in the statements from both central banks with the US Federal Reserve broadly positive on the economic backdrop and the Bank of England hesitant on growth taking Brexit into account. Yields on UK, US and German 10 year bonds ended the quarter at 1.19%, 2.41% and 0.43% respectively.