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momentum

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Newsflash

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Market Commentary

The changes in tone from central banks drove global financial markets in June. The Bank of England and the European Central Bank appear unlikely to follow the path of the Federal Reserve in hiking rates this year. Political uncertainties in the UK grew in June following the Conservative party failing to achieve a majority just weeks before the beginning of already uncertain Brexit negotiations. In addition, questions linger over US economic policy and the ability to implement legislation.

Economic prospects in the Euro Area appear to be improving with GDP growth up to 2% this year, although inflation remains below target. The US has continued to grow, with an annual GDP growth rate of around 2%, whilst the UK has outperformed post-Brexit expectations, albeit with signs of a slowdown ahead. Emerging markets have benefitted from loose global monetary policy conditions and accelerating growth. In turn this has benefitted corporate profits, with earnings rising above the stagnant conditions of the past 2 years, up over 10% year-to-date in the US, and beyond this in Europe and Japan.

During the month, equity market returns have been markedly subdued in the UK and Continental Europe falling 2.5% and 2.2% respectively. Japan and Asia Pacific built upon strong performances last month to return 3.0% and 1.8% respectively in local currency terms. The MSCI World index of developed equities returned 0.4% during June, led by Japan and Asia-Pacific, whilst emerging markets returned 1.0%, also driven by Asia. Bond market returns were on average negative during the month with US Treasuries posting a fall of 0.1%, although US corporate bonds were positive, mostly in the range of 0.1% to 0.3%.

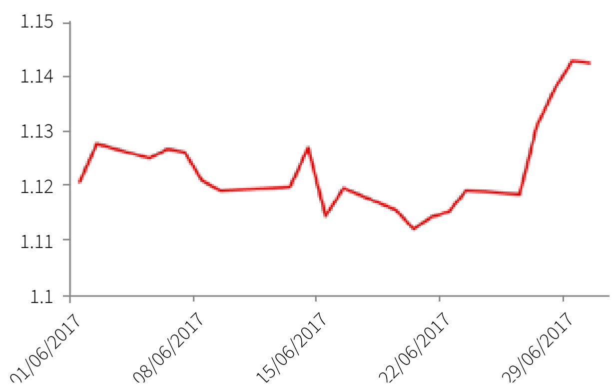
The most notable moves during the month were in currencies and commodity markets. Brent Crude oil fell 4.8% in June, taking its fall to over 20% from its peak earlier in the year. Large efficiency gains in US shale oil production have cut breakeven costs to below $50 per barrel, leading to a surge in production. At the same time OPEC members exempt from cuts have been increasing production. During this month and the quarter it became clear OPEC production cuts in

November 2016 have been unsuccessful in rebalancing supply and demand. A 9 month extension to the cuts has been agreed by OPEC and some non-OPEC members, notably Russia, but the effects so far have been muted.

Figure 1: Brent crude price

The weakness in US Dollar during May continued into June and on a trade weighted basis the US Dollar has fallen over 7% since its peak in late 2016, taking it back to early 2015 trading ranges. The US Dollar fell particularly sharply in the last week of June. Conversely, the Euro rose 1.6% versus the US Dollar in June, ending the quarter up 7.3% following a combination of rising growth, improving economic forecasts and a more favourable political backdrop.

Figure 2: EUR/USD spot price



Politics maintained a contrasting role in driving markets. In the US the Trump reflation trade agenda continued to unwind as it became clearer Trump's big policy initiatives, tax cuts, infrastructure spending and regulatory reform were becoming more distant and facing substantial political hurdles in Washington. Any fiscal boost to growth now seems very unlikely this year and will be considerably smaller than expected in the years ahead.

In contrast, the rising fears of an EU and Euro bloc break-up, exacerbated by the UK's Brexit decision and by the rise of anti-EU political factions in major EU states, were once again quashed as France elected President Macron, leader of the newly formed pro-EU party 'En Marche!' with a substantial majority. In addition, risks of adverse political developments in Italy receded whilst troubled European banks were bolstered by state intervention. It appears any risks of a slow EU break-up have been pushed aside for the foreseeable future.

Conversely, the UK was plunged into political turmoil when Theresa May's attempt to secure a larger parliamentary majority by calling a snap election resulted in a hung parliament following an unsuccessful and unappealing Conservative campaign. The consequent failure to achieve a parliamentary majority has served to weaken the authority of the government, creating further uncertainty in Brexit negotiations, casting doubt around Fiscal management, and raising the risk of a socialist government led by Jeremy Corbyn within the next few years. Following this, it comes as no surprise UK assets performed poorly in June.

With global economic growth improving, central banks have entertained the process of monetary policy normalisation following almost a decade of ultra-loose policy. The US Federal Reserve has been at the forefront of this process, increasing target rates by 25 basis points in June; the fourth rise in this cycle. The Federal Reserve also gave a clear outline for its balance sheet normalisation plans, posing a critical test of markets as liquidity is gradually and progressively withdrawn. The impending phase of policy normalisation creates new challenges for central banks with policy missteps posing grave threats to markets, at least on a short-term basis.

Despite the turbulent month for UK and Continental European equities, the broad global environment remains favourable for risk assets; the synchronised expansion at present appears sustainable with few signs of excess credit, whilst deflationary forces are being replaced by subdued reflationary forces. The 20% fall in oil prices during Q2 will help to sustain this non-inflationary expansion.

The fundamentals for the global economy are good and the economic recovery is broadening on a sustainable basis. In addition, the tightening of monetary policy from the very loose levels of present will be gradual. The tightening moves to date have not been a hurdle for markets and central banks are adopting an extremely cautious, gradualist approach to policy changes. We therefore expect this cycle to be sustained for some considerable time ahead. Opportunities for returns outweigh the risks and we expect equities to continue to outperform bonds as the cycle progresses, hence periodic bouts of weakness in markets will present buying opportunities for risk assets.

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

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Developed markets equities				
United States	S&P 500 NR	**USD**	0.6%	9.0%
United Kingdom	MSCI UK NR	**GBP**	-2.5%	4.6%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-2.2%	8.7%
Japan	Topix TR	**JPY**	3.0%	7.4%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	1.8%	19.8%
Global	MSCI World NR	**USD**	0.4%	10.7%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-0.5%	3.8%
Emerging Asia	MSCI EM Asia NR	**USD**	1.7%	23.2%
Emerging Latin America	MSCI EM Latin America NR	**USD**	0.7%	10.1%
BRICs	MSCI BRIC NR	**USD**	0.7%	16.8%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	**USD**	1.0%	18.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-0.1%	2.0%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-1.0%	0.9%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	0.3%	3.8%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	0.1%	4.9%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	-2.0%	0.2%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	-1.2%	2.3%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-0.5%	-1.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	-0.6%	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	0.3%	4.2%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	-0.3%	-0.4%
Australian Government	JP Morgan Australia GBI TR	**AUD**	-1.1%	2.4%
Global Government Bonds	JP Morgan Global GBI	**USD**	-0.2%	4.1%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	0.0%	4.3%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-0.4%	6.9%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	-0.4%	6.3%

Source: Bloomberg *[e] denotes estimate*

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	**USD**	2.0%	2.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	-6.3%	-6.0%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-0.4%	15.8%
Global Property Securities	S&P Global Property USD TR	**USD**	1.0%	8.0%
Currencies				
Euro		**USD**	1.6%	8.6%
UK Pound Sterling		**USD**	1.1%	5.4%
Japanese Yen		**USD**	-1.4%	4.2%
Australian Dollar		**USD**	3.4%	6.8%
South African Rand		**USD**	0.1%	4.6%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	-0.4%	-5.8%
Agricultural Commodities	RICI Agriculture TR	**USD**	3.4%	1.4%
Oil	Brent Crude Oil	**USD**	-4.8%	-15.7%
Gold	Gold Spot	**USD**	-2.2%	7.7%
Hedge funds	HFRX Global Hedge Fund	**USD**	0.2%	2.6%
Interest rates				
United States			1.25%	
United Kingdom			0.25%	
Eurozone			0.00%	
Japan			0.10%	
Australia			1.50%	
South Africa			7.00%	

Source: Bloomberg *e denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Developed markets equities				
UK - All Cap	MSCI UK NR	**GBP**	-2.5%	4.6%
UK - Large Cap	MSCI UK Large Cap NR	**GBP**	-2.3%	4.3%
UK - Mid Cap	MSCI UK Mid Cap NR	**GBP**	-4.0%	3.8%
UK - Small Cap	MSCI Small Cap NR	**GBP**	-2.9%	9.0%
United States	S&P 500 NR	**USD**	-0.3%	3.5%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-1.5%	11.6%
Japan	Topix TR	**JPY**	0.5%	5.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	0.9%	13.7%
Global developed markets	MSCI World NR	**GBP**	-0.5%	5.0%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	**GBP**	0.1%	12.4%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	**GBP**	-2.1%	0.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	**GBP**	-0.5%	-0.2%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	**GBP**	-1.6%	0.7%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	**GBP**	-3.2%	0.3%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	**GBP**	-3.1%	-0.5%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	**GBP**	-1.4%	0.2%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	**GBP**	-3.8%	-0.8%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	-1.2%	2.3%
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-1.0%	-3.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	-0.6%	-1.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-0.8%	-0.4%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	0.1%	1.7%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	0.1%	3.3%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	0.9%	7.0%
Global Government Bonds	JP Morgan Global GBI	**GBP**	-1.1%	-1.2%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**GBP**	-0.9%	-1.0%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**GBP**	-1.3%	1.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**GBP**	-1.3%	0.9%

Source: Bloomberg [e] *denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Property				
UK Direct Property	UK IPD All Property TR	**GBP**	0.0%*	3.8%*
Global Property Securities	S&P Global Property USD TR	**GBP**	0.1%	2.5%
Currencies				
Euro		**GBP**	0.6%	2.8%
US Dollar		**GBP**	-1.0%	-5.2%
Japanese Yen		**GBP**	-2.4%	-1.4%
Commodities & Alternatives				
Commodities	RICI TR	**GBP**	-1.3%	-10.6%
Agricultural Commodities	RICI Agriculture TR	**GBP**	2.4%	-3.7%
Oil	Brent Crude Oil	**GBP**	-5.6%	-20.0%
Gold	Gold Spot	**GBP**	-3.0%	2.3%
Interest rates				
United Kingdom			0.25%	
United States			1.25%	
Eurozone			0.00%	
Japan			0.10%	

Source: Bloomberg ** estimate*

Asset Allocation Dashboard

Positive (green) | Neutral (yellow) | Negative (red)

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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