INVESTOR INSIGHT

Summer 2019

A look at the markets by RSMR

Welcome

Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

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The global economy: What's going on?

Trade wars + Brexit = modest global growth

Politics, commerce and economics are never far apart and trade battles between the US and China; interminable stress over Brexit and slower economic growth have dampened the world's economic prospects.

Despite this, the global economy has trundled on modestly, led largely by the continuing strength of the US. Asia has not been as strong, mainly due to the slowdown in China, and Europe has been even weaker.

> "Generally it has been another positive quarter for global stock markets."

Economic policy has also continued to switch from likely US interest rate rises at the start of 2019 to forecasts of reductions by the end of the year.

Apart from some falls in May, this confusion and uncertainty has not affected stock markets which remained resilient. Even so, global growth forecasts have fallen and this is partly responsible for expectations of more monetary easing by central banks.

Generally it has been another positive quarter for global stock markets, which has led to some strong portfolio returns, but it is unlikely to continue all year.

The global economy faces several challenges and, while services and consumer-sensitive sectors have resisted the manufacturing downturn, overall growth remains lower.

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The asset classes – a quick update

EQUITIES

Although the second quarter was weaker than the first, this year's returns have been strong for the global indices with the US leading the way.

The only puzzle is why both equity and bond markets have achieved double-digit returns over six months, a rare combination that previously happened only in the first half of 1995.

Usually equities do well when economic activity is improving and bonds when there are gloomier growth or inflation forecasts. Theoretically, one of these markets must be wrong but strong performances for both may be attributed to anticipated central bank easing.

Meanwhile, equities continue to forge ahead, ignoring the negative news and subdued investor attitudes.

The UK market has edged forward very slowly in spite of the political, business and economic pressures created by Brexit. Growth is not far behind other western economies, apart from the US.

FIXED INTEREST

In our last quarterly review, a possible US interest rates reduction was flagged up following the Federal Reserve's (Fed) change in heart at the start of 2019. Now this has become more likely with more than one cut predicted but the Fed and other central banks have alternative ways to address slowing global growth, including restarting and expanding quantitative easing (QE) to give it more impact.

So far, the Fed has limited QE to buying government bonds and mortgage-backed securities but the European Central Bank (ECB) has also bought corporate bonds and securities debt, while the Bank of Japan (BoJ) is also purchasing equities and real estate.

The Fed's performance has affected yields in western markets, particularly long-term assets, which have performed better than forecast for 2019.

Corporate debt has also performed well with yields falling in line with the broader government bond market, but investors must be careful about what they hold as tighter liquidity in bond markets may make it harder to sell assets in times of economic stress.

PROPERTY

Familiar themes dominate UK property where returns remain moderate and continuing Brexit uncertainty is leading many investors to reduce, or sell out, of their allocations, which is putting pressure on capital values.

A disorderly 'No Deal' Brexit may have a negative effect on the London property market and many UK fund managers are already reducing, or avoiding, central London property although it is still supported by overseas investors.

In terms of properties: distribution, logistics and warehouses remain popular due to customer demand for convenience through 'last-mile', and 'same-day' delivery and 'click-and-collect' but this has pushed up prices and driven down yields.

Of the three main property sectors, retail faces the greatest upheaval. Changing shopping trends are forcing retailers to review whether their stores are fit for purpose and in the right place.

Profitability is being squeezed with even well-known brands suffering, resulting in some using company voluntary arrangements to manage their rental commitments.

The fixed income market is pricing in rate falls for 2019. This would boost property securities. However, an interest rate surprise is also possible and this may have a negative effect for property securities and Real Estate Investment Trusts (REITs) if markets need to re-price.

This is something investors and their advisers need to watch.

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Global round-up

- Overall data indicates a slow-down in China's economic activity.
- Japan's manufacturing and technology sectors will lose from any significant disruption to Asian supply chains in a US-China trade war.
- Emerging market economies should slow to around 4.4% in 2019 after 4.8% in 2018, but pick-up slightly to 4.6% in 2020.
- President Modi's Indian election victory is good for the continuing reform in the economy and political stability.
- Controlling inflation is an emerging markets success story with a shift to lower rates – in Vietnam they fell to 2.2%.
- Indonesia has significant growth prospects with political disruption resolved by president Jokowi winning another term.
- The 6.9% US market rise in June was the best for that month since 1955.
- For most of the BRIC economies – Brazil, Russia, India and China – domestic factors can outweigh global problems in 2020.
- The UK Purchasing Managers' Index (PMI) fell to 48 in June suggesting further economic contraction due to Brexit factors and a weaker global economy.

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So, what's next?

If the US-China trade dispute were to escalate and damage the Chinese economy, there could be currency depreciation followed by a global deflationary shockwave.

In the longer term, China's economic rise may lead to increasing international tensions as the global economic power order changes.

Forecasts for overall global growth have fallen and this is partly responsible for predictions of a return to more monetary easing. Growth in the US and Europe is forecast to fall by almost 1% which may encourage central banks to step in again.

In the UK some stocks have suffered from Brexit but they are likely to receive a boost if a satisfactory deal is achieved. Sterling would also benefit but this may hit global exporters by making British goods more expensive overseas.

In some ways, UK companies are 'on hold' until there is more clarity about Brexit, which has affected industrial production and investment.

The latest June data indicates a fall in UK output as companies have run down stockpiles accrued in the run up to the initial March 29 Brexit deadline.

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About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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