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ASSET MANAGEMENT

INVESTMENT REVIEW – March 2019

February saw a continued recovery in stock markets from the set-back in the last part of 2018, helped by the easing of concerns over economic growth, central bank policy and an excess of politics, even if some issues remain. There is scope for markets to be squeezed higher although some further volatility also seems likely.

There is no doubt that global economic growth has slowed, although data can be readily revised and forecasts often seem spurious. While the synchronised progress that prompted optimism at the end of 2017 has faded so have fears that trade wars will compound the slow-down, as the US and China edge away from further conflict. Governments such as the Chinese are ready to provide a stimulus while central banks have eased their gradual tightening of monetary policy, accepting that inflation is still relatively subdued and that they need to tread carefully at this stage of a protracted economic cycle. Politics and geopolitics will continue to predominate given populist pressure and media demands, but in the short term there was an element of progress in the US and UK.

It is all relative, as Brexit remains complex and the eventual outcome uncertain even to those who have been negotiating it, in a manner of speaking, over the last two years or so. This is the month when the UK should leave according to Article 50 yet the probability of a deferral has increased as has the chance of no deal as the deadline of 29th March approaches, or indeed a version of the modestly moderate deal that Theresa May struck. The possibility of a harder deal, however defined, looks remote and so too does a possible Labour government under Jeremy Corbyn, who has mismanaged his opportunity and managed to appear unelectable to most. Defections from Labour and the Conservatives have complicated the political landscape although the Independents might stall at the start. The car industry has struggled and the move by Honda to end production at its Swindon plant in 2021 reflects pressure in the sector as well as subdued investment given the uncertainty. Economic growth slowed to 0.2% in the last quarter of 2018 to make 1.4% for the year, the lowest level since 2009, and the Bank of England has reduced its forecast of real growth in 2019 from 1.7% to 1.2%. Given the range of possible outcomes and the ability of markets to confound expectations that have underpinned our assumptions, we have focussed on reducing the potential impact of no deal on the domestic sectors as well as the impact of a continued rally in Sterling on the value of overseas assets.

One factor in the EU's approach to the last stages of the UK's leaving has been the slow-down in economic growth in the eurozone. Exporting companies have struggled with the recent trade wars, the ebbing of economic growth, low levels in the Rhine even and high levels of particulates in diesel engines. Italy saw a technical recession with two quarters of decline in the second half of 2018 while Germany barely escaped one; manufacturing output has dropped to its lowest level in six years and business confidence has faded. In Spain the socialist-led coalition struggled and the prime minister Pedro Sánchez called a snap election for 28th April. The European Central Bank has said it will exercise caution.

In the US too the Federal Reserve has said it can afford to be patient and that it might even look to cut interest rates. The economy is still reasonably robust if with contradictory indications: retail sales fell by 1.2% in December, the worst drop since 2009, whereas there were 304,000 more jobs created in January when wage inflation stood at a robust 3.2%. In China the economic data has shown the impact of trade wars on an economy in which the authorities were looking to control excess credit, with a drop in imports as well as exports. The government has provided a further stimulus, deferring the debt reckoning for now. The Japanese economy, however, returned to growth in the fourth quarter of 2018, with the data reported in February showing a rate of 1.4%.

In emerging markets Brazil has started on a necessary rise in retirement ages to ease pressure on the public pension schemes, Nigeria has held elections with a strikingly low turnout and South Africa's aid to the state energy utility might help to end the power outages that have curtailed GDP. Ahead of the general elections in India in April Narendra Modi's government has appreciated a dividend from the central bank and a cut in interest rates from 6.5% to 6.25% while the distraction of a show-down with Pakistan has raised tensions.

In the UK the FTSE 100 made limited progress over the month to end up 1.5% at a level of 7075 having been at 7261 in mid-February before the stronger currency inter alia hindered its progress. The mid-sized companies in the FTSE 250 index did better with a gain of 2.5% although the FTSE SmallCap index lagged a little with a rise of 0.9%. For the FTSE All-Share the gain was 1.7% in the month and the total return including income was 2.3%. The FTSE AIM All-Share declined by 1.1%.

In the US the S&P 500 index rose 3%, the more concentrated Dow Jones Industrial gained 3.7% and the technology-oriented NASDAQ index 3.4%. Smaller companies as represented by the Russell 2000 index outperformed with a rise of 5.1% in the month.

In Europe the EURO STOXX 50 index rose by 4.4% in the month although the Euromoney index of smaller companies only made a modest gain of 0.8%. In Japan the Nikkei 225 also continued its recovery with a rise of 2.9%.

The MSCI Emerging Markets index in US$ was limited to an increase of 0.1% in February; while the Chinese Shanghai index gained a further 13.8% in the month other markets were mostly lower. The MSCI Frontier Markets index rose only 0.7% in the month although in Vietnam the index was up 6%.

In the bond markets the UK 10-year gilt yield rose from 1.22% to 1.3% in February and the total return for the FTSE Gilts All Stocks index was -0.9% in the month. In the US 10-year yields also rose a little, from 2.63% to 2.72%, and in Germany they moved up from 0.15% to a still minimal 0.18%. The month saw a rally in high-yield debt although longer-term challenges remain.

Sterling strengthened further by 1.2% against the US$ in the month to close at a rate of $1.33:£ while against the euro it was up 1.8% at €1.17:£.

The price of Brent oil rallied further in February with a rise of 8% from $61 to $66 per barrel. The price of gold varied and ended the month slightly lower at $1313 per troy ounce. Metal prices were mostly higher although the major agricultural commodities fell in price, with a sustained rally elusive. The Vix index of volatility in the US fell by a tenth in the month and is off by over 40% for the year to date, with the sharp falls in December a fading memory.

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