gemini asset management

marketmatters

April 2018

Market Review - Review of markets over the first quarter of 2018

After a strong year for equity markets in 2017, most equity markets were fast out of the blocks in January, only to stumble at the first hurdle heading into February. A brief recovery in stocks in the latter part of February was interrupted again in March by concerns over a potential trade war between the US and China.

February's sell-off was triggered not by weak economic data but by strong wage growth numbers from the US. Wage growth appeared to accelerate from 2.5% to 2.9% year-on-year: a substantial jump over just one month. The speed of the acceleration in wage growth caused investors to worry that US interest rates would have to rise faster than the economy could withstand meaning resulting in a sharp sell-off.

However, the next month's data showed that wages were only growing at 2.6% year-on-year. So, it turns out that wage acceleration is proving more gradual; hence February's panicked selloff was unjustified. In the meantime, US companies had been reporting strong earnings and analysts were busy revising up their earnings estimates for this year as companies started to communicate the effect the tax cuts would have on their earnings.

Just as it appeared that calm had returned to markets, global equities were rocked once again by fears of a global trade war. The US administration initially announced tariffs on steel and aluminium imports. This was followed by a 25% tariff on $60 billion worth of Chinese imports (with the exact goods as yet not specified). The Chinese, in response, have announced increased tariffs on $3 billion worth of US imports. The proposed tariffs on Chinese goods amount to only about 0.1% of Chinese GDP while those on US goods are even less significant for US and global growth. That is not to say that risks to the trade outlook do not exist, but it is important to put the size and importance of any protectionist measures that are announced into context.

World Stock Market Returns (local currency)

Exhibit 2: World stock market returns (local currency)

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD
MSCI EM 28.8%	MSCI Asia ex Japan 38.0%	UK FTSE 100 -28.3%	MSCI Asia ex Japan 67.2%	MSCI Asia ex Japan 15.6%	US S&P 500 2.1%	Japan TOPIX 20.9%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE 100 19.1%	MSCI Asia ex Japan 35.9%	MSCI EM 0.8%
MSCI Asia ex Japan 28.6%	MSCI EM 33.6%	US S&P 500 -37.0%	MSCI EM 62.8%	US S&P 500 15.1%	UK FTSE 100 -2.2%	MSCI Europe ex UK 20.0%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex UK 9.1%	US S&P 500 12.0%	MSCI EM 31.0%	MSCI Asia ex Japan 0.5%
MSCI Europe ex UK 22.5%	UK FTSE 100 7.4%	Japan TOPIX -40.6%	MSCI Europe ex UK 29.0%	MSCI EM 14.4%	MSCI Europe ex UK -12.1%	MSCI Asia ex Japan 19.7%	MSCI Europe ex UK 24.2%	MSCI Asia ex Japan 7.7%	US S&P 500 1.4%	MSCI EM 10.1%	Japan TOPIX 22.2%	US S&P 500 -0.8%
US S&P 500 15.8%	MSCI Europe ex UK 6.6%	MSCI Europe ex UK -42.7%	UK FTSE 100 27.3%	UK FTSE 100 12.6%	MSCI EM -12.5%	MSCI EM 17.4%	UK FTSE 100 18.7%	MSCI Europe ex UK 7.4%	UK FTSE 100 -1.3%	MSCI Asia ex Japan 6.4%	US S&P 500 21.8%	MSCI Europe ex UK -3.0%
UK FTSE 100 14.4%	US S&P 500 5.5%	MSCI EM -45.7%	US S&P 500 26.5%	MSCI Europe ex UK 5.1%	MSCI Asia ex Japan -14.6%	US S&P 500 16.0%	MSCI Asia ex Japan 6.2%	MSCI EM 5.6%	MSCI Asia ex Japan -5.3%	MSCI Europe ex UK 3.2%	MSCI Europe ex UK 14.5%	Japan TOPIX -4.7%
Japan TOPIX 3.0%	Japan TOPIX -11.1%	MSCI Asia ex Japan -47.7%	Japan TOPIX 7.6%	Japan TOPIX 1.0%	Japan TOPIX -17.0%	UK FTSE 100 10.0%	MSCI EM 3.8%	UK FTSE 100 0.7%	MSCI EM -5.4%	Japan TOPIX 0.3%	UK FTSE 100 11.9%	UK FTSE 100 -7.2%

Source: FactSet, FTSE, MSCI, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency. Data as of 31 March 2018.

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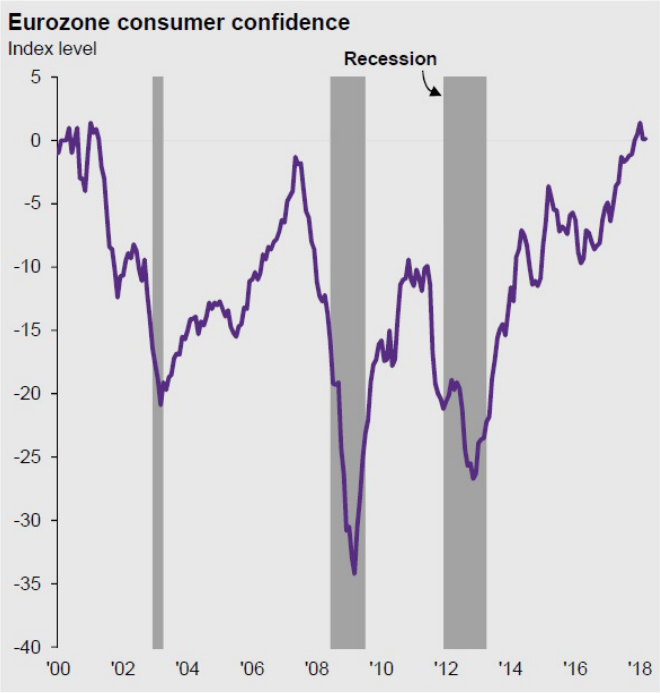
The start of the year certainly has not lacked headlines and following a very calm 2017 we have definitely seen the return of volatility. However, behind all of the headlines there has not been a significant change in the fundamentals i.e. healthy global growth and accommodative monetary policy.

In the Eurozone consumer confidence, which has historically been positively correlated with eurozone equities, has remained at buoyant levels as the unemployment rate continues to decline. The European Central Bank (ECB) also seems as though it is in no rush to raise interest rates. Over the past 18 months, they have consistently revised down inflation forecasts despite revising up its growth forecasts. It is still looking likely that the ECB will remove its quantitative easing (QE) program by the end of the year and the effect this may have is still of concern.



Source: European Commission, Thompson Reuters Datastream, JP Morgan Asset Management, OLCD. Light grey columns indicate recession. Past performance is not a reliable indicator of future returns

In the UK, business surveys remain consistent with continued moderate GDP growth. Although retail sales remain weak, there is some cause for optimism about a pick-up later in the year. Wage growth edged up to 2.8% in the three months to January and inflation in February fell to 2.7% year-on-year. As a result, real wages are starting to increase. With sterling's rally since the start of the year, UK inflation could fall quite quickly, further easing the squeeze on real wages.

The backdrop of improving wage growth and low unemployment, combined with the recent good news that a Brexit transition deal has been agreed, could give the Bank of England (BoE) the confidence to raise interest rates again in May. Two members of the Monetary Policy Committee already wanted to raise rates in March but were outvoted. If a full withdrawal agreement is reached by October, then the BoE may feel comfortable raising rates again in November. Thus, monetary policy is tightening in the UK but at a pretty slow pace.

Apart from the ongoing political uncertainty, the main risk to the UK economy is now signs of weakness in the housing market and the potential impact on consumer confidence were house prices to start falling. New buyer enquiries and the number of newly-agreed sales are lower over the year, according to the Royal Institute of Chartered Surveyors (RICS) survey. However, with unemployment and interest rates low, there is limited selling pressure. This may explain why estate agents' expectations of prices over the next three months have recently picked up.

In the US, growth remains healthy and while fiscal stimulus runs the risk of eventually overheating the economy, it significantly reduces the risk of a recession this year. Key early warning indicators for the economy continue to paint a positive picture of the growth outlook. Consumer confidence is elevated, jobless claims remain low and job openings are the highest on record. House prices continue to rise and building permits for new homes are rising, though not at an obviously excessive pace. Business investment intentions are also strong.

The US Federal Reserve (Fed) appears to be increasingly confident that the US economy can withstand higher interest rates. In March, Fed members, under Jerome Powell's new leadership, revised up their expectations of the pace at which they will increase interest rates next year. The Fed's median expectation is now for three rate rises in 2019 and they were only one member away from shifting their median expectation to four rate rises this year.

Until recently, the market was not convinced that there would be so much monetary tightening. Indeed, the market started the year expecting the Fed to raise interest rates only twice by the end of 2019. Since then, the market has shifted to price in two more rate rises over that period, explaining the rise in US government bond yields this quarter, meaning a reduction in prices as can be seen by the chart below showing government bond returns so far this year. If the Fed does end up tightening at the pace its median member expects, the market still has some catching-up to do, suggesting bond yields could still move higher.

Exhibit 4: Fixed income government bond returns (local currency)

2011	2012	2013	2014	2015	2016	2017	YTD
UK 16.8%	Italy 21.3%	Spain 11.3%	Spain 17.0%	Italy 4.9%	UK 10.7%	US 2.5%	Spain 3.7%
US 9.9%	Spain 6.0%	Italy 7.4%	Italy 15.7%	Spain 1.7%	Spain 4.2%	UK 1.9%	Italy 2.6%
Germany 9.8%	Germany 4.5%	Japan 2.2%	UK 14.1%	Global 1.3%	Germany 4.1%	Global 1.3%	Japan 0.5%
Spain 6.6%	Global 4.1%	Global -0.4%	Germany 10.5%	Japan 1.3%	Japan 3.6%	Spain 1.1%	UK 0.3%
Global 6.3%	UK 2.6%	Germany -2.3%	Global 8.5%	UK 1.2%	Global 2.9%	Italy 0.8%	Germany 0.2%
Japan 2.3%	US 2.2%	US -3.4%	US 6.1%	US 0.9%	US 1.1%	Japan 0.2%	Global 0.1%
Italy -5.9%	Japan 1.8%	UK -4.2%	Japan 4.8%	Germany 0.4%	Italy 0.8%	Germany -1.4%	US -1.2%

Source: FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. All indices are J.P. Morgan GBIs (Government Bond Indices). All indices are total return in local currency. Data as of 31 March 2018.

With the increase in forecast interest rates, one question is certainly what level of interest rates will start to weigh meaningfully on economic activity? Increased servicing costs on borrowing within the corporate sector will inevitably be of concern with leverage in the corporate sector at high levels by historic standards. This could be the primary channel by which higher interest rates eventually pose a risk to the US economy.

Despite the shift higher in expectations for US interest rates, the dollar has weakened in the year-to-date. Markets have focused on the fact that the US will have to borrow more to finance its stimulus and could end up importing more as a result of higher spending, putting downward pressure on the dollar. Against this backdrop of a weaker dollar, it is not surprising that emerging market (EM) equities have held up relatively well compared to many other markets, supported by still-strong GDP and corporate earnings growth.

Overall, despite the volatility, the outlook for global growth continues to look positive, with the removal of monetary policy accommodation still gradual.

Secure Client Login

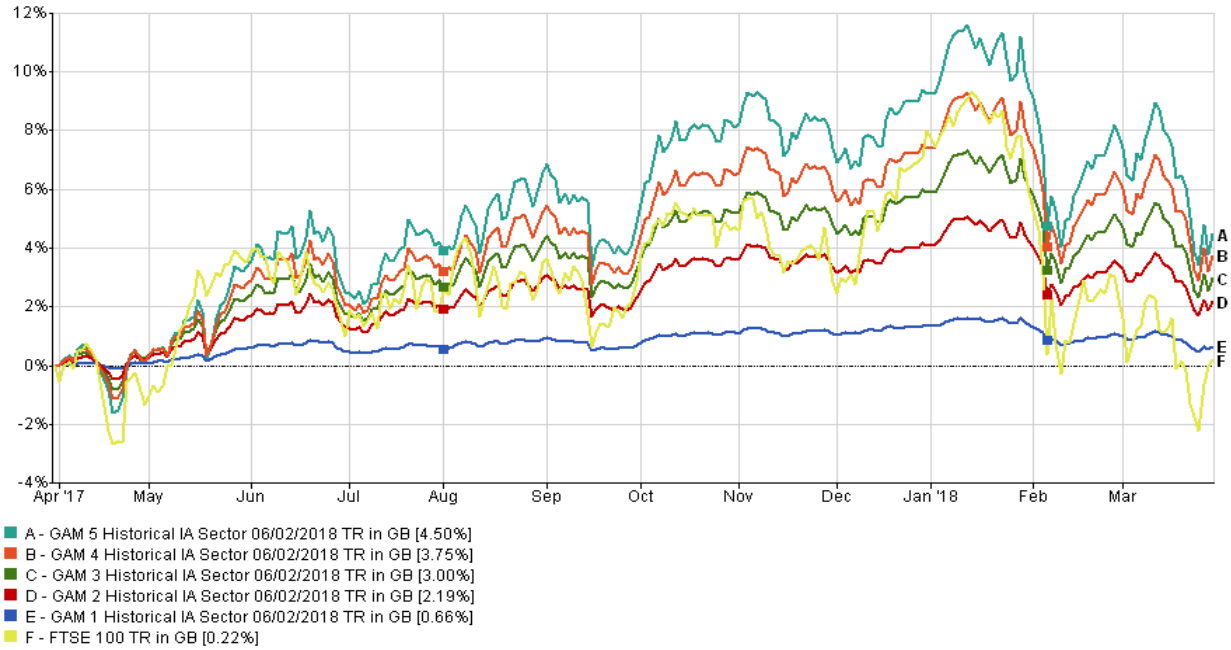
Our client login portal allows the Investment Team to act swiftly with regard the reporting and fund switching process. An increasing number of clients are signing up for this service.

If you have not already registered and would like to do so, please do not hesitate to email us at **investment.team@gemini-wm.com** and we will set you up for this facility.

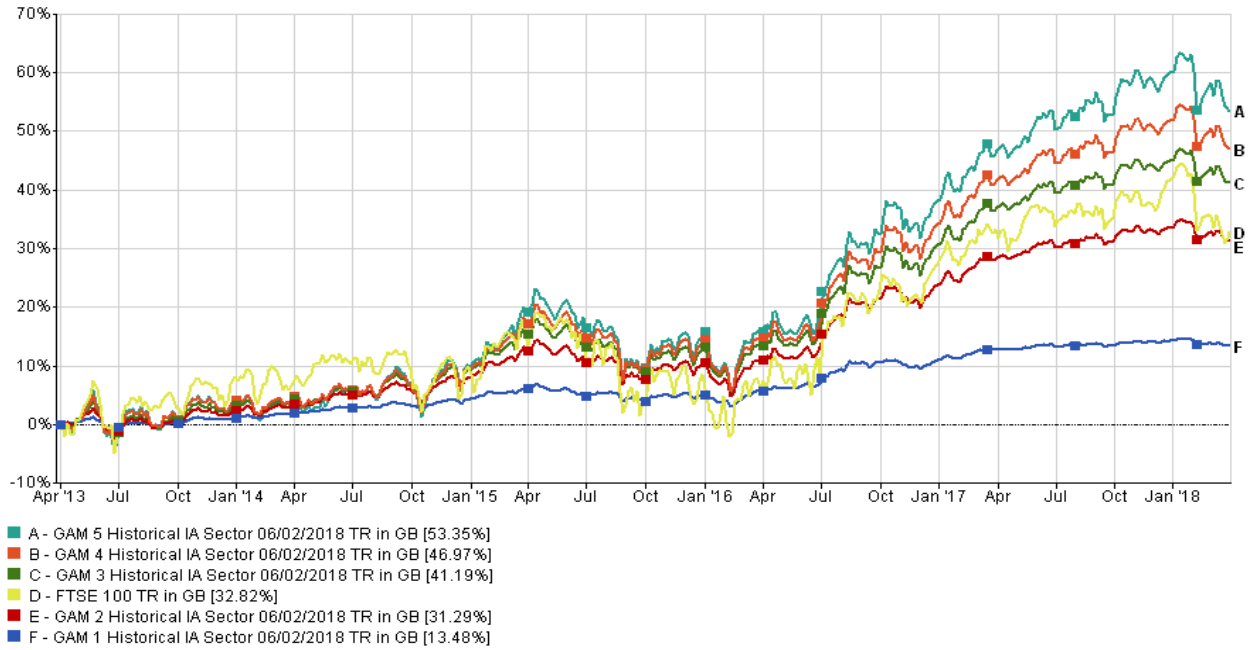
We continue to welcome client feedback as the development of this service remains on-going. You can use one of the two email addresses on the client login portal to contact us, alternatively please contact a member of Gemini's Investment Team on 0121 354 2700

Portfolio Performance

The charts below show performance of our discretionary risk rated portfolios over the course of the last 1 and 5 years. The charts are based upon our existing discretionary models looking back and so only take into account the asset allocation and fund changes made since March 2017 i.e. since the models were created. The data beyond this therefore presumes investment in the same funds and asset allocations as of March 2017. The charts compare performance against the FTSE 100 in order to demonstrate the importance of spreading risk through diversification. Whilst a direct comparison of our portfolios with an equity index such as the FTSE 100 is not like for like it does give an indication of volatility and performance differences on a risk-adjusted basis.



Source: Financial Express Analytics data 31/03/2017 to 29/03/2018. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees.



Source: Financial Express Analytics data 29/03/2013 to 29/03/2018. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees.

Asset Allocation and Fund Review

The investment committee reviewed various asset allocation models, alongside in-house research. As a result of this there were **no changes** to fund choice or the asset allocation models in quarter 1 2018.