Quarter ending 30th September 2019

Global Investment Commentary

SUMMARY

The quarter was marked by a continued slowdown in the global economy, offset during September by further monetary easing by the US and the European Union. After a difficult summer for risk assets, investors returned from the holiday season in positive mood and pushed equities higher, leaving global markets largely neutral for the quarter.

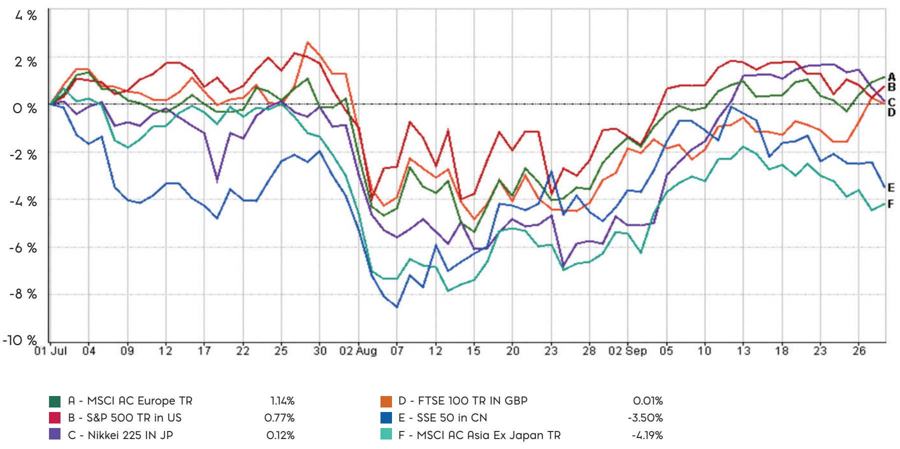
Amusing or bemusing? The UK soap opera continues

On our own shores, more than three years on from the result of the Brexit vote, who'd have guessed market commentators would still be writing about it on a daily basis. The sorry saga dragged on, with parliament passing legislation that will force the government to ask for an extension to Article 50 if it fails to agree a deal with the EU. This marginally benefited the pound. The prime minister then suspended parliament, only for the suspension to be ruled unlawful. Hence, and with a distinct sense of déjà vu, the storyline continues, with an unpredictable election remaining the most likely outcome if a deal cannot be reached in the coming weeks.

The FTSE 100 closed the quarter just 100 points lower than it started, but not before giving investors something of a white-knuckle ride. From the end of July until the middle of August the index fell some 620 points from the quarter's high to low, but clawed its way back to just short of its starting point over the course of the following weeks.

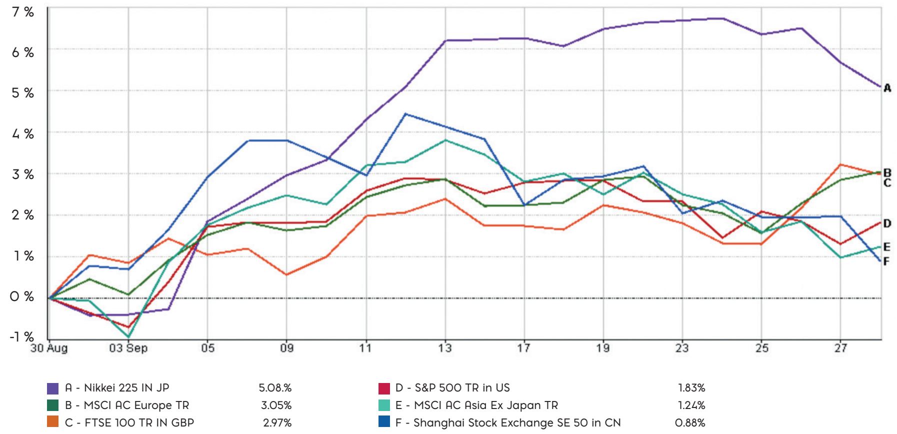
Brexit uncertainty continued to cloud the outlook for the UK economy, leaving the Bank of England watching and waiting. With wage growth at 4%, policymakers are conscious that if Brexit-related and global risks recede, they may still need to raise rates. On the other hand, if downside risks suggested by the results of some business surveys do come to fruition, they will need to follow the US and lower rates.

Figure 1: Performance 01/07/2019 to 30/07/2019



Source: FE

Figure 2: Performance 01/09/2019 to 30/09/2019



Source: FE

Despite the backdrop of uncertainty and all of the unknowns, the FTSE 100 has posted a healthy 14.25% year to date to the end of September.

Federal Reserve cut rates in July and September

US equities painted a similar picture, with the opening and closing levels for the quarter of the S&P 500 within points of each other. Fears of an escalation in the US-China trade war triggered an inversion of two and 10-year bond yields for the first time since 2007 and a general flight to 'safety'. US equities sold off mid-quarter but rallied to make back the ground by the end of September.

The Federal Reserve (Fed) cut interest rates in July and September in an attempt to prolong US economic expansion. This was in light of a slowdown in the pace of growth and concern about employment figures.

Although the US continued to report increasing numbers of jobs, the pace of growth of aggregate hours worked in the economy has slowed significantly. Consumer confidence also declined from previously elevated levels, with muted talk of recessionary signs.

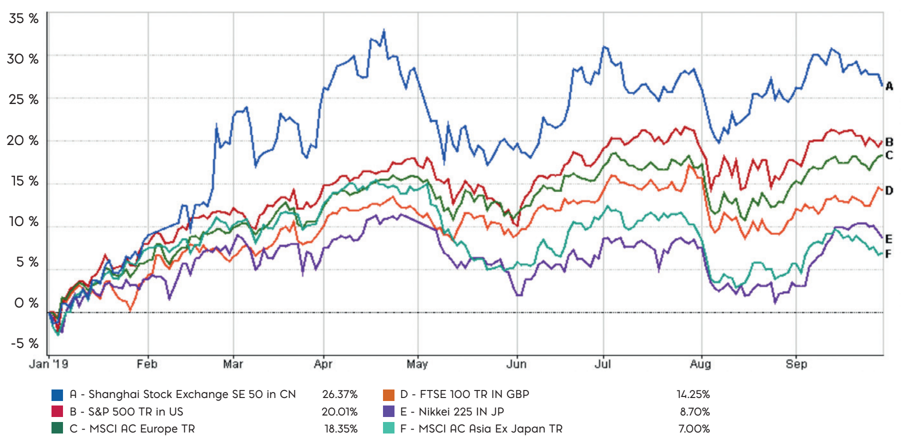
The layman could though be forgiven for asking what all the noise is about, with the S&P 500 up 20% year to date to the end of September.

ECB also cut rates, but further into negative territory

In Europe, the European Central Bank (ECB) acted in response to the weaker economic outlook and particularly weak German manufacturing numbers. The ECB cut interest rates further into negative territory, restarted quantitative easing and committed to continue with asset purchases until it achieves its inflation target. While those asset purchases may have only a limited effect on their own, if combined with fiscal stimulus from the economies that can afford it, they could help to support growth. However, the timing of any such fiscal stimulus in Europe remains uncertain.

As mentioned, the ECB's announcement came against a backdrop of weakening growth, with the September data having the look and feel of an economy that continues to slow, particularly in the manufacturing sector. With growth pushing in one direction and monetary stimulus pushing in the other, European equities delivered 3.05% for the month of September, just 1.14% for the third quarter, but 18.35% for the year so far to the end of September.

Figure 3: Performance 01/01/2019 to 30/09/2019



Source: FE

Japan keeping its powder dry for now, but for how long?

In Japan, the consumption tax hike has just come into force, posing a risk to an economy that is already feeling the effects of the global slowdown in manufacturing. Faced with these risks, Japanese consumer confidence continued to decline this quarter. The Bank of Japan also resisted the temptation to join in the easing game but said it would review the outlook at its next meeting, perhaps hinting at easing to come. Japanese equities were flat for the quarter but delivered more than 5% during September, making up for the negativity during the end of July/ early August. Year to date the Nikkei 225 is up 8.70% to the end of September.

China potentially holds the ace card in trade war poker

Of course, the US-China trade war also continued to play a prominent role in financial headlines throughout the quarter. As things currently stand, further tariffs are due to come into force by the end of the year unless renewed talks between the US and China make progress. Failure to prevent further tariffs could hurt the global economy, so it's set to be another quarter of carefully monitoring the developments on trade and President Trump's Twitter posts.

China's economy continued to slow, with the industrial production rate down to 4.4% from around 7% at the start of 2018. Retail sales growth also slowed, dropping to 7.5% from close to 10% in early 2018. However, growth is still comfortably above that in the US and the US economy is also slowing as a result of the trade dispute. On that basis and also taking into account a US election next year, it's far from clear that China will concede to US demands on trade.

Portfolio Impact

Numerous interlinked factors with unpredictable outcomes give the overall global economy an air of uncertainty and with that, from an investment perspective, comes caution. Could recent Middle Eastern tension escalate and give oil prices reason to spike? Could employers defend balance sheets from economic slowdown and seek to protect profits by cutting workers? Who can predict the eventual ending of what has become the extended box set called 'Brexit' and the result of the potential UK election to follow?

Until we have more clarity on the answers to these questions, we continue to believe that it makes sense to avoid heavily overweight positions in specific asset classes and geographies. The key is to find a balance that avoids being overly exposed during negative times, while being in the game when pockets of positivity present themselves.

Despite the bumps in the road, as investors in UK, US and European developed equites have seen during the year to date (+14%, +20% and +18% respectively), holding one's nerve and remaining invested may provide handsome rewards.

Economic Projections (30/09/2019)

Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2019	2020	2021
UK	1.2	1.1	1.5
USA	2.3	1.7	1.8
Eurozone	1.1	1.0	1.3
Germany	0.5	0.8	1.2
France	1.3	1.2	1.4
Japan	0.9	0.3	0.8
China	6.2	6.0	5.8
India	6.5	6.3	6.9
Asia	5.5	5.4	5.4
Emerging Markets	4.5	4.7	4.8

Source: Bloomberg

Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2019	2020	2021
UK	0.70	0.75	0.95
USA	1.75	1.60	1.75
Eurozone	0.00	0.00	0.05
Japan	-0.10	0.00	0.00
China	4.25	4.15	4.00
India	5.00	4.85	4.85

Source: Bloomberg

Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2019	2020	2021
GBP/USD	1.22	1.31	1.36
EUR/GBP	0.90	0.88	0.86
EUR/USD	1.10	1.16	1.18
USD/JPY	106.00	103.50	105.50
EUR/JPY	117.00	120.00	124.00
USD/CNY	7.19	7.16	7.00
USD/INR	71.83	71.80	71.00

Source: Bloomberg

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