momentum

Viewpoint

Monthly market update

May 2017

global investment management

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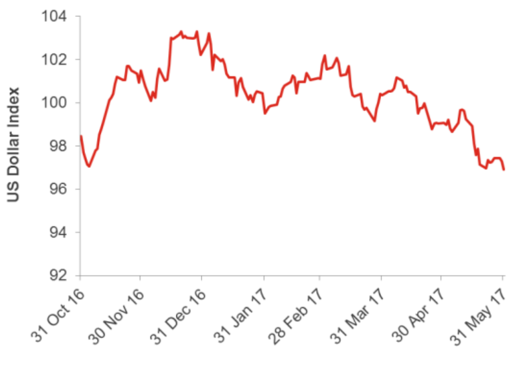
1. Market commentary

The benign conditions that have prevailed in markets through the past six months continued into May, with most risk assets producing positive returns. Equity markets again produced the best returns, led by the UK, Europe (especially peripheral markets) and Asia, but bond markets also made solid progress, as yields drifted lower and credit benefitted from a favourable corporate backdrop. Perhaps the most notable features, however, were a further slide in the US dollar, which fell 2.2% in May on a trade weighted basis, taking its fall to 6.1% from its early January peak and reversing all of the post-election surge; as well as a further drop in the oil price in the face of stubbornly high global inventory levels and evidence of surging oil shale production in the US. Also notable was the continuation of extraordinarily low levels of volatility across markets, with the VIX 'fear' index hovering at ten year lows, punctuated only very briefly in May by concerns that the Russia/Trump scandal could lead to a further weakening of the President and his ability to implement some of his reflationary and business friendly policies and even lead to his impeachment.

Figure 1: USD sacrifices its post-election gains

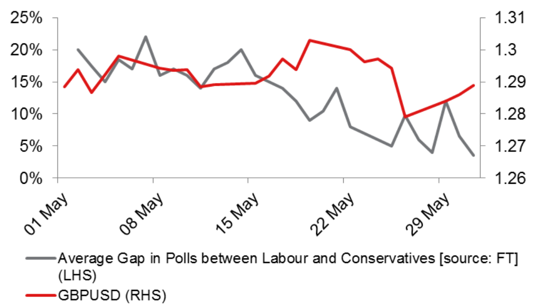


The MSCI World index returned +2.1% in May, with all regions participating on the rise but the US again underperforming other major markets. Emerging markets rose 3.0% driven almost entirely by Asia, as other large markets including Brazil (corruption scandal surrounding the President) and Russia (hit by the decline in the oil price) suffered sharp falls. The favourable global economic backdrop was again the main support to markets, with Europe and Japan continuing to surprise on the upside in terms of data releases while in the US the trend has been more subdued, although still pointing to reasonable growth this year. In both the Eurozone and Japan Q1 GDP grew by 0.5% quarter-on-quarter, and leading indicators point to further strength in Q2.

Of more concern has been evidence of softer growth in China after a strong start to the year, with weak trade data and leading indicators, the authorities have been taking measures to curb a property bubble, tighten credit, rein in off balance sheet lending by banks and control the burgeoning debt mountain. A downgrade of China's sovereign credit rating by Moody's highlighted the risks surrounding the unprecedented surge in debt over the past decade. The prospects of weaker growth in China and concerns about the ability of the authorities to rein in excess credit while maintaining a 6%+ growth rate contributed to weaker commodity prices, notably industrial metals: the iron ore price fell 13.9% in May, taking its fall since mid-February to 34.8%.

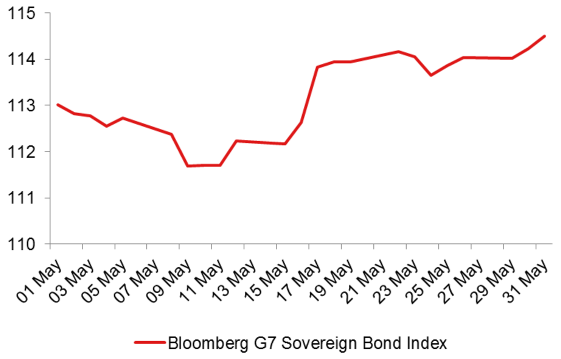
Politics has remained at the forefront of investor attention. In Europe the election of a centrist and firmly pro-EU President, Macron has given confidence that the worst political fears of an EU break-up are receding and, with growth picking up, the euro has risen a further 3.2% versus the US dollar, taking its year-to-date gain to 6.9%. In the US, the unpredictability of President Trump, together with an administration which is looking increasingly dysfunctional, has gone a long way to deflate the Trump reflation agenda. A draft budget released by Mr Trump contained bold spending and tax initiatives but was widely seen as lacking either credibility or support to have any realistic chance of being passed by Congress. In the UK the expectation that the ruling Conservative party would be reinstated with a landslide majority has dissipated in recent days as a relatively understated campaign by Prime Minister Theresa May has been overshadowed by a surge in support for opposition leader Jeremy Corbyn. Although the Conservatives are still expected to win the election on June 8th, and markets are in no way pricing in any other outcome, the risk is that a small majority would seriously weaken the PM both domestically and in the critical negotiations to come with the EU over the terms of Brexit.

Figure 2: Sterling falters as Labour chase Tory lead



Despite the pick-up in global growth this year and rising employment levels inflation has remained remarkably subdued. Weak oil prices are helping to keep headline rates low while core inflation remains at levels which continue to give central banks caution in tightening policy. There still seems little prospect of any tightening in the EU, at least until later this year when a further tapering of asset purchases is likely, or in Japan and the UK, where fears of an economic slowdown as Brexit looms remain paramount. In the US the Federal Reserve (Fed) is widely expected to raise rates for a fourth time in this cycle at its June meeting but its pace of tightening will be cautious and will depend on continuing growth in the economy and employment. Bond markets have reacted favourably with bond yields on major markets falling significantly from their March peaks: in the US the 10 year Treasury yield has fallen by 40 basis points to 2.1%, its lowest level for the year. Credit has continued to outperform safe haven government bonds, with high yield bonds returning 4.8% so far this year and investment grade credit 3.5%.

Figure 3: Good month for G7 government bonds



Markets have performed well this year on the back of higher global growth. However valuations have been pushed higher, especially in the US, and are becoming vulnerable to disappointments. Policy uncertainties remain high and China's debt levels remain a source of considerable uncertainty and risk for investors. This leaves markets vulnerable to a correction and the long period of subdued volatility we have enjoyed over the past few months will surely be tested before too long.

However this cycle is particularly long and it will be important to stay invested, anything less is likely to lead to disappointment. Opportunities for returns outweigh the risks and we expect equities to continue to outperform bonds through 2017, so periodic bouts of weakness in equity markets will present buying opportunities.

Source: Bloomberg. Returns in US dollars unless otherwise stated. May 2017.

2. Market performance – Global (local returns)

Asset class/region	Index	Currency	1 month	Year-to-date
		To 31 May 2017		
Developed markets equities				
United States	S&P 500 NR	USD	1.3%	8.4%
United Kingdom	MSCI UK NR	GBP	4.8%	7.4%
Continental Europe	MSCI Europe ex UK NR	EUR	1.6%	11.1%
Japan	Topix TR	JPY	2.4%	4.3%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	2.7%	17.6%
Global	MSCI World NR	USD	2.1%	10.2%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-1.5%	4.3%
Emerging Asia	MSCI EM Asia NR	USD	4.5%	21.1%
Emerging Latin America	MSCI EM Latin America NR	USD	-2.4%	9.4%
BRICs	MSCI BRIC NR	USD	2.1%	16.0%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	3.0%	17.3%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	0.7%	2.1%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.0%	1.9%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.1%	3.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.9%	4.8%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	0.5%	2.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.1%	3.5%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.6%	-0.4%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.4%	1.2%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	0.9%	3.9%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.2%	-0.1%
Australian Government	JP Morgan Australia GBI TR	AUD	1.4%	3.6%
Global Government Bonds	JP Morgan Global GBI	USD	1.5%	4.3%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.7%	4.3%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	1.9%	7.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	0.6%	6.7%

Source: Bloomberg. e denotes estimate

		To 31 May 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
Property				
US Property Securities	MSCI US REIT NR	USD	-0.7%	0.1%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-1.1%	0.3%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	4.1%	16.3%
Global Property Securities	S&P Global Property USD TR	USD	1.7%	6.9%
Currencies				
Euro		USD	3.2%	6.9%
UK Pound Sterling		USD	-0.5%	4.3%
Japanese Yen		USD	0.7%	5.6%
Australian Dollar		USD	-0.8%	3.3%
South African Rand		USD	2.1%	4.6%
Commodities & Alternatives				
Commodities	RICI TR	USD	-1.5%	-5.4%
Agricultural Commodities	RICI Agriculture TR	USD	-0.6%	-1.9%
Oil	Brent Crude Oil	USD	-2.7%	-11.5%
Gold	Gold Spot	USD	0.1%	10.1%
Hedge funds	HFRX Global Hedge Fund	USD	0.2% e	2.2% e
Interest rates				
United States		1.00%		
United Kingdom		0.25%		
Eurozone		0.00%		
Japan		0.10%		
Australia		1.50%		
South Africa		7.00%		

Source: Bloomberg. e denotes estimate

3. Market performance – UK (all returns in GBP)

		To 31 May 2017		
Asset class/region	**Index**	**Currency**	**1 month**	**Year-to-date**
Equities				
UK - All Cap	MSCI UK NR	GBP	4.8%	7.4%
UK - Large Cap	MSCI UK Large Cap NR	GBP	5.6%	6.7%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	1.9%	8.1%
UK - Small Cap	MSCI Small Cap NR	GBP	2.2%	12.2%
United States	S&P 500 NR	USD	1.8%	3.8%
Continental Europe	MSCI Europe ex UK NR	EUR	5.2%	13.4%
Japan	Topix TR	JPY	3.6%	5.3%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	3.1%	12.7%
Global developed markets	MSCI World NR	GBP	2.6%	5.6%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	3.4%	12.3%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	0.5%	2.4%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	0.0%	0.4%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	0.4%	2.3%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	0.8%	3.7%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-1.7%	2.7%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	0.0%	1.6%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	-2.3%	3.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.1%	3.5%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.2%	-2.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.6%	-0.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.3%	0.4%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	4.2%	1.6%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	4.0%	3.2%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	4.5%	6.0%
Global Government Bonds	JP Morgan Global GBI	GBP	2.0%	-0.1%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	2.1%	-0.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	2.3%	2.8%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	1.1%	2.2%

Source: Bloomberg. e denotes estimate

		To 31 May 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
Property				
UK Direct Property	UK IPD All Property TR	GBP	0.0% e	3.0% e
Global Property Securities	S&P Global Property USD TR	GBP	2.1%	2.4%
Currencies				
Euro		GBP	3.7%	2.2%
US Dollar		GBP	0.5%	-4.2%
Japanese Yen		GBP	1.2%	1.1%
Commodities & Alternatives				
Commodities	RICI TR	GBP	-1.0%	-9.4%
Agricultural Commodities	RICI Agriculture TR	GBP	-0.1%	-6.0%
Oil	Brent Crude Oil	GBP	-2.3%	-15.2%
Gold	Gold Spot	GBP	0.5%	5.5%
Interest rates				
United Kingdom		0.25%		
United States		1.00%		
Eurozone		0.00%		
Japan		0.10%		

Source: Bloomberg. e denotes estimate

4. Asset allocation dashboard

Positive	Neutral	Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Neutral
European equities (relative to developed)	Neutral
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Positive
Emerging market equities	Positive
Fixed Income	
Government	Neutral
Index-linked (relative to government)	Neutral
Investment grade (relative to government)	Neutral
High yield	Neutral
Loans	Neutral
Emerging market debt	Neutral
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Neutral
Yen	Neutral

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