INVESTMENT REVIEW – May 2019

The month of April saw a spring still in the step of stock markets which were helped by encouraging economic data, a reasonable set of earnings reports, conciliatory central banks and the absence of any one political pressure point, although there remain a number of issues. Low interest rates for longer and low inflation, in spite of a spike in oil prices, can support high equity valuations and markets may maintain their momentum.

While it still makes sense not to pay too much attention to short-term economic data, markets cannot help but do so and were encouraged by the report that growth in the US in the first quarter of the year reached an annualised rate of 3.2%. This was better than expected if contradicted in part by some other underlying data, which is a similar position to China where the figure was 6.4%, at the upper end of the government's target range of 6-6.5%, and in the eurozone, which saw growth of 0.4% in the first three months of 2019. Again Spain seemed to reign supreme with a rate of 0.7% and Italy came out of its latest shallow recession. In South Korea, by contrast, the economy declined given weakness in its exports.

Earnings in the US, which dominates sentiment in this regard, have been a little better than expected, if still likely to have fallen by 3-4% in the first quarter and to be on course for growth of only 3-4% for the year as a whole. Forecasts of growth over 10% in 2020 seem ambitious if the country slips nearer to recession but would make the price/earnings rating of the S&P 500 index reasonable at 16.4x, if above a long-term average nearer 15.3x.

The main central banks have maintained their careful approach, still looking to normalise policy but still under less pressure to do so immediately given the continued subdued level of inflation in the US, Europe, Japan and China, even if it was there at a five-month high in March at 2.3% as pork prices rose. The decision by the US to tighten sanctions over Iran, together with issues in Venezuela and Libya, contributed to a further rise in the oil price, as has a more positive demand position. In the short-term higher energy costs can dislocate economies while in the longer-term climate change and a shift to more renewable resources will be the greater issue.

Politics and populism in particular will remain a factor if for now not a deciding one. The US and China are edging towards an agreement to end, or at least limit, the trade wars between them. Their jostling for primacy will continue and is reflected in the stand-off over China's Belt & Road project and over Huawei, a company with 80,000 staff in research and development and one which accounted for about a tenth of the 53,345 patents China filed in 2018 (not far off the 56,142 in the US). In Spain the Socialist party won the largest share of the vote in the election but not a clear majority, while the far-right Vox party took seats. In India the elections continue, in Indonesia the incumbent Joko Widodo won the presidential vote and in South Africa the ANC are likely to retain control after the polls on 8th May, if with a reduced majority. The most striking outcome is perhaps in Ukraine where Volodomyr Zelensky, best known there for a comic role as a fictional president in the television series *Servant of the People*, became a real one when he won the run-off vote with a striking 73% against the incumbent Petro Poroshenko; his challenge will be to manage tension with Russia. Meanwhile the Brexit imbroglio remains.

In Japan the country has entered a new era, the Reiwa, and the working population have been almost forced into a week's holiday. The previous era was noted for natural catastrophes and also a sort of economic one, when the asset bubble burst and the country endured persistently low growth and a degree of deflation. There are many reasons why Japan will have been unique but there are signs that a similar pattern may prevail elsewhere, in the latter part of what has been a complex cycle.

For now markets are inclined to the positive and ready to ignore the risks that high debt and higher rates represent. The US market has reached new highs, if on a very narrow basis as few individual shares have done so. Technology is key, as 5G and AI come to the fore; apparently 45% of Reuters articles are now written by computers, and 45% read by them, although this update has been a human one, for better or worse.

In the UK the FTSE 100 made further progress over the month to end up 1.9% at a level of 7418. The mid-sized companies in the FTSE 250 index did better with a rise of 3.7% and the FTSE SmallCap index made 3.8%. For the FTSE All-Share the gain was 2.3% and the total return 2.7% with income, while the FTSE AIM All-Share was 5.7% higher.

In the US the S&P 500 index rose by 3.9% in the month, the more concentrated Dow Jones Industrial gained 2.6% and the technology-oriented NASDAQ index made a strong 4.7%. Smaller companies as represented by the Russell 2000 index made 3.3% in the period.

In Europe the EURO STOXX 50 index also did well with a rise of 4.9% in April and the Euromoney index of smaller companies had a similar return at 4.4%. In Japan the Nikkei 225 gained 5%.

The gain in the MSCI Emerging Markets index in US$ was more modest in the month at 2%. The Chinese Shanghai index declined by 0.4% although it was still up 23.4% for the year to date, largely reversing the sizeable loss in 2018. The MSCI Frontier Markets index fell by 1.1% in the month although the Vietnamese market was almost unchanged.

In the bond markets the UK 10-year gilt yield rallied a little from 1.0% to 1.19% in April and the total return for the FTSE Gilts All Stocks index was -1.5% in the month. In the US 10-year yields rose a little from 2.41% to 2.5% while in Germany they turned positive again, if barely so at 0.01%. The month saw a decline in most fixed interest indices although high yield debt held up.

Sterling was little changed against the US$ in the month to close at a rate of $1.30:£ and also barely changed against the euro at €1.16:£. The Swiss franc slipped a little in the period.

The price of Brent oil rose further in April to finish the month 6.4% higher at $72 per barrel, which meant it was up 35% for the year to date. The price of gold fell a little to end the month another 0.7% lower at $1284 per troy ounce. Metal prices were mixed, with aluminium soft and palladium stronger. The major agricultural commodities were all down. The Vix index gauge of expected volatility in the US fell further in the month; hedge funds have reversed their approach in December, which seems a distant memory, and have been shorting positions.

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