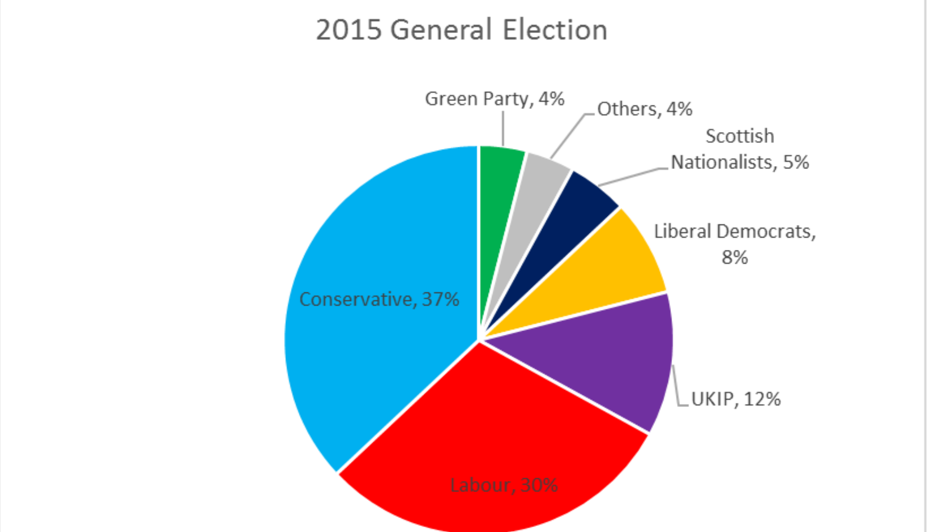
April 2017 – Market Commentary

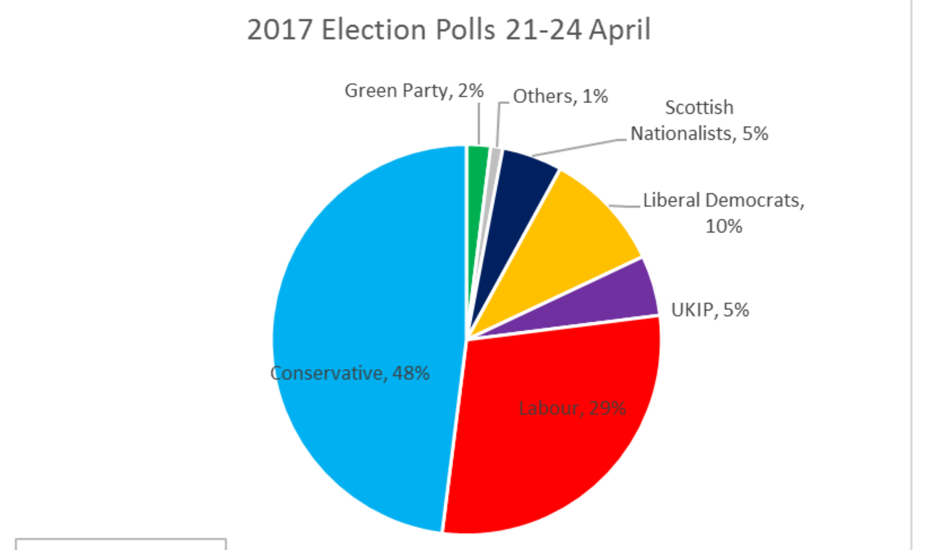
Major markets failed to make significant progress in April. Some profit-taking after a good first quarter, and the ongoing inability of President Trump to enact any of his key policies saw investors waver somewhat in their belief in US growth. After the withdrawal of the American Healthcare bill in March, April was to be the month in which Trump had to try to push his tax-reforming budget through Congress, though this was by no means a sure win for Trump, as US legislation is in place to ensure that an unbalanced budget cannot add further to the US fiscal deficit. In the end, the budget talks on 28th April concluded with a stop-gap funding package allowing a further week in which to agree a budget deal and averting a government shut-down. Elsewhere in the world, Europe began to set out its position ahead of Brexit negotiations, and attention was focussed on the first round of the French elections which, as expected, resulted in a Macron/Le Pen run-off in the second round on 7th May. North Korea continued to twist the tiger's tail, goading the US and the rest of the world after an unsuccessful medium-range missile test.

UK

As if the triggering of Article 50 in March was not a sufficient source of excitement for UK investors, April saw a snap election called for 8th June, where Theresa May will seek to establish a substantial majority in Parliament to strengthen her hand before beginning the Brexit negotiations in earnest. Indeed, the opinion polls and bookmakers are generally in agreement that this is exactly what will happen, and the polls that are published daily show a Conservative lead that is mostly in the high teens or low twenties. As none of the major parties is seeking to make this election a re-run of the Brexit referendum, there is little reason to expect an upset, and the nation is breathing a sigh of relief that campaigning will only last a few weeks, rather than the usual six months.



Source: Electoral Commission



Source: YouGov

After little net movement in March, UK equities lost some of their shine in April as blue chips led the market lower, with the FTSE 100 falling by 1.6%. An aggressive initial position taken by the EU on Brexit talks, and a recovery in Sterling to more than $1.29 (a level not seen since last September) caused the internationally-based large-cap stocks to pause for breath. The rotation towards the less researched mid-cap stocks, and domestically-focussed small-caps continued to be evident, however, as the Mid 250 Index rose by 3.4% and the Small-cap Index by 1.8%. Growth, once again, triumphed over Value-based stocks, though neither category achieved a positive return overall. CPI Inflation remained steady at 2.3% in March, though core inflation, which excludes energy, food, alcohol and tobacco, fell to 1.8%, from 2.0% in February. This did not stop dampen enthusiasm for index-linked gilts, which continued to explore new record low yields, with shorter-dated issues reaching as much as -3.5%. Conventional gilts saw little change across the curve, as expectations continued to be for no change in monetary policy for the present.

The seasonally adjusted UK Markit/CIPS Manufacturing PMI rose to a three-year high of 57.3 in April 2017, up from March's four-month low of 54.2 and above market expectations of 54. Manufacturing production expanded at the fastest pace in three months, driven higher by the strongest inflows of new work since January 2014 from both domestic and export clients. Unemployment also continued to reduce. Against this backdrop, software, electronic equipment and leisure goods sectors all saw strong gains during the month. Conversely, electricity companies continued to suffer from the expectation that Theresa May will introduce a price cap, whilst mining shares saw further losses on commodity weakness and fears for China's economic outlook. Technology hardware companies provided the worst-performing market sector, as news that Apple will stop using graphics chips from Imagination Technologies sent the latter's share price down from 268p to 103p (-62%) at the beginning of the month, sparking profit-taking in a sector that had performed well during the first quarter of 2017.

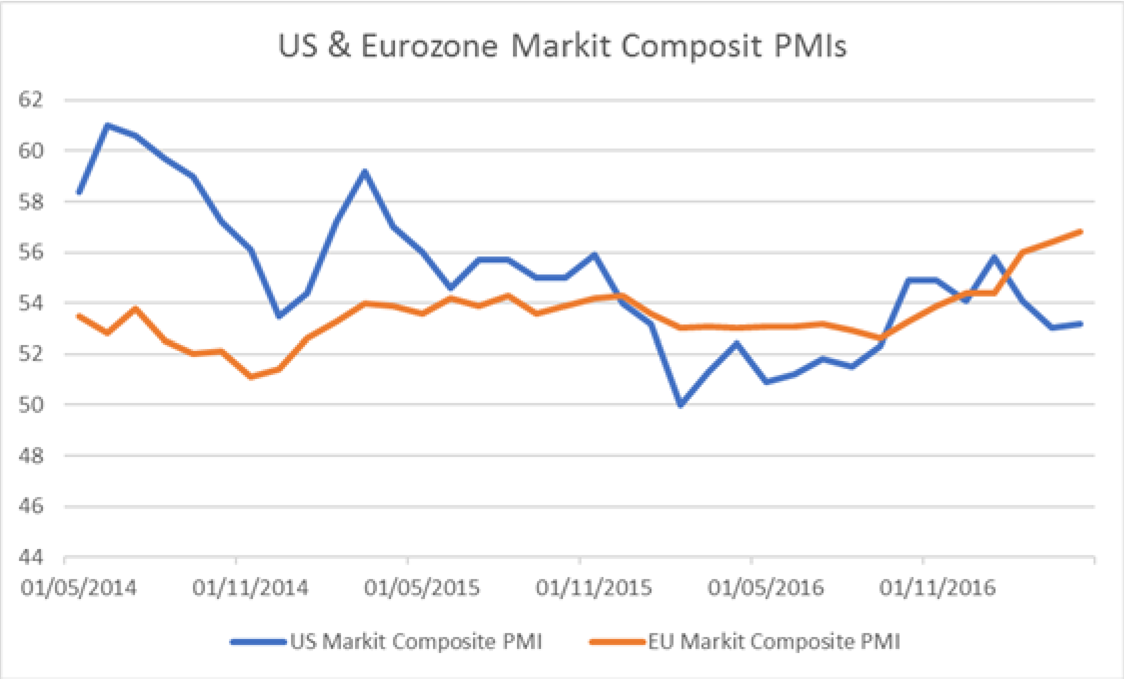
EU

Attention in the Eurozone was focussed on the unified front apparently being presented ahead of Brexit negotiations, and, of course, the first round of the French election. Expectations for a Macron/Le Pen run-off were fulfilled in the first round of voting, which saw the centre-right Francois Fillon and left-wing Frexiteer Jean-Luc Melenchon exit the race for the presidency. Expectations for an outright victory for the pro-EU socialist, Emmanuel Macron on 7th May are entrenched in the stock market and a Le Pen victory would be a substantial upset both politically and economically. The CAC 40 was among the strongest European markets during the month, rising by 3.2% to outstrip the DAX (+1.0%), the MIB (+1.1%) and the IBEX (+3.0%).

The perceived reduction in the risk of Frexit saw the Euro gain against the Dollar, rising from 1.069 to 1.089 over the month and the economic rebound in the EU continued. Consumer prices in the Euro Area are expected to increase by 1.9% year-on-year in April, following a 1.5 percent rise in March. Prices rose at a faster pace for energy and services. Annual core inflation, which excludes volatile prices of energy and unprocessed food and tobacco and which is the focus of the ECB in its policy decisions, rose to 1.2 percent, the highest since June 2013.

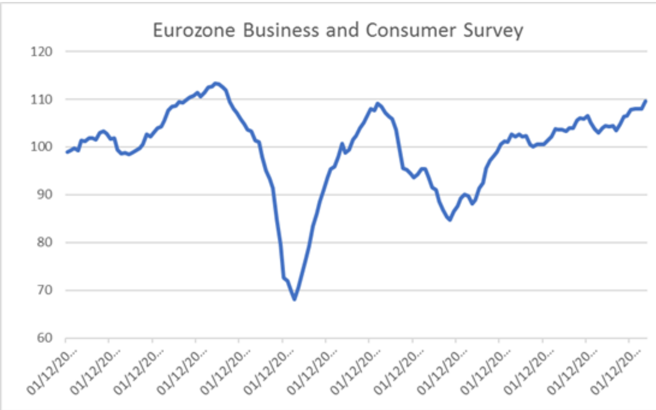
The European Central Bank held its benchmark refinancing rate at 0% for the tenth consecutive meeting and left the pace of its bond-purchases unchanged on April 27th, as widely expected. Policymakers confirmed the monthly asset purchases will continue at a monthly rate of €60 billion until at least the end of the year.

The Euro Area economy expanded 1.7 percent year-on-year in the first quarter of 2017, easing from an upwardly revised 1.8 percent growth in the previous period, in line with market consensus. Economic activity in Eurozone appears to be gathering pace, certainly compared to the US yet QE continues so it will be interesting to see the ECB's next steps.

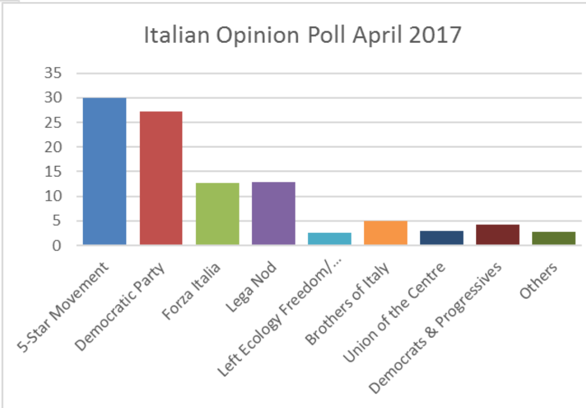


Source: Bloomberg

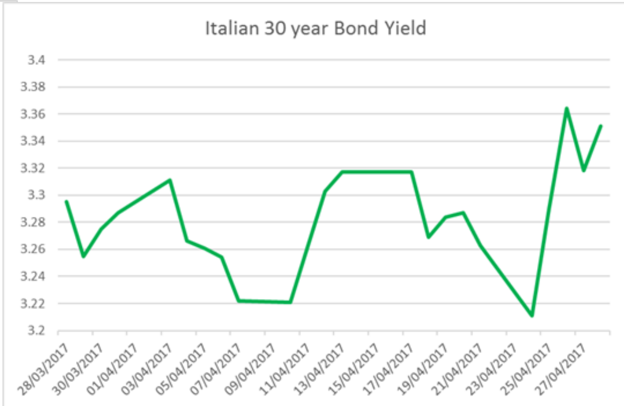
Ahead of the French election, Eurozone Industrial Sentiment continues to strengthen, and reached its highest point since 2011. Eurozone business and consumer confidence hit the highest level in a decade. Meanwhile Italy is now less than a year away from its own elections and the growing popularity of the anti-establishment, Eurosceptic Five Star Movement is beginning to show in the fixed income market, as long-dated government bond yields rose dramatically during the second half of the month. The thirty-year bond reached a yield of 3.36%, rising from below 3.2% as investors prioritised political worries over signs of the ongoing economic recovery in the country.



Source: Bloomberg



Source: Demopolis



Source: Bloomberg

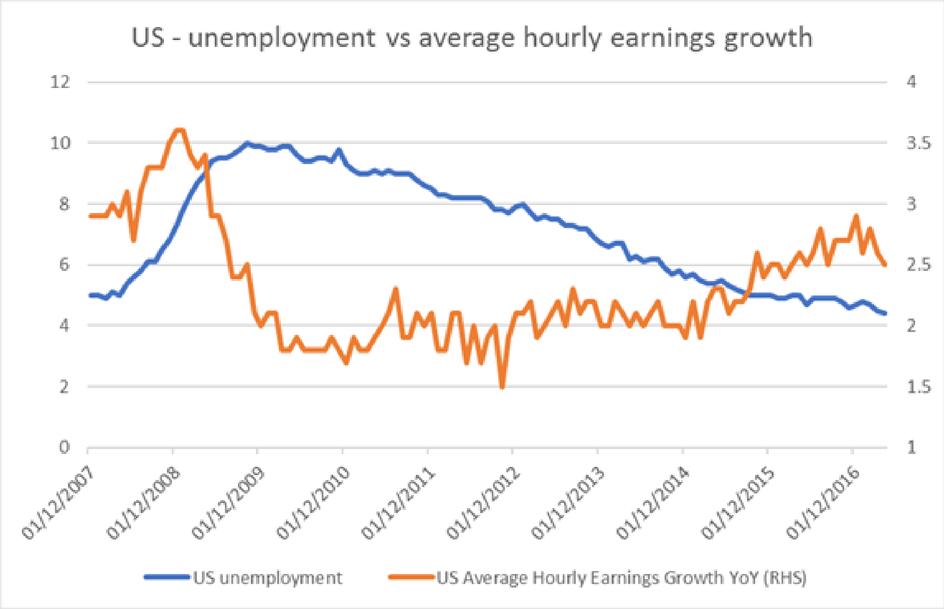
US

There is a substantial amount of disparity in the US political and economic spheres at present. In April, President Trump reached his 100th day in office and marked this by telling reporters that he found the job harder than he expected. Political analysts have also found the Trump administration a difficult period due to the number of discrepancies between what Mr Trump the candidate said, and what Mr Trump the President does. This was particularly obvious in April when Chinese President Xi Jinping arrived in the US for a summit with President Trump. During the election campaign, Mr Trump signalled China as a currency manipulator which hurts the US economy. This rhetoric disappeared during the Mar-a-Lago summit in early April as he backtracked on those comments.

Part of the reason for this was to get China's co-operation in relations with North Korea. Tensions mounted during April as North Korea tested ballistic missiles and the US launched an air-strike in Syria. Mid-month, markets reacted as you would expect to geopolitical crises, with gold increasing and US Treasury yields falling as investors sought safe havens. The S&P500 Volatility Index (VIX - also known as a "fear gauge"), an indication of market stress, rose to the highest level since Trump came to power. By the end of the month, these moves reversed as tensions eased slightly. The VIX index has now fallen to the lowest levels since 2007.

Mr Trump has also failed to deliver on other campaign pledges such as the reform of the tax structure. During his campaign, Mr Trump pledged to reform the US tax system, reducing corporation tax to increase investment and repatriate cash held by companies offshore back into the US. Markets rallied on these proposals. However, the failure of the Republican Party to agree on a repeal of Obamacare suggested it may be more difficult to implement a tax reform than the markets had initially expected. In April, Mr Trump announced his plans for tax reform. As with other proposals, the tax reforms were light on detail and this disappointed the market.

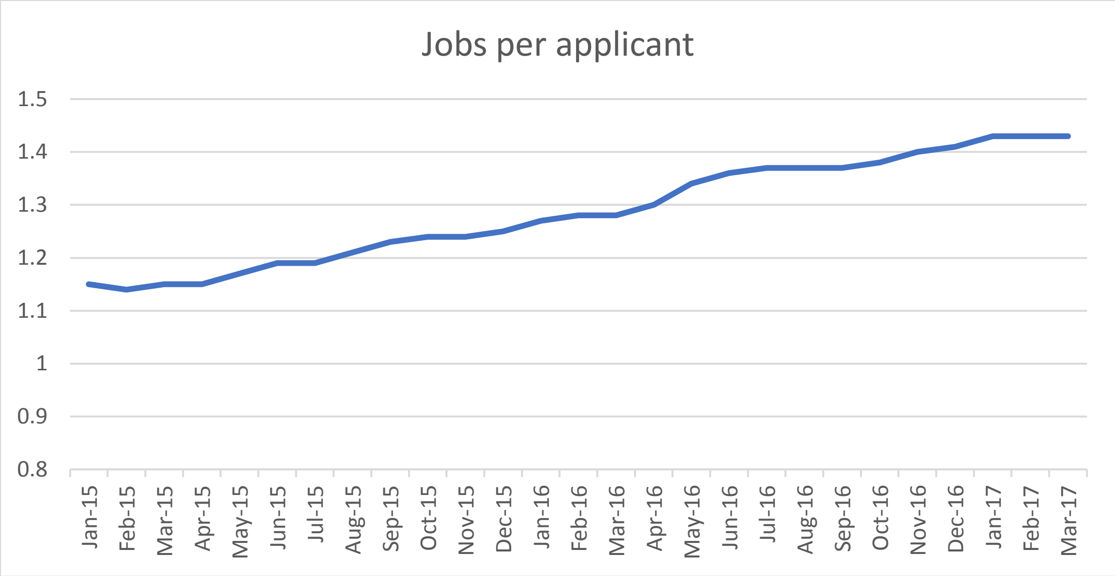
Investors are also evaluating contradictory economic data too. GDP growth figures disappointed analyst expectations although corporate earnings figures for the 1st quarter have been fairly positive so far. In the labour market, the unemployment rate continues to fall, now at 4.5%, the lowest level since 2007, however the widely watched change in Non-Farm Payrolls figures continues to disappoint investor expectations. Inflation figures have also been falling, both actual data (Consumer Price Index data was -0.3% MoM in March) and inflation expectations. However, average hourly earnings figures remain robust, and the Personal Consumption Core Price Index, a measure used by the Fed while determining interest rates, has been increasing. This suggests that there is strength in US employment and that companies are growing, but this is not currently feeding through to inflation or GDP growth. This disparity in economic data goes part-way to explaining the markets performance. Equity markets increased over the month (the Nasdaq Index, consisting of mainly technology companies, hit a new high in April) but that investors are waiting for more clarity on information before embracing the US reflation story, both at an economic and political level.



Source: Bloomberg

Asia Pacific and Emerging Markets

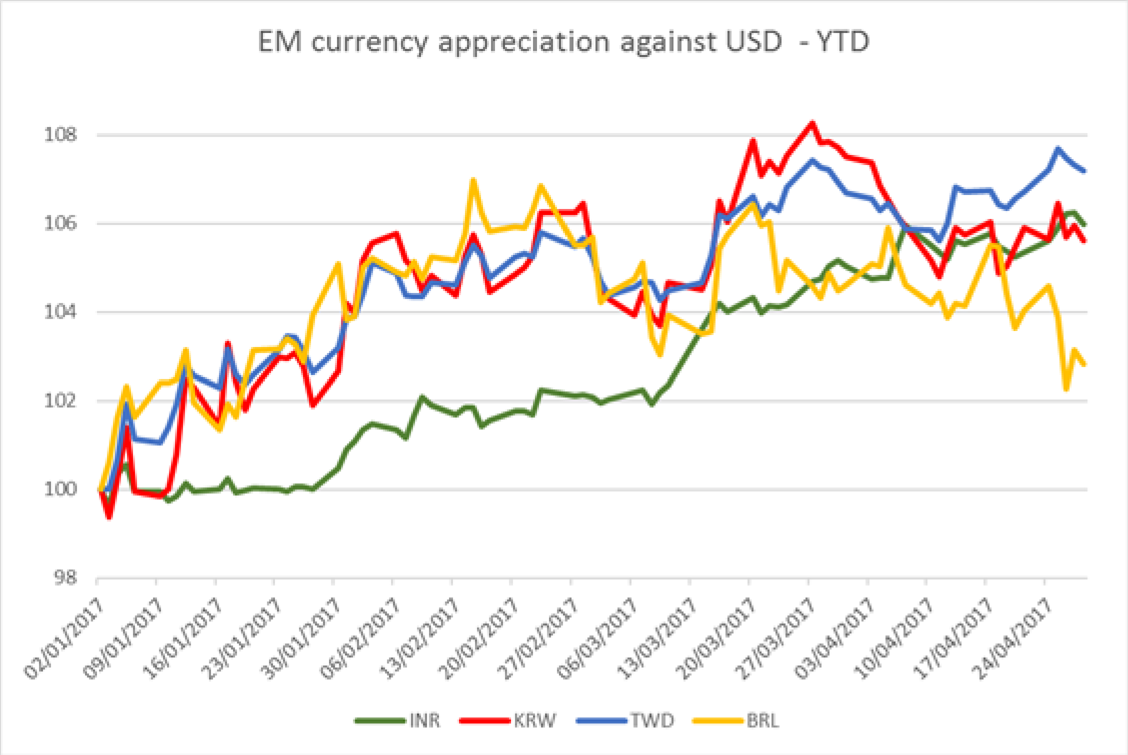
Japanese equity markets were up in local currency terms for the month, however trailed broader global equities. Japanese equities are roughly 2% behind global peers for the year-to-date. In corporate news, troubles at Toshiba's US nuclear unit - Westinghouse, dragged the former blue-chip company to its greatest ever annual loss. The firm is now looking to sell its prized memory chip unit and questions surround its ability to remain as a going concern. Later in the month, sabre rattling between North Korea and President Trump weighed on markets. Relief came in the form of a Macron victory in France, as well as a falling yen, which led to improved sentiment and sharply swung the export-oriented Nikkei index back into positive territory towards the end of April. Despite relatively-weaker equity market performance, economic news remained positive. Industrial production rose 3.2% year on year (yoy), higher than expected. Exports (+12% yoy), retail sales (+2.1% yoy) and employment data (1.45 jobs per applicant) also came in above expectations. At its 26 April meeting, The Bank of Japan maintained accommodative policy measures and held interest rates at -0.1%. The Bank also increased its economic growth forecasts, citing the effect of fiscal stimulus and overseas growth.



Source: Japan Institute for Labour, Policy and Training

Chinese equity markets also had a choppy month, with the Shanghai composite closing down 2.1% in RMB terms and trailing broader emerging markets. Markets were shaken by a crackdown from the China Securities Regulatory Commission, which undertook efforts to curb leverage and urged tighter supervision by stock exchanges of listed companies. The shift seems to suggest a greater focus by the government on reducing financial risk. The People's Bank of China also sought to rein in financial excess, taking steps to drain liquidity, thereby increasing interbank lending rates. Economic data was mildly positive, with GDP growing 6.9% yoy, slightly higher than expectations for a 6.8% rise. Export growth far exceeded expectations coming in at 16.4% for the past year compared to an anticipated 3.2% rise. In contrast, manufacturing and non-manufacturing purchasing manager indicators dropped slightly from last month.

In other emerging markets, Poland had a stellar month with the blue-chip WIG-20 index rising almost 10%. Poland's equity market has been a robust performer year to date, rising over 20% in Zloty terms on the back of strong GDP growth and falling unemployment. Emerging market equities as a whole outperformed developed markets by around 0.7% for the month, this occurred as Macron's win on the 23rd of April pushed the VIX index (an indicator of forecast US market volatility) close to all-time lows, indicating "risk on" sentiment which is typically positive for emerging markets. Year to date emerging markets have outperformed developed by over 5%. This has occurred as longer-term US rates have fallen from recent highs (which is positive for many emerging markets which borrow in USD), and capital inflows into emerging markets have increased. Much of this rise has been attributable to gains from currency, with key emerging market currencies such as the Indian Rupee (+6.0%), Korea Won (+5.7%), Taiwan Dollar (+7.2%) and Brazilian Real (+2.9%) appreciating materially against the US Dollar.



Source: Bloomberg

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