

# Viewpoint

## Monthly market update

*February 2017*



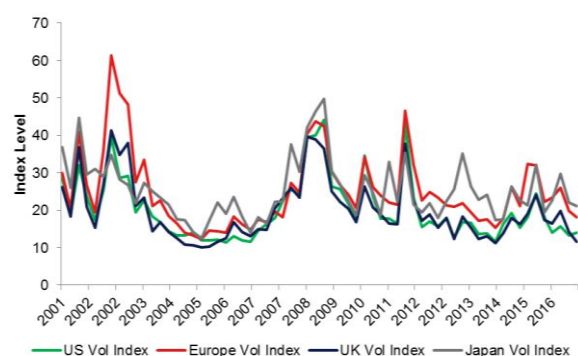
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## 1. Market commentary

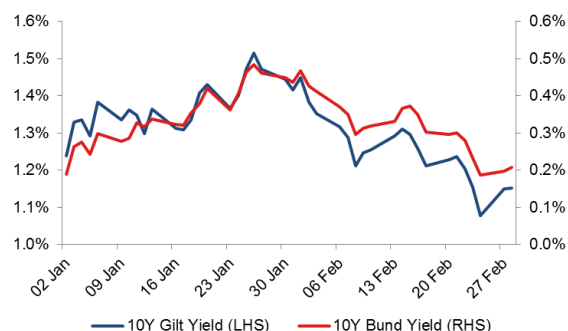
The broad pattern of market performance since Trump's election victory continued in February in a period notable for its particularly low volatility, with the Vix 'fear' index now at its lowest levels since the financial crisis. Equities, led by the US, significantly outperformed bonds again; global developed equities returned 2.8% in February compared with a return of 0.4% from global bonds, taking the year-to-date outperformance of equities to 3.9%. With global growth continuing to show clear signs of acceleration, emerging markets, led by Asia and Latin America, again outperformed developed markets. So far this year they have returned 8.7%, which is 3.4% ahead of developed markets.

Figure 1: Historically low volatility in developed equity markets



The two most notable features of markets in February was the return to strength of the US dollar, which erased much of its weakness in January, and the falls in bond market yields, despite the evidence of strengthening economic growth and higher inflation. The USD rose 1.6% on a trade weighted basis, with the euro falling 2.1% and sterling declining by 1.6%; in contrast the yen was stable and some developing world currencies strengthened. Bond yields generally fell back after the rises of recent months. There was, however, a notable difference in performance between the US, which only saw modest declines in yields in longer maturities, and yields in European markets, which fell much more significantly, with 10-year gilt yields in the UK experiencing a monthly drop of 25 basis points to 1.15% and German bund yields seeing similar sized moves to fall to 0.2%.

Figure 2: Gilt & bund yields fall from January highs

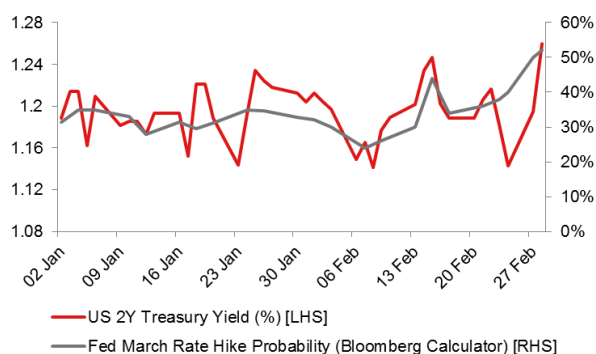


Such moves were somewhat perplexing given the broad evidence of a pick-up in both growth and inflation globally. However, within the euro area, huge scale ECB bond purchases and increasing fears surrounding the French Presidential election in May, with Marine le Pen seemingly benefitting from disarray within the traditional mainstream parties, helped support valuations of safe-haven German bunds, with investors avoiding peripheral European markets.

Depressed gilt yields in the UK were for different reasons: investors began to worry that the widely forecast, but to date non-existent post EU referendum economic slowdown, was beginning to emerge. Such concerns followed marginally weaker trends in consumer spending and other leading indicators, combined with forecasts that rising inflation following sterling's sharp falls, and uncertainty over the terms of Brexit, will dampen confidence and growth in the UK.

In contrast yields on short-dated US bonds moved up. With most data on the economy continuing to improve, the labour market remaining strong and all measures of inflation moving up (both headline and core CPI are above the US Federal Reserve's 2% inflation target) the market has re-priced expectations for impending rate rises. Hawkish noises from members of the Federal Open Markets Committee have pushed yields on two-year bonds to 1.3%, their highest levels since mid-2009, and the market is now almost fully discounting a 25 basis point increase in rates at the mid-March meeting of the US Federal Reserve, with expectations of between one and two further rises this year. There is now a yield differential of 220 basis points between US and German government bonds, a very wide gap by historical standards, which is likely to keep the US dollar well supported.

Figure 3: Correlation between short term US yields and hike expectations



President Trump's first, much anticipated address to Congress proved to deliver nothing new in terms of policy substance. Tax cuts and reforms, one trillion dollars of infrastructure spending, a 10% increase in defence spending, the repeal of Obamacare, and the 'hire American, buy American' initiative, had all been well flagged previously. However, markets were encouraged by a more presidential approach, sticking to a well-crafted script that was noticeably less antagonistic and gloomy than his inauguration speech. His intent is clear and if successfully implemented his moves would undoubtedly be reflationary, but the address did nothing to allay concerns about how policies would be funded. Additionally, nothing was said to reduce the apparent

risk of rising trade tensions, and the focus will now shift to more detailed policy announcements and the ability to steer these through Congress.

Markets have performed well this year and have risen sharply since the US election. The evidence of higher growth has been encouraging and many of Trump's policies are market friendly. However, we are now at the stage where the detail of policy will be subject to higher scrutiny. Political uncertainties remain high at a time when the status quo in Europe also faces several key challenges. Worst case outcomes which would cast doubt over the future of the euro and EU, while unlikely, don't appear in any way priced into markets. With valuations high, markets are vulnerable to a correction and the long period of subdued volatility that 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. February 2017.

## 2. Market performance – Global (local returns)

		To 28 February 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
<b>Developed markets equities</b>				
United States	S&P 500 NR	USD	3.9%	5.8%
United Kingdom	MSCI UK NR	GBP	3.1%	2.6%
Continental Europe	MSCI Europe ex UK NR	EUR	2.6%	2.5%
Japan	Topix TR	JPY	0.9%	1.2%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	3.4%	9.4%
Global	MSCI World NR	USD	2.8%	5.3%
<b>Emerging markets equities</b>				
Emerging Europe	MSCI EM Europe NR	USD	-2.0%	-0.3%
Emerging Asia	MSCI EM Asia NR	USD	3.6%	9.7%
Emerging Latin America	MSCI EM Latin America NR	USD	3.6%	11.4%
BRICs	MSCI BRIC NR	USD	3.2%	9.7%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	3.1%	8.7%
<b>Bonds</b>				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	0.5%	0.8%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.5%	1.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.1%	1.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.5%	2.9%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	3.2%	1.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.5%	1.6%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.2%	-0.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.2%	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	1.1%	1.8%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.3%	-0.3%
Australian Government	JP Morgan Australia GBI TR	AUD	0.1%	0.7%
Global Government Bonds	JP Morgan Global GBI	USD	0.4%	1.3%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.4%	1.2%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	0.9%	3.0%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	1.9%	3.4%

Source: Bloomberg. e denotes estimate

		To 28 February 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
<b>Property</b>				
US Property Securities	MSCI US REIT NR	USD	3.4%	3.3%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	3.3%	-1.7%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	2.6%	8.3%
Global Property Securities	S&P Global Property USD TR	USD	3.3%	4.5%
<b>Currencies</b>				
Euro		USD	-2.0%	0.5%
UK Pound Sterling		USD	-1.6%	0.2%
Japanese Yen		USD	0.0%	3.8%
Australian Dollar		USD	0.9%	6.4%
South African Rand		USD	2.6%	4.3%
<b>Commodities &amp; Alternatives</b>				
Commodities	RICI TR	USD	0.3%	1.2%
Agricultural Commodities	RICI Agriculture TR	USD	-0.1%	3.0%
Oil	Brent Crude Oil	USD	-0.2%	-2.2%
Gold	Gold Spot	USD	3.1%	8.3%
Hedge funds	HFRX Global Hedge Fund	USD	1.1%	1.6%
<b>Interest rates</b>				
United States			0.75%	
United Kingdom			0.25%	
Eurozone			0.00%	
Japan			0.00%	
Australia			1.50%	
South Africa			7.00%	

Source: Bloomberg. e denotes estimate

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

		To 28 February 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
<b>Equities</b>				
UK - All Cap	MSCI UK NR	GBP	3.1%	2.6%
UK - Large Cap	MSCI UK Large Cap NR	GBP	3.2%	2.5%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	2.6%	2.9%
UK - Small Cap	MSCI Small Cap NR	GBP	3.5%	3.9%
United States	S&P 500 NR	USD	5.2%	5.2%
Continental Europe	MSCI Europe ex UK NR	EUR	2.2%	2.5%
Japan	Topix TR	JPY	3.2%	4.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	4.7%	8.8%
Global developed markets	MSCI World NR	GBP	4.0%	4.6%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	4.3%	8.1%
<b>Bonds</b>				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	3.2%	1.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	0.6%	0.3%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	2.6%	1.4%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	5.1%	1.9%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	1.1%	1.2%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	0.9%	0.9%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	1.2%	1.4%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.5%	1.6%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.8%	0.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	2.4%	0.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	2.7%	2.3%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.8%	-0.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.8%	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	0.6%	1.8%
Global Government Bonds	JP Morgan Global GBI	GBP	1.7%	0.8%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	1.6%	0.6%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	2.1%	2.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	3.2%	2.8%

Source: Bloomberg. e denotes estimate

		To 28 February 2017		
Asset class/region	Index	Currency	1 month	Year-to-date
<b>Property</b>				
UK Direct Property	UK IPD All Property TR	GBP	0% <sup>e</sup>	0.7% <sup>e</sup>
Global Property Securities	S&P Global Property USD TR	GBP	4.6%	3.9%
<b>Currencies</b>				
Euro		GBP	-0.5%	0.1%
US Dollar		GBP	1.6%	-0.3%
Japanese Yen		GBP	1.6%	3.4%
<b>Commodities &amp; Alternatives</b>				
Commodities	RICI TR	GBP	1.5%	0.6%
Agricultural Commodities	RICI Agriculture TR	GBP	1.1%	2.4%
Oil	Brent Crude Oil	GBP	1.0%	-2.7%
Gold	Gold Spot	GBP	4.4%	7.7%
<b>Interest rates</b>				
United Kingdom			0.25%	
United States			0.75%	
Eurozone			0.00%	
Japan			0.00%	

Source: Bloomberg. e denotes estimate



## 4. Asset allocation dashboard

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



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