Market Commentary

Market Commentary for the Period 1st April 2017 – 30th June 2017

Global equity markets were strong in broad terms in an active quarterly period. Politics was a key area of focus over the quarter with further controversy from President Trump, elections in France and the UK, Greek debt discussions and a corruption scandal in Brazil. Economic data was mixed alongside an assortment of action and comments from the world's leading central banks. While the US and the UK were generally less reliant on stimulus, Japan and Europe stressed that a high degree of monetary support was necessary to build inflationary pressures and support growth. Fixed income markets were also mixed, with bond prices reacting primarily to the rhetoric of central bank leaders and committee members.

US equity markets posted decent gains amid a period of presidential disputes, an interest rate rise and weaker economic growth. President Trump caused further controversy following multiple announcements over the quarter. He continued to express that he would look to expand lending through reigning back Dodd-Frank legislation. There was an increase in conflict following a missile strike in Syria and ordering a navy fleet towards the Western Pacific following concerns of a nuclear attack from North Korea. Trump withdrew the US from the 2015 Paris Climate Change Agreement and later fired FBI director James Comey over his handling of the inquiry into Hilary Clinton's emails. The Democrats were quick to suggest that this was due to the FBI investigating links between the Trump campaign and Russia.

The US Federal Reserve raised interest rates by 0.25% and indicated that they would look to raise once more by year end. Their decision was based on labour market conditions and inflation which were in line with their expectations. The central bank also added that they would be looking to normalise levels of stimulus by reducing the size of their balance sheet. US first quarter GDP fell to 1.4% q/q (annualised) driven by lower non-residential investment and inventories relative to initial estimates. Inflation fell to 1.9% y/y in May driven by a slowdown in energy, services, shelter, transportation and medical care. Unemployment fell to 4.3% in May marking the lowest jobless rate since May 2001.

UK equity markets were broadly flat over the quarter in a lively political environment elevating investor uncertainty. Prime Minister May made the surprising announcement of a general election in order to acquire more seats in Westminster, as well as avoiding the next election running over key Brexit negotiations. The election resulted in a hung parliament, with the conservatives winning 318 seats of the 326 required leading them to form a coalition with the Democratic Unionist Party of Northern Ireland. As part of the deal, there would be an extra £1bn funding set aside for Northern Ireland over the next 2 years. The first round of Brexit negotiations commenced later in the quarter with the initial focus on expat rights, a financial settlement and other separation issues which were said to have got off to a 'promising start' by UK Brexit Secretary David Davis.

The Bank of England maintained interest rates at their most recent meeting, although more committee members voted to raise rates. This was taking into account macroeconomic data including inflation rising above target. Later in the quarter, one bank committee member expressed that a rise in the interest rate would be justifiable in the second half of 2017, while the Governor Mark Carney felt that current economic data was not strong enough to consider tightening policy. UK first quarter GDP fell to 0.2% q/q which marked the weakest quarterly growth rate in a year driven partly by a slowdown in household spending. Inflation rose to 2.9% y/y in May, surpassing expectations to reach a near 4-year high. This was driven by multiple factors including rising costs of games, toys, holidays abroad, food, clothing and electricity. Unemployment fell to 4.6% in April to reach a 42-year low, while the employment rate reached an all-time high.

European equity markets ended the quarter fairly level as earlier gains were erased later in the period. In the French election, centrist Emmanuel Macron defeated far-right Marine Le Pen with 66% of the votes in the second round. He became the country's youngest president aged 39 and the first president outside the two main traditional parties since 1958. In his speech, he commented that he would guarantee the unity of the nation as well as defend and protect Europe. Eurozone finance ministers initially failed to agree a relief plan for Greece which would prevent the country defaulting on its debt payment due in July. Following further meetings, they later agreed to disburse €8.5bn of funds as the IMF agreed they would provide some limited support.

The European Central Bank set a dovish tone in their most recent meeting, outlining that interest rates are expected to remain low for 'an extended period of time' and that substantial stimulus is still needed to build underlying inflationary pressures. Eurozone first quarter GDP rose to 0.6% q/q, having been revised higher from previous estimates. This was boosted largely by fixed investment and household consumption. On a regional basis, Eastern Europe continued to show the greatest levels of economic growth, while larger economies in Western Europe drew overall growth lower. Inflation fell to 1.4% y/y in May as fuel, heating oil and telecommunication costs fell further. Unemployment fell to 9.3% in April with the rate declining for around 4 years. Greece and Spain continue to hold the highest levels of unemployment at 23.2% and 17.8% respectively.

Japanese equity markets delivered strong returns, supported by a commitment of large monetary stimulus by the central bank. In their most recent meeting, the Bank of Japan reiterated that they would continue with their financial stimulus plans until there was a sufficient and sustainable rise in inflation above target. In their statement, the bank remained positive on the path of moderate economic growth but acknowledged a number of potential risks. Japanese first quarter GDP remained at 0.3% q/q with the rate unchanged for 3 consecutive quarters. While capital expenditure was revised higher, it was not enough to offset weaker private consumption. Inflation remained at 0.4% y/y in May as higher electricity costs were offset by falling prices in fresh fruit and vegetables. Unemployment rose to 3.1% in May, meanwhile, the number of jobs to applicants ratio reached the highest level since February 1974.

Emerging markets performed well in a period of multiple interest rate cuts, stronger Chinese economic growth and the potential for mass infrastructure spending. Chinese President Xi Jinping proposed the Belt and Road initiative at a summit in Beijing. This would recreate the trading routes of old overland and sea through central Asia and wider Europe spanning across at least 65 countries including over 60% of the world's population. The project was estimated to cost $900bn, making it one of the most expensive development projects in history. OPEC agreed to extend oil production cuts until March '18 to support the balance of supply and demand. Despite extending production cuts shortly due to expire, oil prices fell as many market participants expected greater cuts to be announced. In Brazil, in less than 10 months in office, President Michel Temer was reported attempting to bribe a witness in a large corruption scandal involving the oil company Petrobras. Opposition politicians called for a snap election and impeachment while hundreds of protestors gathered in Sao Paulo.

Chinese first quarter GDP rose to 6.9% y/y to reach the strongest expansion since September 2015 driven by higher industrial output, retail sales, fixed asset investment and surging fiscal spending. Multiple central banks across emerging economies cut interest rates including; Chile, Russia and Brazil where rates were cut by 0.25%, 0.5%, and 1% respectively to stimulate growth. While rates were raised in Mexico by 0.25% to curb rising inflation. Credit ratings agency S&P cut South Africa's credit rating one notch to BB+, technically assigning the country 'junk' status. This was following President Zuma dismissing the country's finance minister and concerns over government debt. Later, ratings agency Moody's downgraded China's rating one notch, citing that financial strength is expected to erode over the coming years driven by rising debt.

In fixed income markets, there was a mix of rising and falling bond prices which reacted more to comments rather than action from the developed world central banks. In the UK, higher inflation and more votes to raise interest rates supported a rise in bond yields having an adverse impact on prices. While in the US, despite the central bank raising interest rates and proposing to tightening stimulus, bond yields fell slightly over the quarter. Yields on UK, US and German 10 year bonds ended the quarter at 1.26%, 2.30% and 0.46% respectively.