gemini asset management

marketmatters

July 2019

Review of markets over the second quarter of 2019

In June, the central banks came to the rescue. Confronted by weaker economic data, risks to the trade outlook and still low inflation, the Federal Reserve (the Fed) and the European Central Bank (ECB) indicated that the cavalry is coming in the form of further monetary stimulus. So bad economic news was good news for markets.

Risk assets, such as equities and credit, rallied along with traditional safe haven assets, such as developed market government bonds and gold. Reversing the weakness in risk assets in May, June's strong performance has made it a good quarter and certainly a good start to the year. Developed market equities were up nearly 4% over the quarter and 17% year to date. Credit has also had a good quarter and start to the year. Most government bond indices are also up about 5% year to date, having rallied this quarter.

It may seem counterintuitive for risk assets and safe haven assets to rally at the same time. However, markets have been pricing in Fed and ECB rate cuts and the potential for further ECB quantitative easing (QE), all of which is supportive of developed market government bonds. Rate cuts and further QE can also be supportive for risk assets if they are successful in preventing the current slowdown from turning into an economic downturn. So current market pricing reflects expectations that central bank stimulus will keep the economic expansion going.

Manufacturing surveys have weakened around the world, with a notable decline in the US business surveys and continued weakness in China, Japan and Europe. Germany's manufacturing sector in particular, looks to be struggling.

World Stock Market Returns

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD	2Q 2019
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%	US S&P 500 -4.4%	US S&P 500 18.5%	MSCI Europe ex UK 4.9%
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%	UK FTSE 100 -8.7%	MSCI Europe ex UK 18.1%	US S&P 500 4.3%
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 EM -9.7%	UK FTSE 100 13.1%	UK FTSE 100 3.3%
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 -10.6%	MSCI Asia ex Japan 11.0%	MSCI EM 0.3%
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%	MSCI Asia ex Japan -12.0%	MSCI EM 10.2%	MSCI Asia ex Japan -0.6%
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%	Japan TOPIX -16.0%	Japan TOPIX 5.2%	Japan TOPIX -2.4%

Source: FactSet, FTSE, MSCI, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency. Past performance is not a reliable indicator of current and future results. Data as of 30 June 2019.

Gemini Asset Management Limited
Gemini House, 71 Park Road, Sutton Coldfield, West Midlands B73 6BT
T: 0800 255 0123 E: info@gemini-assetmanagement.com W: www.gemini-assetmanagement.com

One risk is that this weakness in the manufacturing sector could lead to job cuts and falling consumer confidence. May's rise in German unemployment would therefore have been a concern to the ECB. Data in early June also showed a slowdown in the pace of hiring in the US and the conference board's measure of US consumer confidence declined. It is this rising risk to the employment and consumer outlook that has probably been a key driver of the shift towards further stimulus from the Fed and ECB. The market's attention is therefore likely to be focused even more sharply than usual on the labour market data in the coming weeks and months.

Faced with greater downside risks to the economic outlook and falling long-term inflation expectations, the Fed backed up the dovish rhetoric that has been emanating from various members in recent months by indicating that eight out of seventeen members think rate cuts are warranted this year and the market now expects more than 0.5% worth of rate cuts by the end of this year, in sharp contrast to the 0.5% increase in interest rates it was expecting for 2019 back in of September. US 10-year yields have fallen to about 2%.

Fixed Income Returns

2013	2014	2015	2016	2017	2018	YTD	2Q 2019
Euro HY 8.8%	Euro Treas. 13.1%	Euro Treas. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Treas. 1.0%	EM Debt 10.6%	Global IG 3.9%
US HY 7.4%	EM Debt 5.5%	EM Debt 1.2%	EM Debt 10.2%	Global IG 9.1%	US Treas. 0.9%	US HY 10.1%	EM Debt 3.8%
Euro Treas. 2.2%	Euro HY 5.5%	US Treas. 0.8%	Euro HY 10.1%	IL 8.7%	US HY -2.3%	Global IG 8.2%	Euro Treas. 3.4%
Global IG 0.3%	US Treas. 5.1%	Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Euro HY 7.5%	US Treas. 3.0%
US Treas. -2.7%	IL 3.4%	Global IG -3.6%	IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	IL 6.2%	US HY 2.5%
IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Treas. 3.2%	US Treas. 2.3%	IL -4.1%	Euro Treas. 6.0%	IL 2.2%
EM Debt -6.6%	US HY 2.5%	IL -5.0%	US Treas. 1.0%	Euro Treas. 0.2%	EM Debt -4.6%	US Treas. 5.2%	Euro HY 2.2%

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 EMBIG. All indices are total return in local currency. Past performance is not a reliable indicator of current and future results. Data as of 30 June 2019.

Not wanting to be left out and also concerned about the downside risks to the economic outlook, the ECB also came out with fighting talk. ECB president Mario Draghi said that monetary policy would be loosened unless the economy improves and tried to convince markets that the ECB still has plenty of ammunition left if further QE is required and that interest rates could fall even further into negative territory if needed.

The G20 meeting resulted in the US and China agreeing to keep talking about trade, with no escalation in tariffs but also no significant signs of progress in addressing the key sticking points in the negotiations. While the lack of further escalation avoids the worst-case scenario for now, the ongoing uncertainty and potential for a further breakdown in negotiations could continue to weigh on business sentiment.

Local Government Bond Returns

2013	2014	2015	2016	2017	2018	YTD	2Q 2019
Spain 11.3%	Spain 17.0%	Italy 4.9%	UK 10.7%	US 2.5%	Spain 2.6%	Spain 8.6%	Spain 5.5%
Italy 7.4%	Italy 15.7%	Spain 1.7%	Spain 4.2%	UK 1.9%	Germany 2.3%	Italy 5.5%	Italy 3.8%
Japan 2.2%	UK 14.1%	Global 1.3%	Germany 4.1%	Global 1.3%	Japan 1.1%	US 5.4%	US 3.1%
Global -0.4%	Germany 10.5%	Japan 1.3%	Japan 3.6%	Spain 1.1%	Global 1.0%	Global 5.1%	Global 2.7%
Germany -2.3%	Global 8.5%	UK 1.2%	Global 2.9%	Italy 0.8%	US 0.8%	UK 5.0%	Germany 2.0%
US -3.4%	US 6.1%	US 0.9%	US 1.1%	Japan 0.2%	UK 0.6%	Germany 4.2%	UK 1.4%
UK -4.2%	Japan 4.8%	Germany 0.4%	Italy 0.8%	Germany -1.4%	Italy -1.4%	Japan 2.9%	Japan 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. Past performance is not a reliable indicator of current and future results. Data as of 30 June 2019.

In the UK, the news has been dominated by the Conservative Party leadership race. The polls and odds suggest that Boris Johnson is a strong favourite to be the next prime minister.

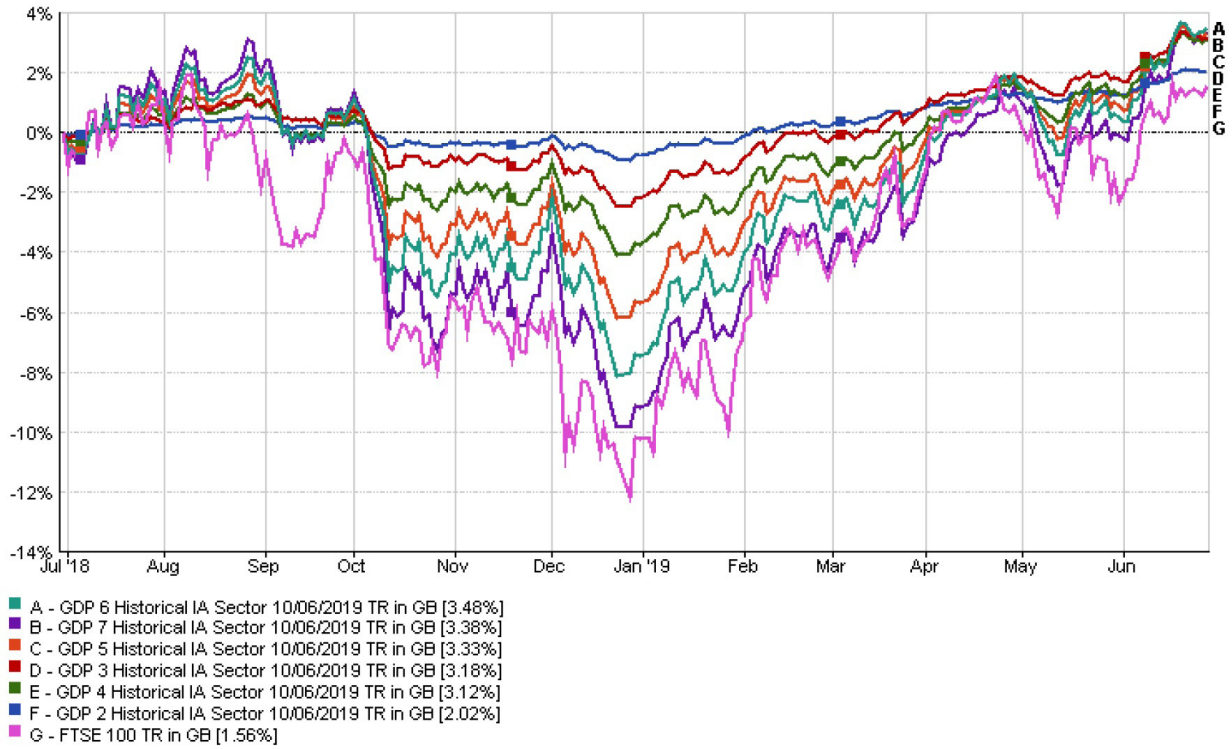
Whoever is prime minister, parliament is still likely to prevent a no deal Brexit, unless a general election or referendum takes place and provides a strong mandate from the population for such an outcome. At the moment, polls suggest only about 30% of UK voters want to leave the European Union without a deal. How the new prime minister hopes to unite the Conservative Party and solve the Brexit impasse remains to be seen.

The Bank of England (BoE) has been less dovish than the Fed and ECB, given concerns around the limited spare capacity in the UK economy and wage growth that has accelerated significantly over the last couple of years. After the BoE meeting, the Confederation of British Industry's reported retail sales measure for June came in at the weakest level since the financial crisis. If a broader swathe of economic data deteriorates, the BoE could well join in the easing party by cutting interest rates.

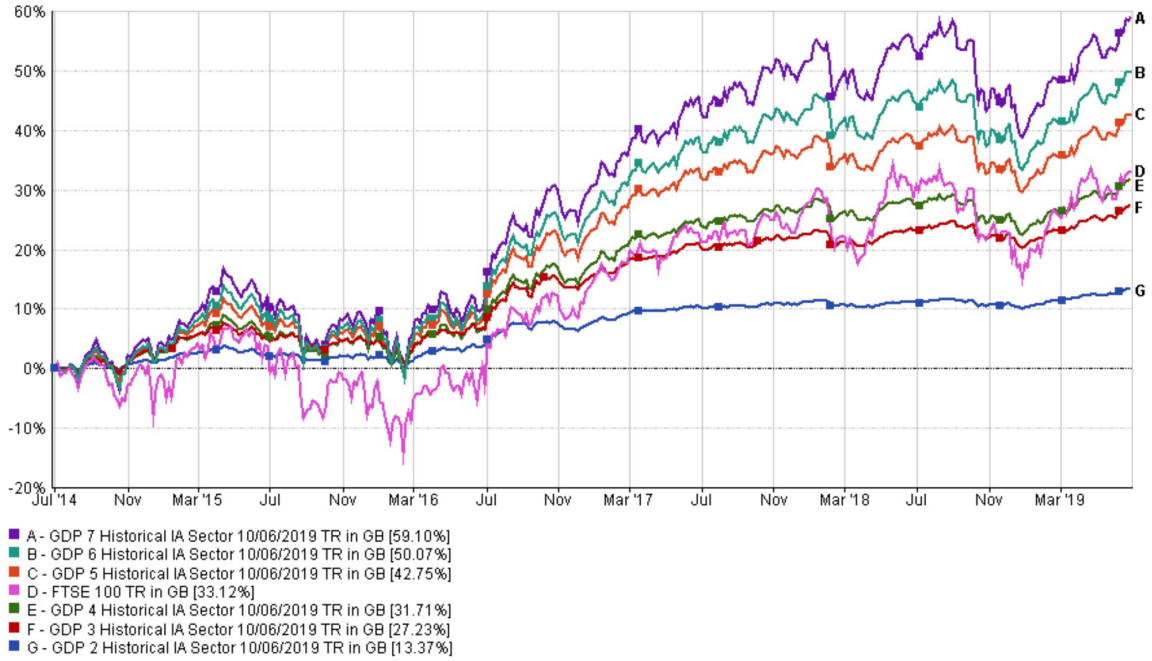
In short, the market has been willing to ignore the bad economic data in the hope that central bank stimulus will help avoid a recession. If the data remains weak, delivery of the hoped for stimulus seems highly likely. Whether the stimulus will be enough to extend what is now the longest economic expansion in history, only time will tell.

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 29/06/2018 to 28/06/2019. 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 01/07/2014 to 28/06/2019. 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 the existing asset allocation models in conjunction with the recommendations and capital market assumptions put forward by our independent actuary, Dynamic Planner. As a result of this there **were changes** to both the asset allocation models and funds during the second quarter.

From a fund perspective the funds that were removed from the portfolios were Merian UK Smaller Companies, Schroder European Alpha Income, Barings Europe Select, Miton US Opportunities, Threadneedle American Smaller Companies, First State Global Listed Infrastructure, Jupiter Absolute Return and Premier Defensive Growth.

There were also a number of additions to the portfolios with the majority of the funds affecting the higher risk portfolios where there is a high concentration to Emerging Market equity. The funds added were SDL UK Buffettology, VT Gravis UK Infrastructure Income, Fidelity Index Japan, Schroder Global Emerging Markets, UBS Global Emerging Markets, Blackrock Emerging Markets, JPM Emerging Markets, Artemis Global Emerging Markets and JPM Asia Growth.

The changes to our strategic asset allocation model were in main limited to a risk 2 through to 7 with a reduction in cash in favour of fixed income and a reduction in the Specialist sector due to the removal of two funds. The asset allocation model is shown below with the reduction in allocation shown in red and an increased allocation in green.

Asset Class	GDP1	GDP2	GDP3	GDP4	GDP5	GDP6	GDP7	GDP8	GDP9	GDP10
Cash/Money Market	0.00%	-18.00%	-20.50%	-8.00%	-8.00%	-1.00%	0.00%	0.00%	0.00%	0.00%
UK Fixed Interest	0.00%	13.00%	15.50%	8.50%	11.00%	5.00%	0.00%	0.00%	0.00%	0.00%
International Fixed Intere	0.00%	5.00%	3.50%	1.00%	0.00%	2.50%	7.00%	5.00%	0.00%	0.00%
Property	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
UK Equity	0.00%	1.50%	0.00%	0.50%	0.00%	-0.50%	3.00%	0.00%	0.00%	0.00%
North America	0.00%	0.00%	0.00%	1.00%	1.50%	0.00%	0.00%	0.00%	0.00%	0.00%
Europe	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Japan	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Far East ex Japan	0.00%	0.00%	0.00%	0.50%	0.00%	0.00%	0.00%	-2.50%	0.00%	0.00%
Emerging Markets	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-2.50%	0.00%	0.00%
Global Specialist	0.00%	-1.50%	1.50%	-3.50%	-4.50%	-6.00%	-10.00%	0.00%	0.00%	0.00%