gemini asset management

marketmatters

January 2018

Market Review - Quarter 4 (October - December) 2017

The end to the year was a good one, topping off a very strong year for equity markets as you will see on the chart below (Exhibit 1). A strong earnings season, continued healthy economic growth and tax cuts in the US certainly helped the final quarter. 2017 as a whole was a year full of political noise, but ultimately, investors held their nerves and continued to push risk assets higher and most markets were up substantially with remarkably low volatility, and very few corrections to the rally.

Over the year, we saw a synchronised global growth acceleration and unemployment rates continuing to decline. As the global economy continued to accelerate, several central banks increased interest rates modestly, although some emerging market (EM) central banks were able to cut rates, in response to lower inflation. Overall, most investors will have enjoyed a remarkably smooth and rewarding 2017 which is generally the norm for risk assets in the final years of a bull market. As always the key question is, can the good times keep on rolling next year?

Exhibit 1: World Stock Market Returns (local currency)

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	4Q2017
Japan TOPIX 45.2%	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%	Japan TOPIX 8.7%
MSCI EM 35.8%	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%	US S&P 500 6.6%
MSCI Europe ex UK 28.6%	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%	MSCI Asia ex Japan 6.3%
MSCI Asia ex Japan 24.1%	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 EM 5.7%
UK FTSE 100 20.8%	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%	UK FTSE 100 5.0%
US S&P 500 4.9%	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%	MSCI Europe ex UK 0.0%

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 December 2017.

UK in focus

UK equities have had to contend with a strengthening sterling over 2017, weighing on the sterling value of foreign revenues, which make up close to 70% of FTSE 100 sales. The more domestically focused medium and smaller company stocks have therefore outperformed in 2017, although performance relative to the FTSE 100 has been broadly flat over the last quarter.

You can see from exhibit 1 above that UK equities have underperformed most other regions in 2017. Part of the reason for the rally in the pound this year has been an increase in the market's perception of the probability of a transitional deal on Brexit. The completion of phase one of the Brexit negotiations in December supports the market's assumption that a transitional deal now looks more likely than it did at the start of the year, even though many challenges remain.

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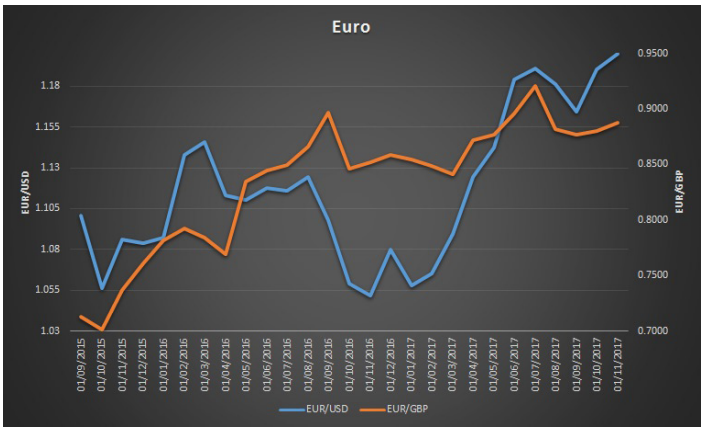
Europe in focus

Despite a good year for the European economy, European equities have underperformed several other markets in local currency terms, highlighting the extremely strong returns delivered elsewhere. European equities had a great start to the year, as business surveys picked up and political risk faded with Emmanuel Macron's election.



Source: Gemini Asset Management Investment team. Data from investing.com

The strong rally in the euro in the first three quarters of the year explains much of the subsequent drag, since May, on European equities in local currency terms. Foreign revenues have had to be translated at a less favourable rate.

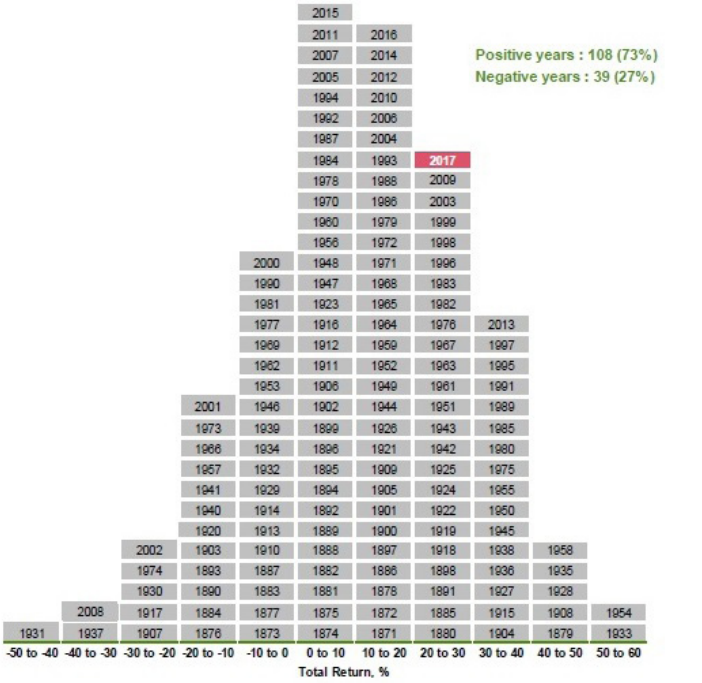
In the fourth quarter, European equities delivered the lowest returns, despite a broadly flat euro vs GBP. Clearly, European companies haven't experienced the same boost from US tax cuts. Furthermore, politics has given European investors reason to pause for breath, with the Catalonian independence referendum on 1 October weighing on the relative performance of Spanish equities since August. Since the start of October, Italian equities have also given up a little of their outperformance for the year as investors start to look ahead to the Italian elections in March 2018, although it should be noted that Italy has still delivered one of the strongest returns this year, up 17%.

US in focus

US equities have had a great year, remarkable not only for their strong returns, but also for their consistency and lack of volatility. US equities delivered positive returns in every single month of 2017, the first time this has happened since 1958.

On average, US equities experience an intra-year drawdown of about 14% but in 2017, the maximum drawdown for the index was less than 3%! Over 2017, tech stocks rose by close to 40%, but the market rally was relatively broad based, with other areas such as materials, industrials, healthcare and financials all returning about 20%. However, defensive bond-proxy sectors such as utilities, telecommunications and real estate investment trusts lagged over both the year and the final quarter.

On an economic front unemployment fell to the lowest level since 2000 and business investment accelerated. The reduction in the corporate tax rate to 21% will boost after tax earnings for US companies in 2018, but the feeling is that this may have already contributed to the strong returns for US equities in 2017. It was not just tax-cut expectations driving US equities higher though; third-quarter S&P 500 earnings per share rose by 6% year on year



Note: Equity total returns using S&P500 from 1873, and bond total returns taken from US 10-year treasuries from 1900. Source: Thomson Datastream, Global Financial Data, Schroders Economics Group, 2 January 2018.

Asia & Emerging Markets in focus

The best-performing equity markets this year have been in Asia and the emerging markets. Several factors have contributed to their strong performance. A weak dollar has historically been supportive of the relative performance of emerging market equities and this proved to be the case in 2017. EM equities have also benefited from a rebound in earnings off of a low base. Furthermore, the rally in tech stocks this year has benefited EM equities, which started the year with about 25% of the index made up of tech stocks. The recovery in some industrial commodity prices, such as copper, has also supported some of the more commodity-focused EM stock markets. It's also been another good year for China. In the fourth quarter, the 19th National Congress laid out a plan for reducing financial risks while focusing on delivering slightly lower, but still very substantial, GDP growth.

Japanese equities have also had a very strong quarter and year. The major driver of Japanese equities this year has been the fantastic performance of company earnings, which rose by 16% year on year in the third quarter. Earnings were bolstered by strong global growth and a pick-up in global trade. Prime Minister Shinzo Abe comfortably won the election in October, providing political stability and boosting confidence that there should be few changes to his economic policies

Fixed Income in focus

Turning to look at central bank action and fixed income markets, the European Central Bank was encouraged by the health of the European economy, to announce in October that it will reduce its monthly quantitative easing purchases down to €30 billion.

2010	2011	2012	2013	2014	2015	2016	2017	4Q2017
US HY 15.1%	IL 10.2%	Euro HY 23.3%	Euro HY 8.8%	Euro Treas. 13.1%	EM Debt 1.8%	US HY 17.5%	Global IG 9.1%	IL 2.9%
Euro HY 14.3%	US Treas. 9.8%	EM Debt 18.0%	US HY 7.4%	EM Debt 6.2%	Euro Treas. 1.6%	Euro HY 10.1%	IL 8.7%	Global IG 1.4%
EM Debt 11.8%	EM Debt 9.2%	US HY 15.5%	Euro Treas. 2.2%	Euro HY 5.5%	US Treas. 0.8%	EM Debt 9.6%	EM Debt 8.3%	Euro HY 0.6%
US Treas. 5.9%	US HY 4.4%	Global IG 11.2%	Global IG 0.3%	US Treas. 5.1%	Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Euro Treas. 0.6%
Global IG 5.8%	Global IG 4.3%	Euro Treas. 11.0%	US Treas. -2.7%	IL 3.4%	Global IG -3.6%	IL 3.9%	Euro HY 6.1%	US HY 0.4%
IL 3.0%	Euro Treas. 3.4%	IL 8.5%	IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Treas. 3.2%	US Treas. 2.3%	US Treas. 0.1%
Euro Treas. 1.1%	Euro HY -1.1%	US Treas. 2.0%	EM Debt -8.3%	US HY 2.5%	IL -5.0%	US Treas. 1.0%	Euro Treas. 0.2%	EM Debt -0.3%

Source: Barclays, BofA/Merrill Lynch, FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. IL: Barclays Global Inflation-Linked; Euro Treas: Barclays Euro Aggregate Government - Treasury; US Treas: Barclays US Aggregate Government - Treasury; Global IG: Barclays Global Aggregate - Corporates; US HY: BofA/Merrill Lynch US HY Constrained; Euro HY: BofA/Merrill Lynch Euro Non-Financial HY Constrained; EM Debt: J.P. Morgan EMBI+. All indices are total return in local currency. Data as of 31 December 2017.

This lower pace of purchases will start in January and last until at least September of 2018. The Bank of England increased interest rates in November for the first time since 2007, noting that any further rate rises are likely to be very gradual and remain highly dependent on the outcome of the Brexit negotiations. In the US, the Federal Reserve (the Fed) raised rates again in December, for the third time in 2017. Trump also announced that Jerome Powell will lead the Fed when Yellen steps down in February. Powell is unlikely to materially alter the likely path of Fed rate rises, but the new Fed members to be appointed in 2018 could potentially shift the path and will warrant close attention.

2017 was the year that the expected acceleration in US core inflation went missing in action, despite a continued fall in the unemployment rate and healthy GDP growth. The inflation disappointment allowed government bonds globally to deliver better returns than many investors had feared. However, a rebound in inflation expectations in the second half of the year, combined with the US tax cuts and central bank tightening, ensured that government bond returns remained paltry for the year and quarter as you can see on the chart above.

Secure Client Login Portal

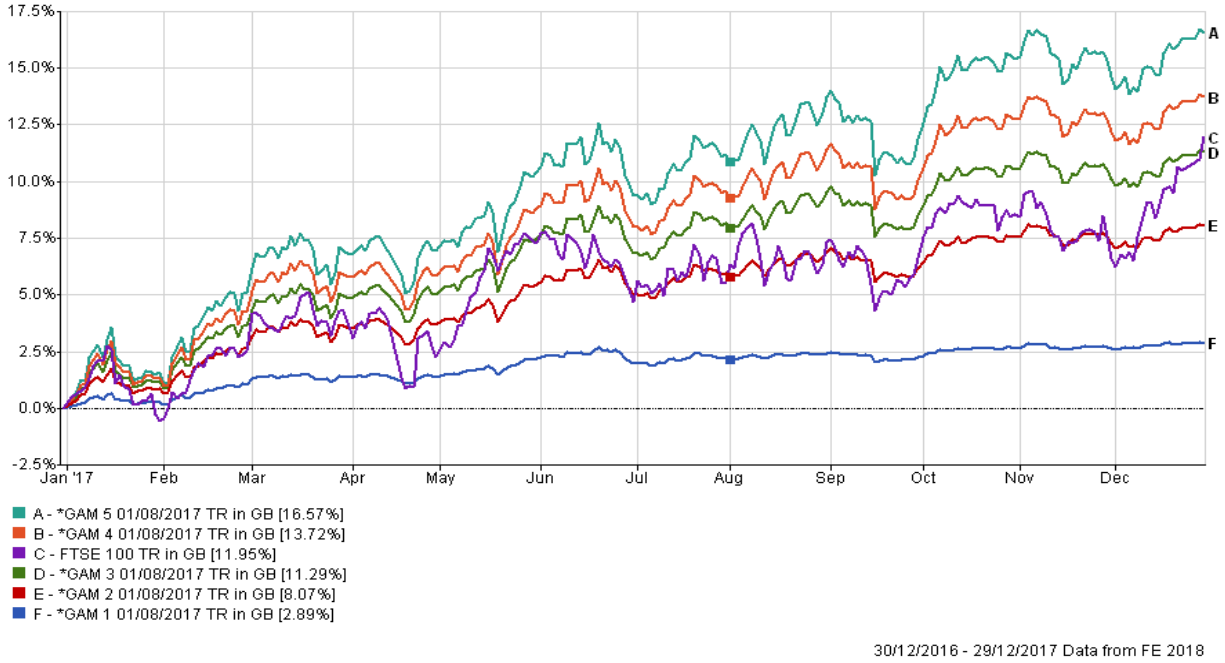
Our client login portal allows the Investment Team to act swiftly with regard the reporting and fund switching process. An increasing number of clients are signing up for this service.

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.

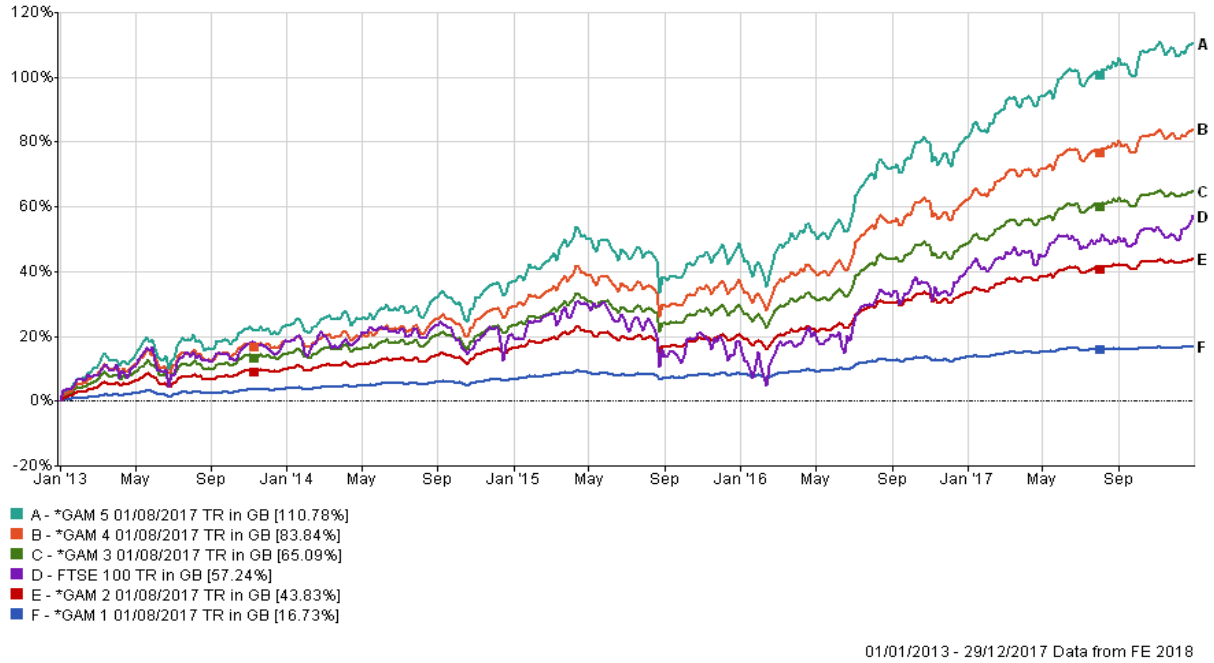
We continue to welcome client feedback as the development of this service remains on-going. You can use one of the two email addresses on the client login portal to contact us, alternatively please contact a member of Gemini's Investment Team on 0121 354 2700

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 30/12/2016 to 29/12/2017. 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 01/01/2013 to 29/12/2017. 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 4 2017.