Spring

Market outlook.

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The UK Economy

Whilst UK wage growth in February was at its strongest since August 2015 and 0.3% higher than March's UK CPI inflation at 2.5%, UK consumer confidence is still negative. With house price inflation cooling and declining retail sales, it is likely to take a long time to rebuild any consumer confidence in the UK and with household consumption accounting for more than 60% of UK GDP, accommodative monetary policy is likely to be maintained for some time. The Bank of England is unlikely about to embark on a period of aggressive rate raises, thereby putting further pressure on the consumer, especially with most recent UK GDP disappointing with growth of only 0.1%.

The Japanese Economy

The past quarter has been extremely timid for Japan by way of policy shift. This has been driven predominantly by 3 factors:

- First and foremost, whilst the broader market is keen for the Bank of Japan's governor, Harihiko Kuroda, to keep monetary policy loose, the reality is that there is little domestic debt left to buy and rather than increase risk by purchasing overseas, policy has remained relatively untouched.
- Secondly, with the U.S. president (Donald Trump) floating accusations globally surrounding trade inequalities and currency manipulation, by keeping further monetary stimulus lean it has kept Japan out of his cross hairs. That being said, Japanese Prime Minister Shinzo Abe and Donald Trump met in mid-April to discuss trade and neither agreed on a method of progression, with Abe citing the recently signed 'Transpacific Trade Partnership' as the best way forward for the U.S. to trade with Japan.
- Thirdly, and probably the most important from a Japanese stability point of view, is Prime Minister Abe getting caught up in a corruption scandal. Abe's approval ratings have dropped significantly in recent months following allegations suggesting he was involved with suspiciously forcing through paperwork concerning the sale of land to a school. Abe is coming under increasing pressure to step down, alongside his Finance Minister Taro Aso. Should this happen, this would call into question the position of Harihiko Kuroda and whether or not he would then stay on as Bank of Japan Governor.

Given the risks of the masterminds behind modern day Japanese policy stepping down, global trade uncertainty, and indeed recently weak data, the outlook for the Japanese market, whilst uncorrelated, remains unstable. However, with reduced research coverage following recent regulation changes, the small and medium sized businesses are becoming increasingly under-researched, creating some value in this space.

The Emerging Markets & Asia Economy

The uncertainty of trade relations with the U.S. is what has unhinged the Asian and Emerging Markets over the short term. However, despite the media headlines, it does not yet appear to be a true trade war, but more one of posturing (particularly by Donald Trump). Trump targeted China as one of America's largest trade deficits, appearing to 'shoot from the hip' in imposing tariffs on $50 billion of goods. The Chinese President Xi Xinping retaliated in a more measured way, suggesting tariffs on targeted goods such as Soy Beans, wine, oranges etc. A number of these targeted goods are from states that previously backed the Trump campaign, and any tariffs could damage output which could be instrumental ahead of the U.S. midterm elections in November. In addition, the majority of Chinese goods targeted by Trump are part of a supply chain for U.S. manufacturers, meaning imposing tariffs will likely impact U.S. corporates and consumers more than the intended recipients. However, despite all of these talks of trade wars, nothing has yet been set in stone, with the U.S. having a 60 day notice/public comment period, and China also allowing a 60 day grace… so, whilst the next month or two will likely be rife with 'Donald Trump Tweets', this will likely end up as a negotiation period resulting in a strong, long term, and stable outcome for both parties.

Overall the Asian and Emerging Markets still look the most attractive on a valuation basis, and continue to appear more functional both politically and economically at present. India continues to look one of the most attractive from a long term growth and opportunity point of view, with 2019 elections driving domestic level policy. The Brazilian markets have been strong through a period of political rupturing that saw former President Rousseff impeached last year following multiple corruption scandals. Ahead of the Brazilian election later this year, former President and leading candidate Lula Da Silva has been arrested and sentenced to 12 years imprisonment for being caught up in the same scandals. Despite leading the polls (36%), his incarceration introduces an element of stability to the market with candidates such Marina Silva and Jair Bolsonaro as suiters that have been detached from the recent corporate and political scandals. So, whilst uncertainty is still rife in Latin America, the yearend will give some clarity to both Brazilian and Mexican politics, allowing for corporates to attract investment and for trade volumes from overseas to gain more confidence.

The US Economy

The past few months have seen global markets primarily driven by U.S. geopolitics. It almost seems condescending to say it, but it has been the Twitter feeds and off-the-cuff comments from the U.S. President Donald Trump that has caused the short term stir in markets. Yes, it could be argued that U.S. valuations are at the top end when looking at historical averages, but the macroeconomic climate is supportive of both corporates and the consumer. Unemployment data, despite some fluctuations, is still operating at extremely low levels, growth remains robust and inflation is beginning to pick up. The mellow strengthening of this data has allowed the Federal Reserve Bank (Fed) and its chair Jerome Powell to remain data dependent when assessing policy. As such, whilst we have seen interest rates rise to 1.75% (at the upper bound) this year, Jerome Powell has stated that the Fed is not under pressure to raise rates quickly. This strong data coupled with the supportive stance from the Fed has been reassuring following a raft of "Trade War" and military tensions driven by Donald Trump's Twitter comments. However, to put each of these into perspective, whilst short term global volatility has been driven by both of these factors, neither seems likely to persist. In relation to the perceived trade war with China, as previously mentioned, the next few months will likely be a negotiating period between the world's two largest economies, resulting in a mutually beneficial arrangement. In addition, whilst the Syrian crisis has magnified existing tensions between the west and Russia, let's not forget that imposing sanctions on Russia is nothing new (remember the Ukrainian tensions?), it has again been Trump's childlike Tweets that have stoked the fires. Despite the press being relatively lax on the detail, a true global trade war, or indeed a cold war with Russia is seemingly unlikely, as with the U.S. Mid –term elections around the corner, Trump will not want to further damage the Republicans chances by draining demand for home state goods such as Soy Beans and Steel whilst increasing production costs of supply chain goods from China. Similarly, Russian President Vladimir Putin will not want to isolate Russia either, politically in this instance. With all of this in mind, whilst there may be some volatility in an upcoming period of low trade volumes in markets, fundamentals remain strong potentially presenting buying opportunities in an environment that looks to be shifting from one of 'momentum and growth', to one of 'value'.

The European Economy

Whilst European Central Bank policy has remained relatively muted year to date, elements of political stability are starting to come to the fore following the raft of elections over 2017/18. In March we saw Angela Merkel sworn in for another term as German Chancellor after securing approval for her party's (Christian Democratic Union) coalition with the centre left Social Democrats; a huge buoy for political consistency as the largest economy in the European block. That being said, elements of uncertainty still remain politically following the relative success of the Italian extremist 'Five Star Movement' party in the Italian elections in March. Despite picking up the largest proportion of votes for a single party, it was not enough to win a majority with them coming second behind a right wing coalition. So, whilst uncertainty still remains as Five Star still seeks coalition terms to form a government, and whilst a further election may yet be a possibility, it must be remembered that no leading parties are seeking to detach Italy from the Eurozone or EU, enabling stability to prevail within the group of nations. With stable growth, employment and indeed inflation data, political stability aids the European Central Bank to take stock prior to altering current monetary policy, which suggests we are not likely to see too much by way of activity from the blocks central bank over the coming quarter... that being said, it seems sensible to expect some pockets of volatility in equity markets over the short term as the Italian political scene is cemented during a period that historically has lower than normal trading volumes (summer). With this volatility comes buying opportunities, as European valuations still look attractive compared to other asset classes over the longer term, bolstered by a loose and accommodative central bank.

Fixed Interest

Whilst the longer term market backdrop is not conducive to a strong debt market, short term volatility in equity markets have displayed some normalised correlation tendencies between bonds and equities, with bonds offering some elements of downside protection in the recent market pull back. It is this normalisation of correlation that is key for any diversified investor. That being said, with no perceived long term fundamental weakness in equity markets and with expectation of an upward (all be it slow) trajectory for interest rates in the west, the longer term prospects for bonds are uncertain at best... particularly as markets price in expected interest rate moves early, and with Mark Carney's Bank of England rate increase expectations hugely volatile (in the space of less than a week expectation of a UK rate rise in May went from 97% to 52%), so too is the outlook for debt when considering its credentials as a volatility constrictor in most portfolios. Following a strong 2017, credit has cheapened, but with no obvious rationale and with spreads widening, it appears to have been a correction with volumes still favouring other asset classes. Corporate bonds remain the more attractive debt structure given the current climate, economic fundamentals, and prospects for the equity markets.

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