Market Commentary for the Period 1st April 2019 – 30th June 2019

Global equity markets were broadly flat over the quarter amid further geopolitical tensions, an extension to the Brexit deadline and caution from a number of central banks. Various economic data points were reasonably positive but given ongoing uncertainty as well as potentially lower inflation ahead, the outlook for interest rates shifted significantly. This led to a large fall in bond yields, a surge in the gold price and provided support for equity markets.

US equity markets delivered decent returns for investors over the period, with markets looking past uncertainty from ongoing geopolitical tensions and focusing more on the outlook for interest rates. President Trump ended sanction exemptions for countries buying oil from Iran including China, India, Japan, South Korea and Turkey meaning that they could face US sanctions if they were to continue buying oil from Iran. The intention was to reduce Iran's oil exports and remove the government's main source of revenue. The expectation of lower supply led to a rise in the price of oil. The US President then announced he would be applying tariffs on all imports from Mexico which would gradually increase until the country dramatically reduced the number of illegal migrants entering the country. Mexico later pledged up to 6,000 troops along Mexico's southern border and the threat of US tariffs was removed.

The Federal Reserve held interest rates steady over the period leaving their economic forecasts unchanged for the rest of the year. The Committee outlined that the labour market remained strong and economic activity was rising moderately but acknowledged a greater level of uncertainty around their forecasts. Members felt that interest rate cuts were more likely than rises later in the year. US first quarter GDP rose to 3.1% q/q annualised following a surge in state and local government spending as well as rising exports. Inflation fell to 1.8% y/y in May driven largely by falls in energy prices, clothing and medical care commodities. Unemployment fell to 3.6% in May, the lowest rate in 49 years.

UK equity markets were mildly positive over the quarterly period following a raft of Brexit developments and the wider political backdrop. The EU granted a six month extension to the end of October to reach a Brexit deal. This led to the UK having to participate in the European Parliament elections where Nigel Farage's Brexit Party topped the polls, although more anti-Brexit parties won votes in aggregate. Theresa May then announced she would be stepping down as Prime Minister in early June following pressure from her own party MPs. 10 Conservative MPs entered the running for the position as the next Prime Minister which was later reduced to a battle between Boris Johnson and Jeremy Hunt. The risk of a no-deal was elevated with both outlining they would potentially leave the EU without a deal and that amendments to the Irish backstop would be required.

Interest rates were left unchanged by the Bank of England over the quarter. They noted that recent data had been broadly in line with expectations but downside risks to growth had increased including global trade tensions and greater risk of a no-deal Brexit. The Committee continued to outline that the outlook and direction of policy would be dependent on the nature and timing of the EU withdrawal.

UK first quarter GDP rose to 0.5% q/q led by household and government expenditure as well as investment, although it was noted that this was driven largely by companies stockpiling ahead of the initial Brexit deadline, temporarily elevating growth figures. Inflation fell to 2% y/y in May in line with expectations following falling transport costs. Unemployment remained at 3.8% in April, a 44 year low. Average wage growth fell slightly, but continued to surpass inflation at 3.1% y/y.

European equity markets were supportive with investors turning their attention to dovish comments from policy makers. The European Central Bank outlined that they were prepared to provide more stimulus if they felt the market outlook threatened the ability to meet their inflation target. In an earlier meeting, they suggested the earliest point for any rise in interest rates would be the second half of 2020. Key risks included geopolitics, threat of protectionism and emerging market vulnerabilities. The Italian government proposed the issuance of a new form of government bonds to help pay the states debts. Some questioned whether this was the countries first steps in preparation for an EU exit, but the President of the European Central Bank outlined that this would be an illegal act.

Eurozone first quarter GDP rose to 0.4% q/q with the largest positive contribution from household consumption and services. Inflation fell to 1.2% y/y in May, the lowest rate in over a year driven by a slowdown in energy and services costs. Unemployment reached 7.6% in April, the lowest rate since August 2008. The lowest rates were recorded in Czechia, Germany and the Netherlands while Greece, Spain and Italy posted the highest levels of unemployment.

Japanese equity markets were flat over the period amid comments from central banks outside the domestic economy. The Bank of Japan maintained interest rates and stimulus over the period, but warned downside risks in economies overseas required close attention for their impact on business and consumer sentiment. Japanese first quarter GDP rose to 0.6% q/q following continued improvement in net trade and greater business spending. Inflation fell to 0.7% y/y in May led by electricity, housing and transport & communication. Unemployment remained at 2.4%, amongst the lowest levels in 26 years.

While many single country emerging market equities posted mild to strong returns over the period, the overall market was dragged lower by losses across Chinese equity markets, which make up the largest proportion of the wider index. Trump raised tariffs on around $200bn of Chinese exports following trade discussions which were moving 'too slowly'. China responded with its own levies on thousands of US goods. Trump also declared a national emergency over IT threats, signing an executive order effectively barring US companies using foreign telecoms believed to be posing national security risks. This targeted Chinese company Huawei which would restrict the company buying components from the US. Fears of further tariffs then softened with Trump and Xi Jinping agreeing to resume trade talks while at the G20 summit in Osaka.

A number of central banks across emerging market economies cut interest rates over the period by 0.25% to 0.5% in Russia, India and Chile. The Bank of Russia pointed to slowing inflation and indicated further rate cuts were likely. The Indian central bank noted concerns over the sharp slowdown in investment activity and moderation in private consumption. While the Chilean bank outlined concerns over global trade policy uncertainty and lower growth prospects.

Activity across bond markets was extraordinary over the period following some rapid movements. Yields on government bonds fell to levels last seen just under three years ago in both the UK and US, with Germany moving further negative to reach the lowest level in history delivering strong returns for investors. These moves were predicated over recent central bank meetings, with the US outlining the prospect of interest rate cuts on the horizon and Europe pushing out any hike in interest rates until later next year. This led to many expecting lower interest rates to persist for much longer than originally anticipated. Yields on UK, US and German 10 year bonds ended the quarter at 0.83%, 2.00% and -0.33% respectively.

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