Keeping you informed matters

Economic review

April 2019

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Outlook

The first quarter of 2019 has been markedly better for risk assets than the final quarter of 2018. The S&P 500 has rallied some 22% from its December 2018 low. Brexit remains the key factor holding back the UK economy although economic growth around the world has softened, the interest rate environment is likely to remain more supportive of asset prices going forward.

We are a bit reluctant to add to the many millions of words already expended on the issue of Brexit but nonetheless, it is an issue that investors have to confront. The problem is, of course, that we simply do not yet know whether Brexit will be "hard" or "soft." It is true that Parliament has legislated to take hard Brexit off the table but, at the same time, without voting for something that Parliament can agree on.

It is worth remembering that unless and until Parliament does agree on a path forward, it has already legislated for a hard Brexit. That is the default legal position deriving from the Article 50 submission that the House of Commons overwhelmingly voted for over two and a half years ago.

One of the ironies of the whole process is that UK markets are, to some extent, protected from the fallout of Brexit because of our "non-membership" of the Euro.

In the event of a hard Brexit, sterling will fall, the value of overseas earnings will rise and stocks with a large amount of non-UK earnings will perform well. UK stockmarket investors benefit from a natural currency hedge.

Conversely, one of the problems that UK listed assets will face in the event of a soft Brexit is a likely revaluation upwards of sterling. UK stockmarkets tend to rise when sterling falls and tend to fall when sterling strengthens.

Growth in the UK has been impacted by the vacillation over Brexit. Goldman Sachs estimates that the cost to the UK is running at some £600 million per week or £31.2 billion per annum. As a result, the UK is one of the least liked markets in the world.

Unlike many other developed markets, UK listed assets do not trade at a premium to GDP. Currently unloved, the UK market is one of the cheapest developed markets.

It would not be unreasonable, therefore, to expect stockmarket stability in the face of a sterling revaluation. Moreover, it seems to us that we have reached the point where almost any "deal" would provide the clarity around which businesses could plan. Nonetheless, this is a risk for UK investors.

Looking to the future, the absence of inflation anywhere in the developed world is supportive of a softer path, not just of US interest rates, but of rates elsewhere as well. A softening in the US rates outlook also suggests that we may have passed "peak dollar."

If the US dollar (USD) has peaked, and both fundamental and technical analysis suggests that it has, then it will open the door to a sunnier outlook for Emerging Markets (EM). Rising US interest rates tend to tighten policy in the EM world as many currencies are formally or implicitly tied to the US currency. If USD strength goes into reverse, Emerging Markets in Asia and Latin America are likely to benefit.

China is a more difficult conundrum; the sheer scale of the economy raises the prospect of geopolitical tension between it and the US. Nonetheless, the authorities have relaxed policy somewhat over the quarter and whilst growth has been revised down from 6.5% to 6%, the focus is on the "quality" of that growth and on curbing excess borrowing. In summary, China is still a net positive for global demand.

This cycle is different to earlier cycles in that unconventional monetary policy has been at the forefront of the recovery from the banking and credit crisis of 2008. Equally, we seem to be emerging from policies of "austerity." For these reasons, we regard the recent jitters in stock and bond markets as "mid-cycle" corrections. In the absence of inflation, Central Banks have no incentive to bring the current expansion to an end.

Key facts about the world

United Kingdom

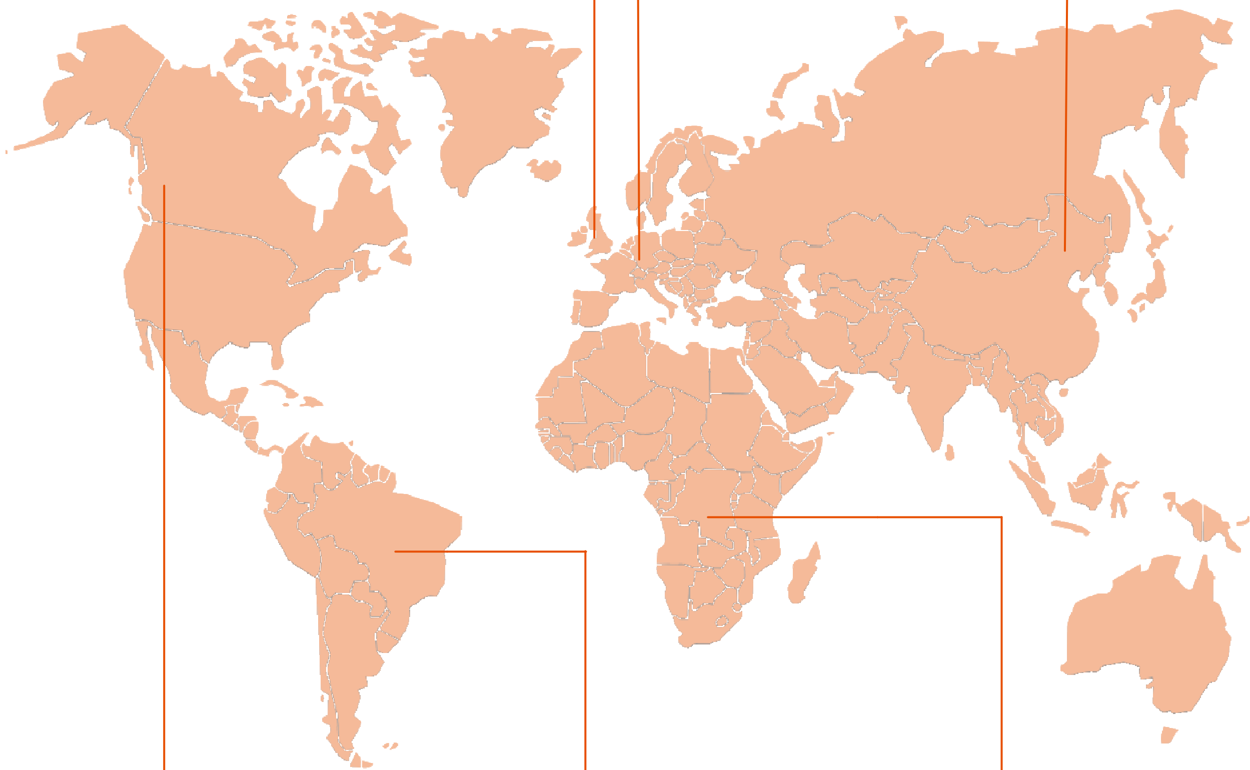
- The uncertainty around Brexit is still a cloud over UK equity markets
- While UK equity markets have rallied by around 11% YTD, valuations remain cheap

Europe

- Decline in Germany's growth forecast from 1.9% to 0.8%
- Italy large debt levels and slowing economic growth shows further signs of weakness in a major EU economy
- ECB rate hike delayed

Asia

- The Chinese economy reported its weakest economic expansion in 2018
- Signs of growth in the first quarter of 2019
- Consumer sentiment in Japan drops to three year low



North America

- Interest rate rises are on hold by the Fed
- Fastest growth of household income in the developed world

South America

- Strong growth in Brazil as new president is elected
- Inflation forecast in Argentina stands at 36%

Africa

- Presidential elections in Nigeria leaves the incumbent in power
- Slower Chinese growth a risk to commodity exporters

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Q1 Performance Review

A strong rebound in Equities

- Strong growth in technology, emerging markets and financials
- In the UK, smaller companies have outperformed the broader market
- Large UK companies have performed well but remain undervalued
- Weak growth and consumer sentiment in Japan
- Fixed interest exposure provided positive returns during rising markets

Technology, Emerging Markets & Financials Outperform

After a relatively difficult end to 2018 which saw several equity markets suffer double-digit falls, the first quarter of 2019 has been a source of respite with global equities rebounding. Some regions and sectors have inevitably performed much better than others.

The best performing funds during the first quarter were the Jupiter Financial Opportunities fund – buoyed by strong growth in FinTech and US financials, JP Morgan Emerging Market fund – helped by a weaker dollar and a more dovish Fed which is good for emerging markets and the Loomis Sayles US Equity Leaders fund thanks to its exposure to fast growing US tech companies whose valuations were beaten down in the second half of 2018.

In the UK, smaller companies have outperformed the broader UK market, which is to be expected in a rallying market. The Merian UK Smaller companies fund returned 10.09% in the first quarter versus a 9.38% return from the broader UK market. Large cap UK funds like JOHCM UK Equity Income and JOHCM UK Opportunities underperformed the market in this period but still have a strong underlying valuation which could be a catalyst for future returns.

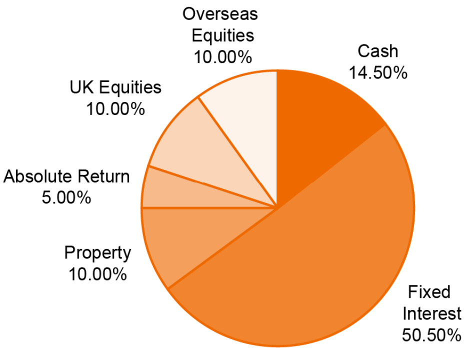
Japan has not rebounded as strongly as the other markets in this period as economic growth remains below expectations coupled with weak consumer sentiment.

Our fixed interest exposure has also provided positive returns in a period of rising equity markets. The best performer in this period was the L&G All Stocks Index Linked Gilts which rallied by 5.86%.

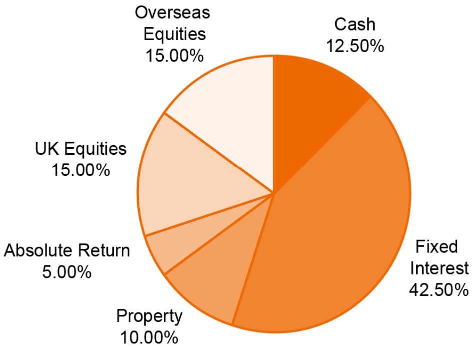
SECTOR	3 months	1 year to 31/03/19	1 year to 31/03/18	1 year to 31/03/17	1 year to 31/03/16	1 year to 31/03/15	5 years (annualised)
IA North America	11.20	0.37	15.79	33.54	-0.36	25.29	14.15
IA Asia Pacific Excl. Japan	9.20	7.24	3.16	35.19	-7.55	19.78	10.62
IA UK All Companies	9.02	2.80	2.83	18.07	-2.18	5.93	5.28
IA UK Equity Income	8.76	0.41	3.58	15.26	-0.73	8.90	5.32
IA Global Emerging Markets	8.04	8.87	-1.33	35.55	-8.14	12.53	8.52
IA Europe Excluding UK	7.57	5.80	-1.24	24.21	-1.48	6.77	6.42
IA UK Smaller Companies	6.91	14.57	-2.55	19.09	8.52	-2.09	7.16
IA UK Index Linked Gilts	6.05	-0.13	6.25	20.65	0.79	19.25	9.00
IA Property Other	5.38	2.10	23.32	7.27	3.26	16.27	7.51
IA Japan	5.08	9.13	-3.48	32.24	-2.13	24.36	11.14
IA £ Corporate Bond	3.90	1.76	2.97	9.45	-0.51	11.32	4.90
IA £ Strategic Bond	3.65	2.27	2.07	8.19	-0.77	7.32	3.76

Source: Morningstar, bid-bid pricing.

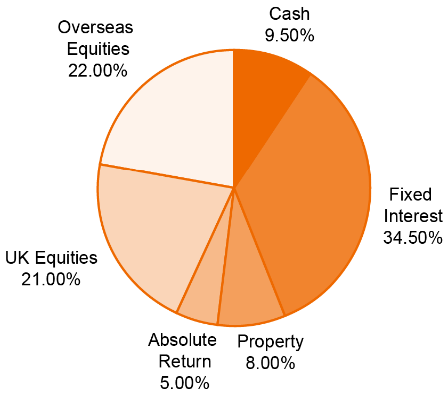
Very Conservative



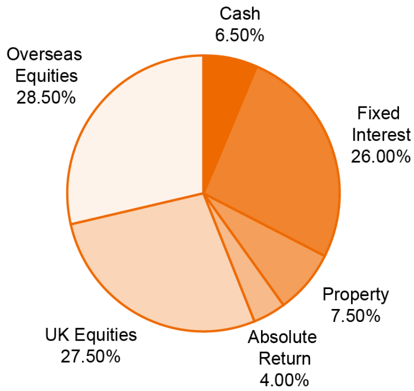
Conservative



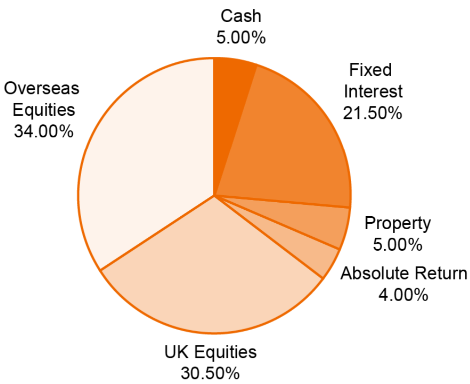
Cautious



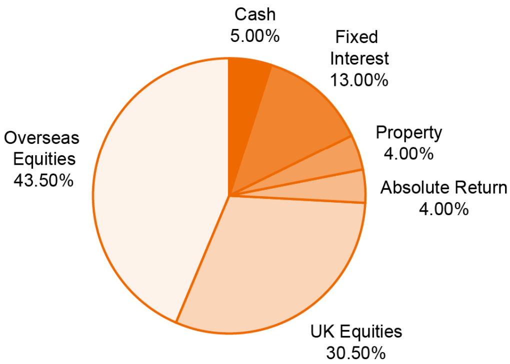
Balanced



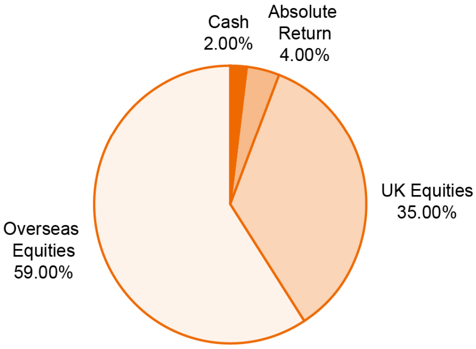
Growth



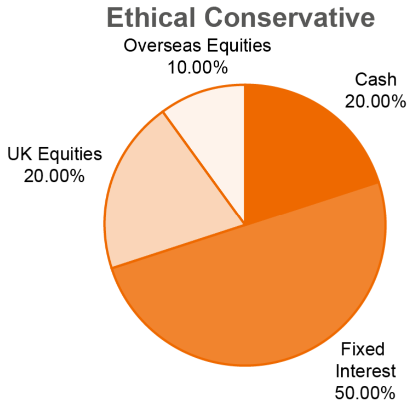
High Growth

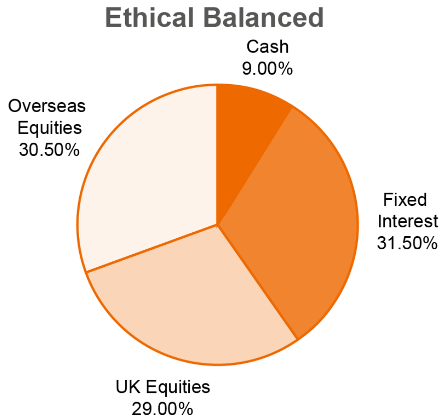


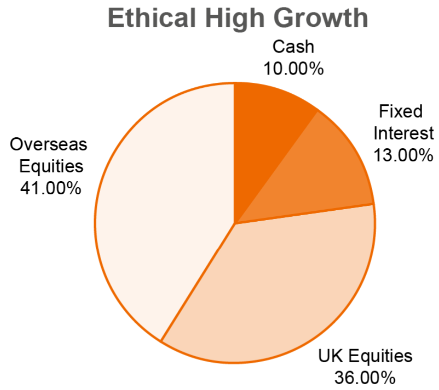
Adventurous



The positioning of our ethical strategies







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