Market Commentary for the Period 1st April 2018 – 30th June 2018

Global equity markets were divided over the quarter with gains across developed markets and weakness among Asian and emerging markets in broad terms. Political uncertainty was widespread with escalating tensions from the US over trade tariffs, an uneasy coalition government in Italy, the Spanish Prime Minister being forced out of office and close voting between ministers in the UK over Brexit. Fixed income markets were largely influenced by changing expectations over interest rates. Government bonds generally held up well relative to those issued by corporates indicating investor preference for safety.

US equity markets delivered strong returns over the period despite escalating political tensions. The Trump Administration enforced sanctions on 24 Russian oligarchs and 12 companies to punish the country for actions in Crimea, Ukraine and Syria as well as attempting to overthrow Western democracies. President Trump later withdrew the US from the Iranian nuclear deal which imposed a range of restrictions on Iran's nuclear activities. He also re-imposed the highest level of economic sanctions on Iran. Conversely, Trump and Kim Jong-un signed a brief declaration on denuclearization in their joint summit. Trump confirmed that US sanctions would remain in place until North Korea removed their nuclear activities. He later implemented trade tariffs consisting of a 25% tariff on steel and 10% tariff on aluminium imports. The European Commission confirmed that they would look to impose rebalancing measures and take any necessary steps to protect the EU market from trade diversion. Further trade tariffs were implemented against China due to alleged intellectual property theft to which the Chinese government vowed to respond with retaliatory measures.

The US Federal Reserve raised interest rates by a further 0.25% over the period marking the 7th interest rate hike from the lowest point. In their most recent statement the central bank acknowledged that the labour market had continued to strengthen and economic activity was rising at a solid rate. Policymakers projected a further two hikes by the end of 2018. US first quarter GDP fell to 2% q/q (annualised) which was revised lower due to weaker than expected personal consumption and business inventories. Inflation rose to 2.8% y/y in May marking the highest rate since February 2012 driven largely by rising fuel and shelter costs. Unemployment fell to 3.8% which was the lowest rate on record since April 2000.

UK equity markets produced significant gains, recovering the losses from the previous quarter. MP's debated and voted on 15 amendments to the EU Withdrawal Bill. They voted to reject an amendment which would have allowed parliament to block a 'no deal' Brexit. The Bank of England maintained interest rates over the quarter although one extra member of the committee voted for a rate rise which brought forward market expectations for the next hike. The central bank commented in their statement that policy tightening would likely be appropriate to lower inflation to its target range. That said, any future interest rate rises would be gradual and limited. UK first quarter GDP fell to 0.2% q/q partially driven by lower business investment. Inflation remained at 2.4% y/y in May and unemployment was unchanged at 4.2%, the lowest rate in over 42 years.

European equity markets ended flat after a period of political volatility and loosening monetary policy. Following months of political deadlock, populist parties the League and Five Star Movement agreed a coalition government in Italy. The coalition announced Giuseppe Conte as the country's next Prime Minister. Initially, the ruling President Mattarella vetoed their choice of finance minister which the coalition later changed. The Spanish Prime Minister Rajoy was forced out of office by a no confidence vote in parliament and Socialist leader Sanchez took over as Prime Minister.

The European Central Bank made no changes to policy but did confirm that they would reduce their quantitative easing program from September to December, at which point it would end. In their statement, they stated interest rates would likely remain unchanged at least through the summer of 2019. European first quarter GDP fell to 0.4% q/q with net trade detracting from overall growth. Inflation rose to 1.9% y/y in May driven predominantly by higher oil prices. Unemployment fell to 8.5%, the lowest rate since December 2008.

Japanese equity markets posted strong returns amid an environment of mixed economic announcements. The Bank of Japan left policy unchanged reiterating that their stance of monetary easing would remain until inflation was sustainably above their target rate. Japanese first quarter GDP fell to -0.2% q/q which was the first contraction recorded since the fourth quarter of 2015. A rise in business spending was more than offset by an unexpected decline in household consumption. Inflation rose to 0.7% y/y in May led by higher costs for food and transport. Unemployment fell to 2.2%, the lowest rate since October 1992. The number of jobs available to each applicant reached its highest level since January 1974.

Emerging market equities suffered losses with foreign capital flows experiencing a sharp reversal. Interest rates were raised across a number of emerging economies including Mexico, Turkey and India with the aim of either supporting the domestic currency or tackling higher inflation. Argentina's central bank raised interest rates for the third time over eight days to 40% in an attempt to support the falling peso currency. The IMF later agreed to provide a $50bn loan over a 3 year period to Argentina to provide financial support and bolster market confidence. China's central bank announced that they would be reducing their reserve requirement ratio (money required to be kept on hand by banks) releasing around $108bn of funds to use the day before US trade tariffs would be implemented on China.

In response to President Trump's sanctions, Iran prepared to restart uranium enrichment, a process key for the production of nuclear energy and weapons. The oil price rose sharply following the announcement on supply concerns. Conversely, South Korea and North Korea agreed a peace treaty to work towards de-nuclearization of the Korean Peninsula after a summit between leaders. This followed over 30 years of North Korean missile tests and over 10 years since a presidents' meeting.

In fixed income markets, bond yields across developed markets changed to largely reflect expectations on interest rates leading to mixed returns. In the UK, yields fell taking account of a large shift earlier in the quarter where a combination of weak economic data and comments from the Governor extended out expectations for rate rises. On the other hand, the US central bank raised interest rates with policymakers expecting two further hikes this year. Bond spreads rose leading to losses which could be interpreted as investors having a preference for the safety of governments rather than corporates. Yields on UK, US and German 10 year bonds ended the quarter at 1.27%, 2.85% and 0.30% respectively.