INVESTOR INSIGHT

Autumn 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.

We hope you find this useful.

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The global economy: What's going on?

Global markets volatile due to feverish political climate

Continuing feverish global politics during the summer, with Brexit turmoil occupying the UK and Europe and the US trade war with China, saw an increase in volatility and by autumn most regional stock markets were only marginally positive.

Generally, global economic growth deteriorated, although the US still delivered positive economic data with consumers bolstering resilience to the trade disputes that downgraded growth forecasts.

Inconsistent statements from President Trump about tariffs contributed to the volatility in bond and equity markets but were not the sole factor.

> "The weakest econominc growth is in Europe"

Assets subject to risk were particularly turbulent in August when the US announced new tariffs and China allowed the yuan to weaken against the dollar while stopping buying US agricultural products. Talks have re-started but a deal does not seem close.

The weakest economic growth is in Europe where the European Central Bank (ECB) has lowered interest rates and started more bond purchases to stimulate the economy.

Slowing global trade is clearly a factor in weaker growth as Chinese demand has slowed, particularly in the auto market, but also across other sectors and the wider Asian region.

The UK remains fairly strong although Brexit difficulties are almost certainly damaging the economy. Companies are unable to plan or invest with such uncertainty, and are spending valuable time and assets preparing for different potential scenarios.

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The asset classes – a quick update

EQUITIES

Although there have been small market increases during the last three months, volatility caused by political and economic uncertainty has added to investor uncertainty. A recent fund managers' survey found many fear an economic downturn in the next year, driven by worries about trade tensions, with a 52% chance of this happening.

Investors still expect equities to outperform bonds but they may well deliver flat returns over the next twelve months. One concern is whether central bankers will manage to prop up their economies as they loosen monetary policy.

In spite of this, equity markets have edged to new heights. Valuations are also quite steep and it is important that investors avoid trying to maximise returns by exposing themselves to greater risk, as many uncertainties, such as the next move by the US Federal Reserve (Fed), global trade, economic growth, and political tensions, may continue to create volatility.

FIXED INTEREST

The last quarter was generally good for government bonds, helped by central bank easing and rising concerns about global GDP growth.

In local currency terms, US Treasuries delivered more than 2%, global investment grade credit returned 1.2%, US high yield delivered 1.3% and Euro high yield, 0.9%.

The Fed has cut rates twice in 2019, but has not clearly signalled more reductions, which will depend on economic conditions.

Investors have boosted fixed interest demand by continuing to search for safe havens and, as long-term interest rates remain low, investors continue to hunt for acceptable returns.

Longer-term assets have done well, including index-linked holdings, but there appears to be less value in sovereign and corporate debt. Bond market valuations also look expensive.

Investors must remain vigilant about what they hold as several potentially tricky issues face corporate debt holders, including an increasingly crowded position in credit, and concerns about credit market structure affecting the ability to buy or sell quickly at a realistic value, which has not been tested since the financial crisis a decade ago.

Lower grade bonds have been in demand for their returns but these may now have reached levels that no longer offer a sufficient premium, compared with more highly-rated bonds, for the additional credit risk involved.

PROPERTY

Property sector returns have remained modest but positive, although investors may suffer losses as funds move pricing to 'bid values' to accommodate withdrawals.

Most recent commercial property surveys reflect the high street with weak demand and higher shop vacancies, while industrial property, including warehousing, is seeing increased demand.

Offices seem to be stable but anecdotal evidence suggests the Brexit impasse is hindering investor and occupier decisions.

When studied regionally, the pattern of positive rental projections for industrial property and negative for retail is replicated nationwide.

The office sector is more nuanced with prime office rents rising across most regions while secondary office rents – those in less-desirable locations or with lower-quality tenants – are expected to decline in London and remain flat in the south and the Midlands. Marginal growth is expected for secondary office rents in the North.

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Global round-up

- The Asian car market is struggling, with sales falling by more than 40%.
- Argentina experienced major difficulties in August with the peso weakening 26% against the dollar.
- Analysts predict the Japanese economy will shrink by an annualized 2.7% in the last three months of 2019.
- The Manufacturing Purchasing Managers Index for Germany fell to 41.4 in September.
- India's stock market has performed poorly with foreign direct investment (FDI) at only 0.6% of GDP.
- In Japan, Prime Minister Abe is moving to complete a core policy initiative of increasing consumption tax from 8% to 10%
- A recent US chief executive officers' confidence index showed a 6% year-on-year fall.
- Britain's trade deficit with the rest of the world has reduced and tax revenues for the government have increased.
- Although China's annual growth rate has slowed to around 6.5%, it still makes a substantial contribution to global gross domestic product (GDP) growth.

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So, what's next?

While 2019 may shape up as a good year for market returns, profits are still pedestrian, with low growth expected in developed markets and flat profits across the emerging world.

Although central banks are applying some quantitative easing to kick-start global growth, their mechanisms are relatively blunt as interest rates are already very low and it seems unlikely that they will have the same effect as they did following the financial crash.

All the signs are that market volatility will continue for the rest of the year if uncertainty about global growth, trade wars and political instability persist.

The last quarter may be uncomfortable as investors are less active and liquidity tightens.

Our usual advice remains: second-guessing market fluctuations in an increasingly unpredictable world is impossible. Long-term investors should rely on portfolio diversification to create some stability through a period of economic turmoil.

> “The US-China trade negotiations appear to be adversarial, and so is US politics as the world's biggest economy moves towards a 2020 election.”

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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