AMR Financial Market Review

Winter Report January 2018

AMR
FINANCIAL MANAGEMENT

Review – Equities & Bonds

Interest rate concerns were offset in July by reassurances from Fed chair Janet Yellen that rate rises would remain muted and data dependent, while the rate of inflation fell in the UK on lower fuel prices. Good economic news continued in the month with positive China trade data. The Q2 earnings reporting season began, with generally positive results lifting US equities to all-time highs. In the UK, Diageo, HSBC and Rolls Royce's Q2s were well received, while AstraZeneca fell sharply on disappointment following a drugs trial result. August was quiet from a corporate perspective, with Gilead announcing an $11.9bn purchase of Kite Pharma. China GDP growth increased to 6.9% in the first half of 2017, while US and Japan GDP growth was also strong, with growth in the Eurozone also accelerating. UK growth however deteriorated, slowing to 0.3% in the second quarter. It was geopolitics however which drove markets during the month, with concern surrounding the brinksmanship between the North Korean missile programme and the US response to it, which saw safe haven assets outperforming. Toward the month end, a series of hurricanes caused widespread damage to parts of the US and Caribbean which impacted on financial stocks. Global equity indices rose strongly in September, led by the US which made record highs on more detailed Republican tax proposals and generally positive global economic data, particularly from the Eurozone which showed strong job creation. UK shares underperformed as Sterling strengthened following Bank of England hints that interest rates were likely to rise in November despite relatively weak data. Following strong year to date gains, Asian equities were mixed on continued North Korea concerns and a downgrade for Chinese debt. Fixed income markets were weaker on the month as the Fed confirmed that it would begin to reduce the size of its balance sheet, although corporate bonds outperformed government bonds.

Equity markets were strong in October, buoyed by strong data and corporate results, with global shares making multi-year highs. Corporate bonds outperformed safe haven government bonds. In the UK, utility stocks weakened after Prime Minister May re-launched the idea of price caps. There was concern over prospects for the UK consumer as real wages again showed a fall over the year on higher inflation. The Q3 earnings season started with broadly well received results, although GKN and Reckitt Benckiser were weaker following theirs. The oil price rose on strong global demand through the month, leading to outperformance by energy stocks. Toward the month end, encouraged by an improving economic backdrop the European Central Bank announced that they would halve the scale of monthly bond purchases to €30bn. But in November, despite continued good economic data and corporate results, equity markets were mixed as investors observed the path of the much-anticipated US Tax reforms through Congress. European equities underperformed on concerns that inflation remained low, while tech-heavy Asian indices gave up some of their strong year to date gains. With output curbs set to remain in place throughout 2018 the oil price continued to trend upward, touching $64, highest since 2015, and Shell outperformed following announcement of a share buyback. In the US, Retailers were led higher by post Black Friday optimism, and Broadcom's $130bn bid for Qualcomm marked the largest ever technology sector deal.

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Key Indicators

Equity Market Indices	*29/12/17*	*30/06/17*	*% change six months*	*31/12/16*	*% change one year*
UK – FTSE 100	7687.77	7312.72	+ 5.1	7142.83	+ 7.6
UK – FT ALL Share	4221.82	4002.18	+ 5.5	3873.22	+ 9.0
UK – FT Mid 250	20726.26	19340.15	+ 7.2	18077.27	+ 14.7
UK FT Small Cap	5911.89	5584.96	+ 5.9	5143.22	+ 14.9
USA – Dow Jones	24719.22	21349.63	+ 15.8	19762.60	+ 25.1
USA – S&P 500	2673.61	2423.41	+ 10.3	2238.83	+ 19.4
USA – Nasdaq	6441.42	5646.92	+ 14.1	4863.62	+ 32.4
Japan – Nikkei 225	22764.94	20033.43	+ 13.6	19114.37	+ 19.1
Europe – FT Europe ex UK	209.99	201.28	+ 4.3	188.28	+ 11.5
Asia – FT Asia Pacific ex Japan (£)	644.37	597.95	+ 7.8	538.13	+ 19.7
Emerging – FT Emerging (£)	620.58	567.66	+ 9.3	527.47	+ 17.7
Global – FT All World (£)	371.89	350.83	+ 6.0	334.71	+ 11.1
Currencies					
£/$	1.35	1.299	+ 4.2	1.236	+ 9.5
£ / Euro	1.13	1.139	– 1.1	1.172	– 3.8
£ / Yen	152.11	146.35	+ 3.9	144.12	+ 5.5

Sources: FE Analytics, returns shown in local currency unless otherwise stated, income withdrawn.

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The Bank of England reversed the 'emergency' post-EU referendum rate cut, but accompanied the rate rise with a relatively dovish statement, such that markets only expect one more rate increase in 2018. In early December, markets cheered a breakthrough in UK-EU talks, with sufficient progress deemed to have been made to progress to discussions on trade and Sterling strengthened. US rates rose for the third time this year, but with a dovish accompanying announcement from the Fed. Toward the month end, Trump's flagship $1.5tn tax reform bill was passed by Congress. Global equities finished the year at all time highs and despite the end of QE in the US, US ten-year yields remained unchanged on the year.

This led to stronger defensives and multinationals, driven by a fall in Sterling, while the domestically focused mid 250 underperformed. Safe haven government bond yields increased sharply toward the end of the month as interest rate expectations increased although corporate bonds outperformed on positive economic data. During the month, the best performances were seen from Asian and US equities, with UK and European equities both giving back some gains.

Outlook

The past six months have seen the continuation of one of the longest bull markets in history for both equity and bond markets. At the heart of this performance has been loose monetary policies from central banks globally and an improving macroeconomic backdrop with a rate of growth that is considered robust enough, but not too strong that it warrants a more aggressive tightening response from central banks. This is referred to as a 'Goldilocks' scenario by market commentators, with growth that is neither too hot nor too cold. Low interest rates and growth support the elevated valuations that many shares have achieved, meaning that the rate of growth and prospects for rises in interest rates are keenly watched by analysts.

Some central banks have begun the process of tightening, or at least slowing the rate of monetary expansion. The US Federal Reserve has increased rates three times this year, with three more expected next year and has begun to reduce the size of its balance sheet, accumulated through the years of QE. The Bank of England has increased rates once, with one more increase expected next year. The ECB has not yet tightened policy but is slowing the rate of monthly purchases. The Bank of Japan remains very much in expansionary mode despite good economic data. China is pursuing policies targeted at reducing speculative bubbles in housing and financial products whilst attempting to leave the trajectory of overall growth unchanged. Central banks remain focused on inflation, in particular inflation expectations which may lead to more robust wage demands by employees. In Western economies, the global economic recovery has been characterised so far by low wage growth despite high levels of employment and there seems to be little sign of wage demands getting out of control. Indeed, the European Central Bank may welcome signs of collective bargaining through trade union action in Germany. In the UK, wage growth remains negative after inflation is taken into account, although this effect will diminish as the effects of Sterling depreciation following the EU Referendum pass through the annual data. Overall, we see limited scope for inflation to reach levels which will require a more aggressive central bank response at this time, but will monitor central bank statements for changes in rhetoric.

The effects of Trump's $1.5tn tax reform are uncertain, but initial signs are encouraging, with companies committing to pay bonuses to employees and bring forward capital expenditure plans. It remains to be seen how much of the corporation tax cut is allocated to share buybacks, special dividends or M&A, but in any case, it represents further support for equities. Elsewhere, there are other long-term dynamics that are exciting, such as the trend toward automation, electric vehicle technology and e-commerce which will present opportunities for companies globally. Companies in Asia have a significant share in these growing industries, which makes us positive on prospects for Asian economies transitioning from being driven by low value-added exports to consumption and services to support wealthier populations.

Fixed Interest is likely to simply provide returns from coupons, but there are also prospects for limited gains from interest rate differentials reducing between higher risk bonds and sovereign bonds. However, now that central bank base rates are no longer falling, there is little scope for the sort of gains experienced in previous years.

We remain alert to risks; any prospects for a disorderly Brexit will damage the UK and European economies so we will closely monitor negotiations. Any signs of a bond market sell off gathering pace in anticipation of higher than currently expected interest rates globally will also impact on equity markets. Policy error in China would have ramifications for the global economy. Despite these risks, we are optimistic on prospects for equity markets in 2018, albeit we do not expect a continuation of the double-digit growth of 2017 combined with such low levels of volatility given some of the uncertainties that lie ahead.

Key Indicators

Equity Market Indices (£ Total Return)	% change six months	% change 2017	% change 2016	% change 2015	% change 2014	% change 2013	% change 2012
UK – FTSE All Share	+ 7.21	+ 13.10	+ 16.75	+ 0.98	+ 1.18	+ 20.81	+ 12.30
UK – FTSE 100	+ 6.94	+ 11.95	+ 19.07	– 1.32	+ 0.74	+ 18.66	+ 9.97
UK – FT Mid 250	+ 8.52	+ 17.78	+ 6.66	+ 11.17	+ 3.66	+ 32.27	+ 26.11
UK – FT Small Cap	+ 7.24	+ 18.15	+ 14.29	+ 9.17	+ 0.89	+ 32.77	+ 27.82
USA – Dow Jones IA	+ 12.50	+ 17.02	+ 38.96	+ 6.02	+ 16.89	+ 27.25	+ 5.40
US – S&P 500	+ 6.67	+ 10.62	+ 32.67	+ 6.58	+ 20.02	+ 29.10	+ 10.16
US – Nasdaq	+ 9.97	+ 19.22	+ 29.86	+ 13.16	+ 21.88	+ 37.52	+ 12.29
EU – FTSE Europe ex UK	+ 3.89	+ 17.12	+ 16.32	+ 9.54	– 0.92	+ 26.00	+ 19.11
Japan – Nikkei 225	+ 8.83	+ 12.64	+ 24.62	+ 13.29	+ 0.10	+ 26.90	+ 4.59
Asia – FT AW Asia Pac ex Japan	+ 8.96	+ 24.45	+ 26.88	– 3.52	+ 9.74	+ 1.51	+ 15.90
Emerging – FT AW Emerging	+ 10.88	+ 21.06	+ 35.43	– 10.31	+ 7.87	– 5.29	+ 12.76
Global – FT AW World	+ 7.10	+ 13.84	+ 29.56	+ 4.04	+ 11.30	+ 21.03	+ 12.00

Unit Trust Sectors (Retail, £ Total Return)

Unit Trust Sectors (Retail, £ Total Return)	% change six months	% change 2017	% change 2016	% change 2015	% change 2014	% change 2013	% change 2012
Mixed Inv 0%-35% Shares	+ 1.76	+ 4.51	+ 8.28	+ 0.20	+ 4.98	+ 4.17	+ 6.20
Mixed Inv 20%-60% Shares	+ 2.75	+ 6.95	+ 9.90	+ 1.12	+ 4.82	+ 8.57	+ 8.12
Mixed Inv 40%-85% Shares	+ 4.26	+ 9.78	+ 13.11	+ 2.31	+ 4.76	+ 13.77	+ 9.60
Flexible Investment	+ 4.65	+ 10.61	+ 13.54	+ 2.04	+ 5.00	+ 14.43	+ 10.02
UK All Companies	+ 6.06	+ 13.74	+ 10.71	+ 4.86	+ 0.46	+ 25.96	+ 14.96
Uk Equity Income	+ 4.14	+ 11.05	+ 9.05	+ 5.18	+ 2.81	+ 25.18	+ 13.61
UK Smaller Companies	+ 11.10	+ 26.63	+ 7.70	+ 14.68	– 1.89	+ 37.17	+ 22.08
Asia Pacific ex Japan	+ 8.96	+ 24.45	+ 26.88	– 3.52	+ 9.74	+ 1.51	+ 15.90
Europe Excluding UK	+ 3.89	+ 17.12	+ 16.32	+ 9.54	– 0.92	+ 26.00	+ 19.11
Global Emerging Markets	+ 10.45	+ 24.47	+ 31.71	– 10.47	+ 2.37	– 4.06	+ 12.64
Japan	+ 10.52	+ 17.45	+ 23.88	+ 16.08	+ 0.66	+ 26.20	+ 3.37
North America	+ 6.63	+ 9.47	+ 31.15	+ 4.64	+ 17.63	+ 30.41	+ 6.32
Global Equity Income	+ 4.79	+ 11.07	+ 22.51	+ 2.11	+ 6.97	+ 20.74	+ 10.55
Global	+ 6.39	+ 14.04	+ 22.27	+ 3.09	+ 6.99	+ 20.68	+ 10.24
Technology & Telecoms	+ 9.11	+ 23.83	+ 25.05	+ 8.15	+ 14.40	+ 28.32	+ 10.60
Property	+ 2.99	+ 5.67	+ 5.54	+ 5.25	+ 12.01	+ 5.94	+ 9.61
Targeted Absolute Return	+ 0.83	+ 2.86	+ 0.02	+ 2.66	+ 3.01	+ 6.32	+ 3.09
Sterling Corporate Bond	+ 2.05	+ 4.86	+ 8.55	– 0.41	+ 9.25	+ 0.48	+ 12.82
Sterling High Yield	+ 2.19	+ 6.20	+ 9.81	– 0.45	+ 1.40	+ 6.49	+ 19.08
Sterling Strategic Bond	+ 1.65	+ 4.63	+ 6.91	– 0.43	+ 5.76	+ 3.32	+ 13.67
Money Market	+ 0.06	+ 0.13	+ 0.25	+ 0.04	– 0.02	+ 0.08	+ 0.15
UK Gilts	+ 1.39	+ 1.48	+ 10.03	– 0.36	+ 12.62	– 4.96	+ 1.65
UK Index-Linked Gilts	+ 2.56	+ 1.85	+ 21.64	– 1.32	+ 17.31	– 0.43	+ 0.09
Global Bonds	+ 0.37	+ 1.55	+ 12.69	– 1.30	+ 4.08	– 2.86	+ 6.06
Global Emerging Market Bond	+ 0.30	+ 3.76	+ 23.95	– 3.71	+ 4.59	– 9.58	+ 12.10

Sources: FE Analytics, returns in Sterling unless otherwise stated, net income reinvested.

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