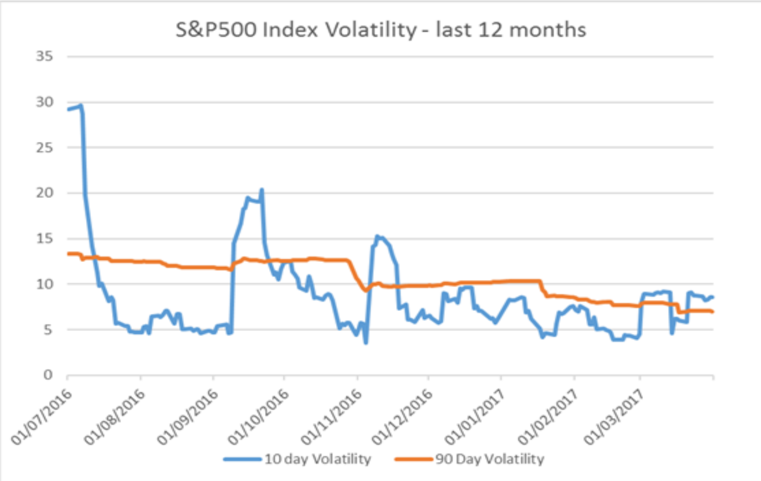
March 2017 – Market Commentary

Markets ended the first quarter of 2017 in a fairly steady manner. Equity markets moved sideways and volatility remained at low levels. Economically, there was nothing particularly out of the ordinary for investors to digest. The US Federal Reserve raised rates, which was almost entirely priced in by the markets. Inflation figures continued to be strong, particularly in the UK which is feeling the effect of the Sterling fall post-Brexit. Employment figures continued to improve, especially in Japan. There was a sense of steadiness in the economic data, which corresponded with the low volatility exhibited by the markets.



Source: Bloomberg

The major events during the month were political. In the UK, Prime Minister Theresa May triggered Article 50 on the 29th of March, officially signalling the UK's intention to leave the European Union. Negotiations will now begin, although EU leaders won't meet until the end of April to start to discuss the UK's terms of departure. There is a two-year window for negotiations and the market is likely to react as details of these negotiations emerge.

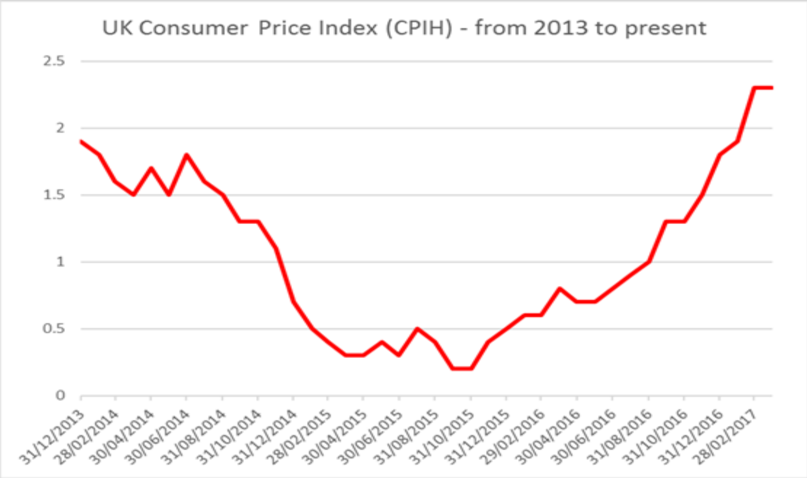
In Europe, investors were fixated with the Dutch election for increasing signs of populist support. In the end, the result was a disappointment for Geert Wilder's anti-immigration PVV party, and the incumbent Prime Minister, Mark Rutte, who won the election and is now in the process of forming a coalition, claimed that he had halted the "wrong sort of populism". All eyes now turn to the French Presidential election, with the first round on the 23rd of April. Markets are anticipating a run-off between Emmanuel Macron and Marine Le-Pen, the centrist and far-right wing candidates respectively, however support for the other two main candidates, the conservative François Fillon and the far left-wing Jean-Luc Mélenchon, signal that this could become a four-horse race going into the first round.

In the US, the main news surrounded the American Healthcare Act which President Trump shelved when he realised it wouldn't get through the House of Representatives, despite the Republican majority there. The repeal of Obamacare was a central tenet of Mr Trump's candidacy and was seen by political commentators as a fairly easy win. However, its failure to come into law now puts into question the other, more controversial, policy proposals espoused by Trump, for example the reform of the tax system. One of the reasons for the strong rally from November was on the policies planned by the new President and their far-reaching effects on the US economy. The market is now pricing in the possibility that these may no longer happen, which could result is more volatility from the low levels that we have seen so far this year.

UK

March in the UK saw the Chancellor, Philip Hammond, deliver his first UK budget, aimed at 'Brexit-proofing' the economy. The annual budget statement, which used to have market traders glued to their screens, has become increasingly irrelevant as much of the content is anticipated and/or leaked ahead of the announcement. This year, once again, saw few surprises and little reaction from the markets as the budget was fiscally neutral and viewed largely as setting the stage for the Autumn Statement, by which point there will be some indication of how Brexit negotiations are proceeding.

Data released during the month did nothing to dampen hopes for the continuing health of the UK economy, with confirmation that GDP grew by 1.8% during 2016. Figures showed that strong growth in consumer spending had driven a fall in the household savings ratio. Manufacturing saw quarterly growth of 2.1% in January, reaching a seven-year high, whilst services output fell slightly although it remains relatively strong. The new central measure of inflation, CPIH (Consumer Price Inflation Including owner-occupiers' Housing costs) showed a rise of 2.3% in February, inevitably reflecting increased price pressure from energy and imported goods.



Source: Bloomberg

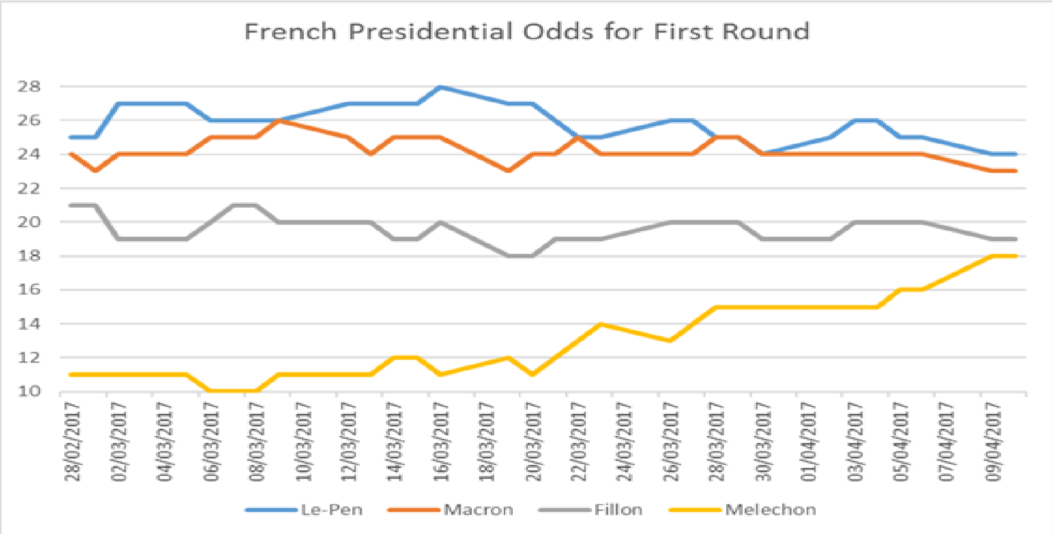
29th March saw the triggering of Article 50 of the Treaty on European Union, giving notice of the UK's intention to leave the EU and commencing the two-year period for exit negotiations to take place. Despite a great deal of media fanfare, and statements from both UK and EU politicians, investment markets remained largely indifferent to this development and the FTSE 100 ended the month just 0.8% up from February. Sterling was similarly little changed against the Dollar, Euro and Yen, as recent currency gyrations driven by Brexit and more recently Donald Trump finally calmed down, at least until EU leaders meet on 29th April to discuss the UK's terms of departure. Early statements have indicated that a hard line will be taken by the EU, but it is far from clear that either side has a dominant position in this negotiation, and there will doubtless be turbulent times ahead for markets as the news from Brussels unfolds. In the fixed income market, gilts were steady and the Monetary Policy Committee opted to keep rates unchanged once again, as had been widely expected.

In equities, the neutral performance from the FTSE 100 Index belied the wide range of movements in underlying industry sectors. Technology hardware companies outperformed the rest of the market, driven by Spirent, an international telecoms hardware testing company, up 13.0% as investors continued to search for sectors that will benefit from increased spending by corporate America. Oil services companies also fared well, driven by a £5bn merger between John Wood Group and Amec Foster Wheeler. Conversely, Electricity stocks led the underperforming sectors with SSE falling 9.6% after Prime Minister, Theresa May, said that she would 'fix' the energy market for consumers, hinting at a price cap on energy. Miners also suffered as concerns were expressed over the future direction of iron ore prices. Workers at the Chilean Escondida copper mine returned to work after a 43-day strike, invoking a clause that enabled them to keep their old contract for eighteen months. The resolution was seen as negative for the mine's owner, BHP Billiton, weakening the company's hand in future negotiations.

EU

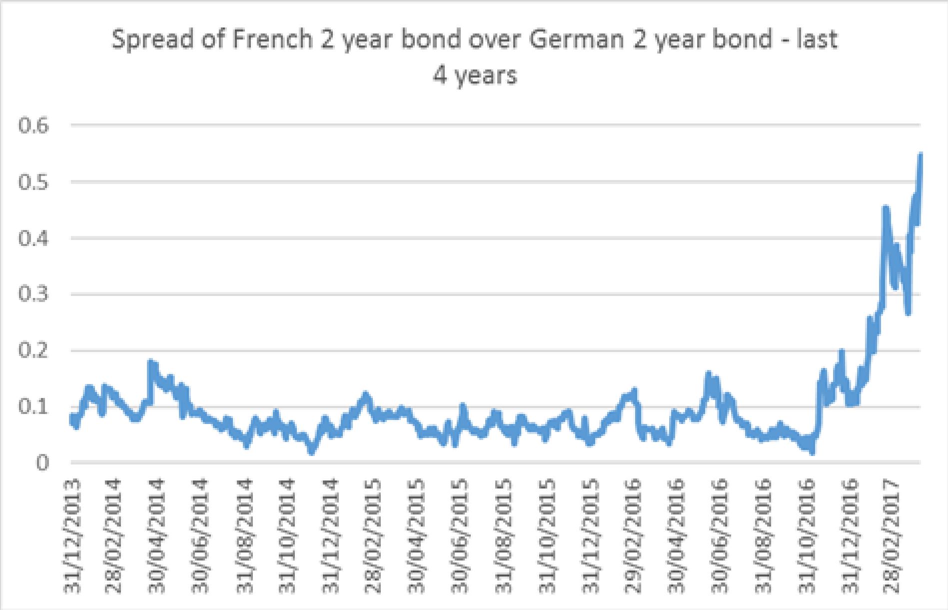
Politics continued to dominate the European headlines in March. The Dutch election came and went without any major impact. Incumbent Prime Minister Mark Rutte won the election and, although they lost 8 seats, they remain the largest party and are now in the process of searching for coalition partners. Geert Wilders anti-immigration party, PVV, did increase its share of the vote, and number of seats, but did less well than opinion polls and analysts had been expecting. This allowed Prime Minister Rutte to claim to have stopped the "wrong sort of populism". In the end, the result of this election didn't cause the impact that some political commentators had been concerned about.

If the Dutch election was the appetiser, the main course in European politics over the summer is undoubtedly the French Presidential election. The first round is to be held on the 23rd of April, with the run-off between the two leading candidates to be held on the 7th of May. Opinion polls have Marine Le-Pen of the National Front, and Emmanuel Macron, an independent and previous minister under current President Hollande, as clear winners in the first round, with Mr Macron likely to win the second round. However, François Fillon is not far behind, despite the corruption scandal surrounding his candidacy. At the second live television debate, the far-left wing candidate, Jean-Luc Mélenchon was judged to have performed best by a snap poll immediately following the debate. His stance is fairly similar to Ms Le-Pen, in that he is a euro-sceptic and a protectionist who would take France out of NATO. Mr Mélenchon's support has been increasing recently and there is some momentum to his campaign, which could become a four-horse race going into the first round. A Le-Pen/Mélenchon second round vote could have serious implications for France's position in the European Union.



Source: Bloomberg

Therefore, while markets are pricing in more risk concerning the Presidential election (for example, French 2 year bonds are trading at the highest spread over the German 2 year bonds since 2012), they still expect a Macron victory in May. It is important to remember that the President is only one part of the legislature. The National Assembly elections in July could have a bigger impact in French politics especially as Mr Macron's party, *En Marche!,* lacks grass root candidates and support. So even if he does win, he may lack assembly support to made any radical changes.



Source: Bloomberg

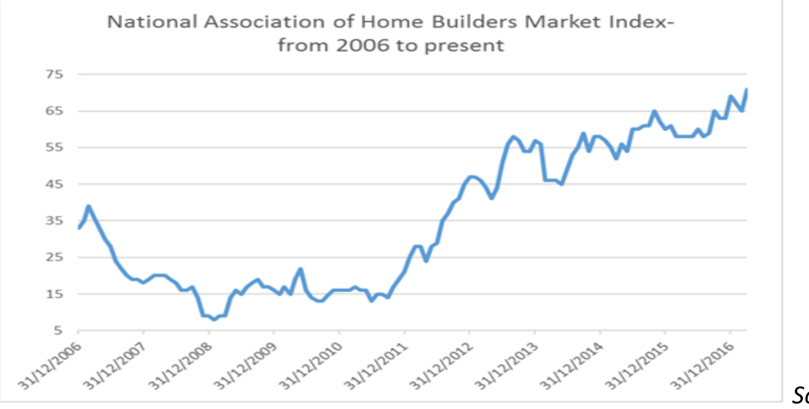
Away from the political spectrum, European economics continued to improve. Inflation figures pulled back slightly from their February figures across the Eurozone. Unemployment figures continue to fall and retail sales figures remain robust. Equity market performance was strong as European equities recovered a little of their recent underperformance against the US and UK. The ECB kept rates unchanged although the end of March signals the change in their bond purchase Quantitative Easing programme. From April, the ECB will look to buy €60bn of bonds per month, rather than the previous €80bn per month. The market will continue to keep an eye on economic data while following the political news surrounding the French election.

US

The US equity market continued to be driven by the actions of President Trump and the main feature in March was the last-minute shelving of the American Healthcare Act, which proposed to replace Obamacare. Horse-trading throughout the day on 24th March failed to rally enough support from within the Republican party to secure the bill's success and its withdrawal, late in the day, was a blow to equities leading the S&P 500 Index to its eighth consecutive down day. Hospital stocks and other healthcare companies were boosted by the failure of the healthcare reform bill, which would have led to an additional 24 million Americans being uninsured over the next ten years.

The markets had already been losing confidence in Trump's ability to deliver on many of his promises, and the healthcare setback led to speculation about his ability to push through his flagship tax reforms. Eight weeks ago, Trump said he would be releasing a "phenomenal" tax plan within two or three weeks. But, as yet, there is no sign of a plan, and the administration hasn't yet publicly answered the most basic questions about what a possible tax reform plan would look like. White House Press Secretary Sean Spicer has emphasized that job creation and economic growth are priorities -- an indication that controlling costs may not be Trump's primary concern. That could make tax cuts difficult as, without a plan to offset the lost revenue, Congress would have to enforce legislation to prevent tax cuts from increasing the US fiscal deficit.

Elsewhere, March saw the first of what is expected to be several increases in the Fed rate this year, as Janet Yellen announced the third-rate rise since the 2008 crisis, raising US rates from 0.75% to 1%. Yellen pointed to a number of indicators showing the US economy to be in good health, and suggested that the appropriate "normal" rate for the economy should be a real rate of around 1%. Consumer prices were 2.7% higher in February vs a year earlier, inflation excluding food and energy was reported at 2.2% and a National Association of Home Builders housing market index also rose to its highest level since 2005. March's rate hike had been fully discounted and was met with only a four-basis point increase in yield at the long end of the curve.

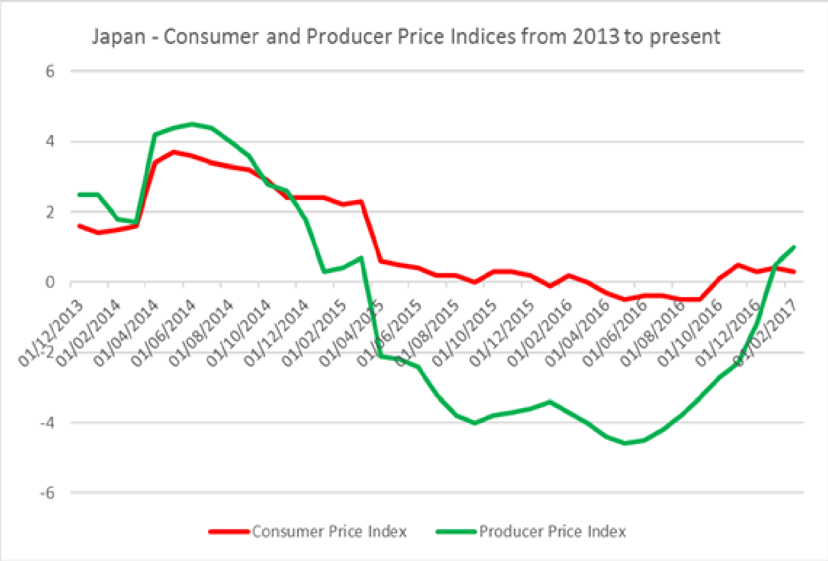


Source: Bloomberg

Equities reacted positively to the comments on the economy, rising 90 points in the minutes following the announcement, however, the equity market ended the month little changed, as investors were cautious ahead of Trump's upcoming summit with the Chinese leader, Xi Jinping, in early April.

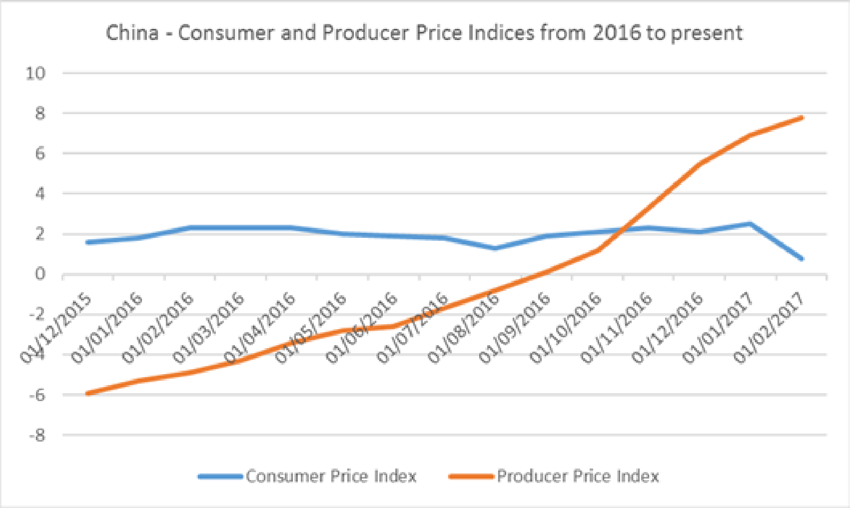
Asia Pacific and Emerging Markets

The inverse correlation between the strength of the Japanese Yen and equities continued to play out in the first quarter. The Yen had a strong month against the US dollar, which drove the majorly exporting companies that dominate the Nikkei index down. Japanese equities have now erased all of their gains and are flat on the year. Despite this, the economic news coming out of Japan is encouraging. Inflation numbers continue to be positive, with the Consumer Price Index (CPI) remaining around the +0.3% level YoY. The Producer Price Index (PPI) continues to grow and is now at +1% YoY. PPI looks at rising prices from the perspective of the producer of goods rather than the end consumer, and can therefore sometimes be a leading indicator of CPI growth. Industrial production has picked up and the jobless rate continues to fall, and is now at 2.8%, which is multi-year lows. The Bank of Japan continues to keep monetary easing on hold with its yield curve control policy which targets a zero percent yield for the 10-year Japanese Government Bond, so it is very much steady as she goes in Japan for now.



Source: Bloomberg

There is also a sense of steadiness surrounding the Chinese market at present. Equity markets have been strong. China A-shares (Chinese companies listed on the mainland) and H-shares (Chinese companies listed in Hong Kong) were up over 4% and 9% respectively in the first quarter, as part of a broader rally in Emerging Market assets. The currency has also remained fairly steady against the US dollar in March. The People's Bank of China (PBoC) followed the US Federal Reserve's increase and tightened liquidity in March by raising short term borrowing costs in an effort to control capital outflow. This will also help to stem the increase in credit in China which has concerned the market. GDP growth expectations remain constant at +6.8% YoY. Similarly, to Japan, Consumer Price Index inflation numbers appear reasonably benign at +0.8% YoY, while Producer Price Index inflation is rampant at +7.8% YoY, the biggest print in over 5 years. The PBoC will be vigilant if PPI growth starts to impact consumers.



Source: Bloomberg

Elsewhere in Emerging Markets, investors are beginning to regain confidence in developing countries. The MSCI Emerging Market index was up over 2% in March, adding to what has been a stellar start to the year, and inflows in Emerging Market funds are increasing. Of course, the Emerging Markets space is extremely broad and there are dichotomies in the performance during this period. India has been a particularly strong performer (+12% in the first quarter) while other countries have not fared so well. Emerging market investments can be particularly impacted by politics. A prime example of this in March came from South Africa, where President Jacob Zuma dismissed his Finance Minister Pravin Gordhan, a man well respected by the markets. This was seen by commentators as a move for President Zuma to replace pro-market politicians with loyal allies. The markets reacted by selling the South African Rand. South African bonds were also downgraded to junk status by Standard & Poor's.

Emerging Markets are also synonymous with commodities. The spike down in the oil price mid-March, due to increasing oil supply numbers particularly from the US, had an obvious impact on the major oil exporters, such as Russia. In Brazil, an investigation into meat exports pushed the market down. Brazilian police launched an investigation into the alleged bribery of officials who inspect and approve the quality of beef and poultry exports. Brazil is the largest exporter of both meats worldwide and this probe into sales of tainted meat caused some countries to enforce a ban of Brazilian meat imports. This had a devastating effect on the main food manufacturers and, therefore, on the Brazilian market as a whole. There can be substantial additional political and corruption risks involved in trading some Emerging Markets, but it is a diverse investment space which has provided decent returns so far this year, for those who are willing to take on the additional risk involved.

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