Market Commentary for the Period 1st January 2018 – 31st March 2018

Global equity markets suffered with most regional markets flat or negative over the quarterly period. Much of the financial press was focused on President Trump's plans to enforce tariffs on a number of countries, later sparking concerns of a potential trade war with China. Whilst this was certainly an adverse market event, the prospect of multiple central banks raising interest rates faster than expected was a discreet development encouraging market volatility. Fixed income markets were not immune to the wider market declines, as bond prices adjusted to higher interest rate expectations.

US equity markets held up well on a relative basis despite a number of unfavourable announcements in the region. Speaking at his first semi-annual monetary policy testimony, the new central bank Chairman Jerome Powell signalled that the central bank could hike interest rates by a greater extent taking note of strong economic growth and need to control inflation. President Trump announced plans to impose tariffs on steel and aluminium imports. Canada and the EU (where the US imports most steel from) responded by bringing forward their countermeasures. Much of the attention was drawn to China where tariffs of up to $60bn on Chinese imports would be enforced. This was after the Trump Administration determined the country was encouraging theft and transfer of intellectual property from US businesses. China responded by saying they would look to apply tariffs of up to $3bn on US imports. Days later, Trump's Economic Adviser resigned noting that he was an advocate of free trade. Fears of a potential trade war outbreak had a negative impact on markets.

The US Federal Reserve raised interest rates by 0.25% over the period with the central bank commenting on continued strength in the labour market and rising economic activity. They raised their economic growth forecasts for 2019/20 leading the market to raise expectations for further interest rate rises. US fourth quarter GDP fell to 2.9% q/q (annualised), despite being higher than market expectations. Inflation rose to 2.2% y/y in February led by rises in fuel oil, transportation services, energy and apparel. Unemployment was unchanged at 4.1% for the fifth consecutive month, remaining a 17-year low.

UK equity markets suffered fair losses over the period with the market failing to recover from the end of January sell-off. One factor working against the UK market was the strength in pound sterling, particularly against the US dollar. This is due to the amount of revenue the UK market earns from overseas, which is worth less when converted back into sterling. Prime Minister May rejected the EU's draft legal agreement which proposed keeping Northern Ireland in a customs union, effectively creating a new border in the Irish Sea. The UK and EU later agreed on a transition deal which would lead to the orderly withdrawal of the UK. The deal included EU citizens' rights, detail on trade, fishing policy and Northern Ireland to stay in parts of the single market and customs union.

The Bank of England maintained interest rates and stimulus over the quarter. They outlined in their most recent meeting that inflation was expected to ease in the short-term but remain above the 2% target. They upheld their view that further interest rate rises would be necessary to tame inflation, although this would be a gradual move. UK fourth quarter GDP fell to 0.4% q/q following slowing business investment and fall in net trade. Inflation fell to 2.7% y/y in February, the lowest rate since July 2017. UK unemployment fell to 4.3% marking the lowest rate in 42 years.

European equity markets ended the quarter lower, in line with broader equity markets. The populist 'Five Star Movement' achieved around one-third of the votes in the recent Italian general election. There were discussions around the party joining forces with the other populist 'Lega Nord' to form a majority, although sceptics outline the ideological differences between the two parties. In Germany, a coalition deal was agreed between Angela Merkel's CDU party and the SPD ending five months of political deadlock.

The European Central Bank left interest rates unchanged and reaffirmed that current stimulus levels would continue until the end September. The central bank did however remove one reoccurring line from its statement which outlined that they would be 'ready to increase the asset purchase programme in terms of size and/or duration'. They felt the outlook for growth to be greater than previously expected in the near term and inflation will move towards the 2% target in the medium term. Key risks to the growth outlook include primarily global factors, including rising protectionism and FX/other financial market developments. European fourth quarter GDP fell to 0.6% q/q following softer growth from Germany, Italy, Greece and Latvia. Inflation fell to 1.1% y/y in February marking the lowest rate since December 2016 driven largely by lower costs for food, alcohol and tobacco. Unemployment was unchanged at 8.6% in January, remaining a 9-year low.

Japanese equity markets were in decline with no major positive data surprises able to elevate prices. The Bank of Japan maintained interest rates and left its stimulus programme unchanged over the period by unanimous vote. The central bank remained relatively upbeat in their statement highlighting increasing exports and business investment, as well as improving corporate profits and business sentiment. They reiterated that highly accommodative policy measures would continue until inflation reached its target rate sustainably. Japanese fourth quarter GDP fell to 0.4% q/q marking the eighth consecutive quarter of expansion. Inflation rose to 1.5% y/y in February jumping to the highest rate since March 2015 following higher transport and food costs. Unemployment rose to 2.5% in February.

Emerging market equities sustained the global equity market sell-off to end the quarter broadly unchanged. Vladimir Putin won a six-year term as Russian President with over 76% of the vote. This victory extended his expected time in office to almost 25 years. There were various changes amongst emerging economy central banks. Interest rates were cut in South Africa, Russia and Brazil by between 0.25 - 0.50% with all citing lower inflation as a key contributing factor. Conversely, interest rates were raised in Mexico by 0.25% amid persistently higher inflation. Chinese GDP was announced at 6.9% over the 2017 period, well above the government's target of 6.5%. Strong industrial growth, higher exports and a resilient property market were all core drivers of economic growth.

In fixed income markets, bond yields were broadly higher as the market priced in further expected interest rate hikes across the US and UK, which had an adverse effect on bond prices. Credit markets were also negatively impacted by the wider risk-off sentiment in the market. Yields on UK, US and German 10 year bonds ended the quarter at 1.35%, 2.74% and 0.49% respectively.