Market Commentary for the Period 1st October 2018 – 31st December 2018

Global equities were negative over the period with China and other emerging markets generally performing better than developed market equities. Rising concerns of a global slowdown, further interest rate hikes, rising geopolitical concerns, and the removal of stimulus from central banks, all contributed to a sell-off for risk assets. The slowdown in China was a key theme in the period as economic growth and a number of other key indicators slowed. Pressure remains on China from the trade dispute with the US and also from a strong dollar. President Trump lost control of the house to the Democrats in the US mid-term elections meaning further fiscal stimulus in the US would be less likely. The Federal Reserve (Fed) continued along its path of raising rates and quantitative tightening which have been a headwind for markets. Fixed income markets were negatively impacted by expectations for interest rates.

US equity markets ended the period in negative territory despite macroeconomic indicators remaining fairly strong. Concerns of the sustainability of US growth started to set in as earnings reports began to disappoint while the Fed continued with monetary tightening. The segment of growth stocks that have driven US markets higher in recent years fell heavily on concerns they would not meet investor expectations following a decline in their outlook. President Trump publicly criticised Jay Powell, the chair of the Fed, stating policy was too tight and that further rate hikes would be a "mistake" threatening the US economy (and by implication the uptrend in US stock markets). There were further developments on the trade war with China at the G20 summit in Buenos Aires in December as President Trump met with General Secretary Xi Jinping. The US agreed to a 90 day deferral in planned tariff increases to allow more constructive negotiations to take place. China outlined its intention to buy a 'very substantial' amount of agriculture, energy and other goods from the US to reduce the trade imbalance. In December, a dispute between Democrats and Trump over funding for a border wall led to a partial US government shutdown.

The Fed hiked interest rates by 0.25% to 2.50% in the quarter despite heavy criticism from President Trump. This was on the back of solid economic growth and a strong labour market. But forecasts for 2019 saw the expectation of two further rate rises rather than the previously estimated three. Quantitative tightening continued in order to reduce the size of the Fed's balance sheet. US third quarter GDP was reported slightly lower at 3.4% with net trade dragging on growth more than initially estimated. Inflation fell to 2.2% y/y in November making it the lowest reading since February. This followed falls in the price of oil and gasoline which offset increases in costs of shelter, used cars and trucks. Unemployment remained at 3.7% in November, a 49-year low.

UK equity markets closed the period in the red with Brexit uncertainty continuing to deter investors. Sterling has remained volatile through Brexit developments and ended the period back to recent lows against the US Dollar. Prime Minister May finally concluded a draft withdrawal agreement with the EU but postponed the House of Commons vote until the New Year as a defeat seemed likely. Dominic Raab resigned from his post as Brexit Secretary citing concern over the regulatory regime proposed for Northern Ireland and the planned "backstop" arrangement. Tory backbenchers initiated a vote of

no confidence in the Prime Minister which she won decisively. At year end, the position was therefore that the Article 50 period expires on 29th March 2019 with May's withdrawal agreement, or an amended version of it, being ratified, or the UK exiting the EU with "no deal". But the UK Parliament had been increasingly vocal in seeking out other possible solutions.

The Bank of England held its rate at 0.75% by unanimous vote in their December meeting. They stated that uncertainty around Brexit had intensified considerably and that the near-term outlook for global growth had softened with inflation expected to fall below the 2% target in coming months, primarily due to the falling oil price. UK third quarter GDP was confirmed at 0.6% q/q. Household spending and exports were the main drivers of growth while business investment had fallen over three consecutive quarters. Inflation fell to 2.3% y/y in November, the lowest rate since March 2017, mainly due to the cost of transport, food and non-alcoholic beverages. Unemployment remained at 4.1% in October, with the number of job vacancies near an all-time high. Average weekly earnings also saw their biggest rise since July 2008.

European equity markets also posted negative returns over the period. France saw the rise of its own populist movement, the "Yellow Vests", protesting against inequality in the country as support for President Macron reached new lows. The European banking sector suffered over the period due to its exposure to emerging markets and further money laundering scandals, with Danske Bank and ING being punished by the regulators. The populist government in Italy proposed an increase in its budget deficit to 2.4% of GDP causing friction with EU authorities. The European Central Bank (ECB) maintained interest rates but confirmed they would commence the reduction of stimulus at their most recent meeting with quantitative easing stopping at the end of 2018. The ECB also highlighted they expect rates to remain at record low levels until at least mid-2019. European third quarter GDP fell to 0.2% q/q due to a negative contribution to external demand, making it the weakest growth rate since Q2 of 2014. Inflation fell to 1.9% y/y due to a broad based price slowdown making it the lowest inflation rate in six months. Unemployment remained at 8.1% in September remaining the lowest jobless rate since late 2008.

Japanese equity markets also declined over the period. The Bank of Japan left its interest rate unchanged at its December meeting and maintained their upbeat view on the domestic economy. Japanese third quarter GDP fell to -0.6% q/q, with natural disasters having weighed on personal consumption and capital investment more than initially estimated. Inflation declined to 0.8% y/y in November due to slower growth in food prices, cost of transport and housing. Unemployment increased slightly in November to 2.5%.

Emerging market equities were mostly negative over the period. The strengthening dollar, concern arising from the ongoing trade dispute between China and the US, and signs of a slowdown taking hold in the Chinese economy, impacted returns over the period. Agreement to talks between US and China in early 2019 raises some hope of progress on resolving trade issues. Brazil outperformed other emerging markets over the period as the market rallied following the election of President Bolsonaro with the Brazilian Real strengthening on the result. Bolsonaro is seen as market friendly given his agenda to simplify taxes, privatise state-owned enterprises and implement pension reform, which should see Brazilian debt decline. Interest rates rose across a number of countries, including Russia and Thailand, which saw rates rise by 0.25% to 7.75% and 1.75% respectively. Mexico saw a greater increase of rates over the quarter of 0.5% to 8.25%

In fixed income markets, bond yields fell for a number of developed economies. This was despite a rate rise from the Fed as fears of a global slowdown and mild inflationary pressures drove safer government bond yields, including US treasuries, down from recent peaks. The US yield curve flattened over the period causing speculation that the US economy may be on a path to recession, although not supported by current data. Italian government bond yields declined from their recent spike after a climb down by the Italian government in budget deficit discussions. Sterling suffered

over the period amidst further disagreement around Brexit, the Dollar maintained its strength and the Euro was volatile around a variety of political issues across the member states, notably France and Italy. Yields on UK, US and German 10 year bonds ended the quarter at 1.21%, 2.69% and 0.18% respectively.

Past performance is not a guide to future performance. The value of investments and any income from them can fall as well as rise and is not guaranteed. The comments in this Market Commentary are based on our views at 9th January 2019. These views are subject to change. They are for information only and do not contain any forecasts or recommendations.

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