ASSET CLASS COMMENTARY

Date	Q1 2018
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Equities:

- January saw a continuation of the trend from most of 2017, with equity market posing strong gains. Progress in the US tax reform saw the S&P 500 rise 5.7%, extending the run of consecutive monthly gains to 15. US Dollar weakness also helped sentiment, with higher Beta markets seeing strong gains in local currency terms (though they were firm in local currency terms too); the Bovespa in Brazil rose 11%, Greece saw 9.5% gains and Russian equities were up 8.6%. In Europe, the Stoxx 600 rose 1.7% on the month, led by the Dax which was up 2.1%, as signs of expansion in the region led Investors to look ahead to the possibility of the ECB exiting its ultra-loose monetary policies. In Japan, investors too were encouraged by global growth hopes, rising 1.1%, though some of the earlier gains were removed as a consequence of late month Yen strength. The MSCI Emerging Markets Index saw gains of 8.3% in local currency terms (+7.6% in USD), as Chinese banks and Tech companies saw a strong rally on the back of a weaker Dollar and hopes for stronger Global trade growth. A stand out underperformer was the UK- the FTSE All Share Index was down 1.9% on the month as Sterling strength sapped demand for Large Cap overseas focussed company's such as BP and Shell. There was also talk of the Bank of England raising interest rates faster than previously expected. At the global sector level, cyclical stocks (tech, financial and consumer) handily beat more rate sensitive firms (real estate, utilities and telecoms).

- Commodities were strong performers, (again for currency reasons), with Oil up 7.1%, Wheat up nearly 6% and Gold and Silver seeing gains of 3.2% and 2.4% respectively. Copper was the laggard, falling 3.2% on the month.

- In February, things changed dramatically; higher than expected wage growth caused bonds to fall, but things worsened significantly when equity Index volatility exploded, with the VIX Index rising from c. 12% to above 100 at one point, driven by the panic buying back of previously short Volatility positions. The declines were global in nature, with US markets (the S&P 500) down 3.7%, with European markets falling even further (the Dax -5.7%, the Swiss Index down 4.6%). The MSCI Europe (ex-UK) fell 3.67%, whilst the FTSE All Share was down 3.3%. Asia and Emerging Markets were not spared either- Japan was down 3.7%, whilst the MSCI EM Index fell 4.61%, with Chinese shares fell 6.36%, for its worst month since January 2016. It was the worst February for the S&P 500 in 9 years, whilst European shares fell the most since Brexit, (June 2016) and Japanese shares also feel the most since that time. US Dollar strength exacerbated the extent of the falls, with the US Dollar Index seeing the best gain in a year.

- Commodities were not immune either- Oil (Brent Crude) fell 6.4%, Natural Gas -11%, whilst Copper Zinc and Lead also fell between 3-4%. Gold and Silver too retreated, falling 1.5% and 4.5% respectively, as Dollar strength combined with rising Oil production figures weighed on prices.

- In March, things seemed to calm down, but the tranquillity was not to last. Increasing trade tensions between the US and China spurred a big sell-off in Technology stocks (the so-called FANG stocks were down 8.2% in March alone). Financials across the globe also fell sharply -down 5-6% in both Europe and the US, the latter seeing their worst performance since January 2016, as bond yields fell in response to the equity market's woes. The rise in the Fed Funds rate (to 1.5-1.75%) at the end of the month was generally expected, but the committee's forecasts of continued tightening into 2019 was not, further pressuring markets. The Dow Jones lost 3.6% on the month, underperforming both the S&P 500 and most other major markets. Asia and Japan fell c.2%, with the FTSE All Share Index and Emerging Markets down a similar amount. A combination of Sterling strength (possibly due to the Bank of England's hints of a rate rise in May) and global market weakness has led to 3 consecutive monthly declines for UK shares.

- Commodities benefitted from US Dollar weakness, with Gold up more than 2% and Crude Oil +5.5% (and the sixth month out of seven). Surprisingly, however, both Copper and Silver were lower on the month, despite a string rally for both as March came to a close.

Bonds:

- January saw negative returns for most major markets, with Gilts losing 2.1%, US Treasuries 1.5% and Bunds down 1%, as economic data continued to surprise (on the up-side) and the positive sentiment from the passage of the Tax Bill weighed on prices. Only Italian and Spanish bonds eked out gains on the month (+0.4% and +1.1% respectively). Against the background of economic optimism, it is no surprise that Corporate bonds outperformed their Sovereign equivalents across the Globe. The BOA Global Index of Investment Grade Credit fell only 0.7%, with High Yield bonds actually rising (+0.6% in Local currency terms), mainly due its slightly shorter duration, relative to Government bonds. Emerging markets bonds too saw strong returns, as the Dollar weakness boosted sentiment (+4.5%), though US Dollar EM bonds were unchanged (for the same reason).

- In February, there was a similar picture to equities (for much the same reasons); for US Treasuries, 10-year yields rose from 2.7% at the start of the month, to reach a high of 2.95% at one point, before falling back to 2.86% at the close of March. Interestingly, European bond prices were flat, with yields oscillating +/- 4-5 basis points on the month. UK Gilts (both conventional and Index-Linked) actually rose on the month (around 0.3%), taking yields down around 2-3 basis points. The US yield curve steepened at the fastest rate since July 2017, though this had been largely unwound by month end. Inflation break-evens (a measure of market expectations regarding future consumer price gains), rose a little on the month. Investment Grade Credit fell on the month, underperforming their Government equivalents, the Global I.G Corporate Index falling 1.8% on the month in USD (but was up a little in GBP and Euro terms). Global High Yield bonds did a little better, falling only 1.3% in USD (and up in Sterling and Euro terms), again due to the view that global growth would offset the negative effect of higher interest rates. Emerging markets bonds too fell, -2% for hard currency (i.e. USD) bonds, but only 1.2% for Local currency versions.

- As with equities, markets seemed to regain some of their composure in March, despite the confirmation of the Fed's decision on rates. The over-riding factor was the potential growth-destroying effects of a Trade War with China. US Bonds were the strongest since August 2017, up 1% on the month, led by the long end of the Bond market (10- year and 30-year treasury yields fell by 0.075 and 0.9% respectively. As a result, the yield curve spread between 2-year and 30-year bonds dropped to below 0.7% the lowest since October 2007.

In the UK, bonds were also strong, on expectations that the Bank of England's pace of rate rises would remain extremely cautious; Gilt yields fell 10 basis points on the month, with Index-Linked Gilt yields falling 0.11%. German Bunds, too, rose sharply with yields falling even further, to just 0.5% (from 0.65%). The possibility that this was just a "flight to safety" is highlighted by the fact that Corporate credit spreads widened, as investors moved to safer government bonds. Both European and US Investment Grade credit (along with global high yield bonds) saw significant underperformance, with spreads widening 14bps and 21bps respectively, as Investors began to worry about the "Trade Effect" on growth. The sharp rise in LIBOR, (the benchmark for Global Corporate credit costs), which at 2.3% has this year out-paced the rise in US Short term interest rates, is threatening a sharp rise in interest servicing costs for both US and European companies, not to mention the over-indebted consumer. According to Bloomberg, US credit card debt is currently \$1.03 trillion, with over \$350 trillion in loans tied to LIBOR. It is therefore clear that markets are getting nervous about the implications for Corporates from continued Fed tightening.

Property (Sterling terms unless stated):

- In January, there was a major split between Asia/Japan and the rest of the world in performance terms. Whilst Japan rose 5.8% and Asia was up 3.5% on the month, all other regions saw declines of 2-3%, whilst the US fell 8.9%. Developed markets saw 4.88% declines, but ex the US, it was only down 0.5%, highlighting the outlier status of US property prices. In Dollar terms, prices rose across the board, by c.1.3-4.6%, except in Japan/Asia where double digit gains were recorded.

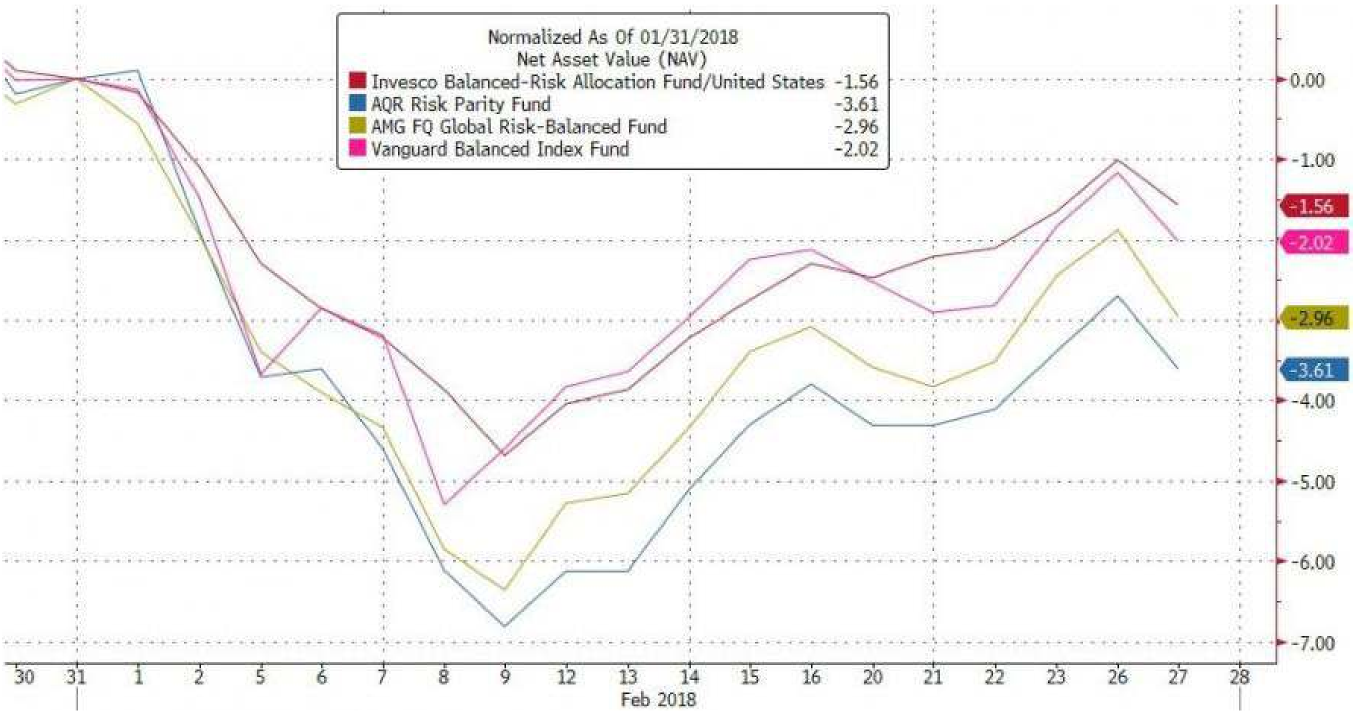
- In February, following on from asset price declines in equities and bonds, prices were uniformly lower, ranging from -3 to-5%, once again with the exception of Japan, which was flat. The UK was at the rear of the pack (-5%), but Asia, the US, the Eurozone region all saw c. 4.5% losses. The rise of the Dollar in February didn't help much, with the aforementioned regions seeing 7.5%- 8% losses in USD terms. Developed markets property fell by 6.7%. At mid-month, prices were in some cases 7% or more lower, though an end of month recovery trimmed losses somewhat.

- After a quiet start to the month of March, prices rebounded a little, but then fell away, as Interest Rate worries continued to dominate thinking. A rebound towards month-end left most regions +/- 2%, with Japan and Asia seeing c.2% losses. Eurozone Property rose by 2.5% whilst the UK, (helped by the Strength of Sterling), saw gains of 4.3%. Minor gains in the US left Global Property Indices almost unchanged in March, as the tug of war between Equities and Bonds began in earnest. Dollar returns were slightly higher as the currency showed signs of bottoming out, at least for the present, with UK Property up 6.17% and Europe up c.4.3% on the month.

“Volmageddon” and Interest Rates:

Despite warnings about the one-way positioning in Volatility markets, it took a major spike in prices to awaken investors to the dangers of being short volatility indices (specifically the VIX Index). Equally predictably, there have been casualties, with the announcement of a Hedge Fund closure- there will be more to come.

In the firing line has been Risk Parity funds, those that use “equal risk” allocations to create asset portfolios. The problem has always been that it assumes that Bonds and Equities are negatively correlated on a permanent basis, which is true MOST of the time, but not, it seems at moments of market stress. As the chart below shows, although they recovered into the close of February, at one point they were down 5-7% in less than a fortnight!



A new twist has now emerged, as the prospect of rising US Interest rates undermines the “low interest rates justify high US stock prices” meme. As interest rates rise, stocks no longer look cheap, causing a sell-off, which in turn leads to bond yields dropping, sparking equity buying, which pushes bond prices down leading to equities being sold again, in what appears to be a continuous cycle. Some have referred to 2.8-3% yields as being a relationship singularity; how this plays out is anyone’s guess, but it creates an environment of rising volatility, in which Risk Parity funds could struggle to go anywhere until such time as it is resolved one way or another, as the relationship between Stock and Bonds may be in the process of altering, perhaps permanently.

Index	Monthly Change	3M & YTD Return	12 Month Return	3 Year Return
	GBP	GBP	GBP	GBP
UK & Europe				
FTSE All Share	-1.82%	-6.87%	1.25%	18.63%
FTSE Mid 250	-0.87%	-5.71%	5.34%	23.27%
FTSE Small Cap	-1.70%	-4.82%	5.95%	32.46%
S&P 500	-4.32%	-4.43%	1.01%	41.19%
Nasdaq Composite	-4.52%	-2.38%	7.65%	57.90%
MSCI Europe(ex-UK)	-3.27%	-4.77%	2.97%	24.11%
Dax	-1.72%	-7.18%	0.70%	22.50%
CAC 40	-3.63%	-3.72%	6.69%	37.52%
Emerging Markets				
MSCI Emerging Markets	-3.60%	-2.20%	11.36%	36.33%
MSCI Asia Pacific (ex-Japan)	-3.96%	-4.13%	7.60%	33.50%
Topix	-3.46%	-2.62%	8.22%	41.42%
RTS	-6.53%	4.50%	-2.02%	50.80%
Sensex	-5.87%	-9.12%	-1.73%	19.12%
Bonds				
FT Actuaries All Stocks Gilts	2.05%	0.26%	0.46%	10.60%
FT Actuaries I-L Gilts	2.46%	0.10%	0.53%	22.63%
ML Global Corporate Bond	-1.37%	-4.33%	-5.00%	16.63%
Citi £ Corporate Index	0.46%	-1.40%	1.66%	12.69%
Citi World Government Bond	-0.27%	-1.17%	-3.29%	17.16%
Citi 3-Month UK Sterling Eurodeposit	N/A	0.10%	0.37%	1.53%
Other				
FTSE NAREIT Index	0.40%	-7.00%	-5.02%	14.84%
Gold	-1.33%	-1.76%	-5.20%	18.02%
HFRX Hedge Fund Index	-2.74%	-4.55%	-8.00%	7.45%
UK RPI	N/A	N/A	N/A	N/A
US 3 Month T Bills	-1.65%	-3.20%	-9.81%	7.62%
EBI (Global)				
EBI Bond Portfolio	0.16%	-0.38%	0.46%	3.44%
EBI 20	-0.46%	-1.25%	0.90%	9.41%
EBI 40	-1.08%	-2.12%	1.29%	15.51%
EBI 60	-1.70%	-2.99%	1.63%	21.72%
EBI 80	-2.32%	-3.87%	1.93%	28.04%
EBI 100	-2.95%	-4.74%	2.18%	34.36%
EBI (Home Bias)				
EBI Bond Portfolio	0.22%	-0.47%	0.14%	4.60%
EBI 20	-0.42%	-1.48%	0.72%	9.09%
EBI 40	-1.06%	-2.49%	1.23%	13.62%
EBI 60	-1.70%	-3.49%	1.69%	18.17%
EBI 80	-2.35%	-4.50%	2.08%	22.75%
EBI 100	-3.01%	-5.51%	2.42%	27.35%

Bitcoin (USD)	-34.60%	-54.30%	669.00%	2837.00%

Source: FE Analytics