

Monthly Markets Review

Overview of markets in May 2018

Please note any past performance mentioned in this document is not a guide to future performance and may not be repeated.

Highlights

- Global equities gained overall in May although regional performance was mixed. Economic data remained broadly supportive but politics in Europe and trade worries weighed on some riskier assets.
- US equities advanced with economic data resilient enough to allow investors to shrug off trade sanction uncertainties.
- Eurozone equities saw negative returns as political uncertainty in Italy dominated market moves. Financials, especially banks, saw sharp declines.
- The FTSE All-Share index rose over the month. Sterling declined against ongoing strength in the US dollar.
- Japanese equities fell amid a stronger yen, political developments in Europe and a switch of focus in US trade rhetoric towards automobile imports.
- Emerging markets equities lost value, with US dollar strength a headwind. Brazilian equities were heavily down as a truck driver strike paralysed the economy and amplified political uncertainty.
- Government bond yields fell (i.e. prices rose), reflecting increased risk aversion over the month.

US

US equities advanced in May, with economic and earnings data proving resilient enough to allow investors to shrug off an escalation in trade sanction uncertainties. Late in May, the Trump administration confirmed that it would proceed with steel and aluminium trade tariffs for Canada, Mexico and the EU, and also withdrew from the Iran nuclear deal. The more combative stance stoked fears of retaliation from major trade partners and did unsettle markets. However, the positive tone set by economic data over the month allowed markets to stay ahead overall.

In April, US unemployment fell to 3.8% - its lowest level since December 2000. However, [wage inflation remained muted](#), leaving the expected pace of Federal Reserve rate normalisation unchanged. US retail sales also maintained solid growth in April after strong gains in March, suggesting the soft patch of spending data in Q1 was temporary. Industrial production has also improved notably.

The strongest sector - by some margin - was technology. Several tech majors posted double digit gains in May. The industrial sector also gained ground. The US decision to exit the Iran nuclear deal added further support for oil prices and the boosted the energy sector. Traditionally interest rate-sensitive sectors were somewhat weaker. Utilities, consumer staples and telecoms all declined.

Eurozone

Eurozone equities ended May in the red with the MSCI EMU index returning -1.4%. Political uncertainty in Italy dominated market moves. The populist Five Star Movement and the League appeared close to forming a government but President Sergio Mattarella blocked the appointment of a Eurosceptic finance minister proposed by the two parties. This triggered a sell-off of Italian assets by investors fearing a snap election,

although the two parties rekindled coalition talks by the end of the month. Political risk also affected Spain with Prime Minister Rajoy facing a vote of no confidence on 1 June.

Against this backdrop, the financials sector led the declines, followed by telecommunication services, utilities and energy. Among financials, the Italian lenders Intesa Sanpaolo and UniCredit suffered the steepest declines while Telecom Italia was the weakest of the telcos. However, information technology and healthcare notched up good gains.

Economic data from the eurozone continued to point to steady growth, albeit at a slower pace than last year. [GDP growth for the first quarter](#) of the year was estimated at 0.4%, down from 0.7% in Q4 2017. The flash eurozone composite purchasing managers' index¹ for May came in at an 18-month low of 54.1 in May, compared to 55.1 in April. Eurozone annual inflation jumped up to 1.9% in May from 1.2% in April, mainly as a result of higher energy prices. The eurozone's economic recovery continues to show up in labour market data with the unemployment rate falling to 8.5% in April compared to 9.2% in the same month last year.

UK

The FTSE All-Share index rose 2.8% over May, enjoying a second consecutive month of strong relative performance versus global equities. UK equities continued to bounce back as international investors further reduced their underweight in the country, according to the latest issue of the Bank of America Merrill Lynch's survey of global asset allocators. The [absence of a rate hike](#) helped support the market as it contributed to a decline in the value of sterling (against ongoing dollar strength), while merger and acquisition (M&A) activity acted as another support.

Resources sectors performed well against the backdrop of supportive Chinese economic data. In addition, crude oil prices remained firm amid geopolitical uncertainty after the US withdrew from the Iran nuclear agreement. This was offset in part by weak performance from financials and particularly the large cap banks. They performed poorly amid concerns around the wider fall-out of political uncertainty in Italy. A number of mid-cap companies became the subject of new bid interest in the month. This helped to drive the outperformance of the FTSE 250, which rose 3.1% over the period.

Sterling performed poorly after the Bank of England backed away from a much-anticipated rate rise. This was following a raft of disappointing economic data, which culminated in the bank reducing its 2018 growth forecasts. It is now expecting the UK economy to expand by 1.4% this year, versus 1.8% previously.

Japan

The recovery in stock prices seen in April continued into the first half of May but this was followed by a sharp decline which left the market 1.7% lower for the month as a whole. The yen saw a similar change in direction mid-month to end stronger against most major currencies.

The abrupt reversals for both the equity market and the currency was driven partly by political developments in Europe and partly by a switch of focus in US trade rhetoric towards automobile imports. As a result, sector leadership also changed and, although the picture for the month is not completely clear cut, defensive areas such as pharmaceuticals and railways generally outperformed for the month in total. Weaker areas included autos and auto-related companies, such as tyre producers, together with a range of industrial and financial sectors.

Although the composition of the next Italian government could have important implications within Europe, there are few direct implications as yet for Japan despite the initial reaction of the equity market. Conversely, investors seem to have come to terms quickly with the on/off status of the North Korea summit meeting with the US. The possibility of specific US tariffs being applied to auto imports could have a greater potential to disrupt Japanese companies. At this stage stock prices are simply reacting to sentiment and the exact implications are very uncertain given the complicated global supply chains in place for all the major auto assemblers.

¹ The eurozone purchasing managers' index is produced by IHS Markit and based on survey data from around 5,000 companies based in the euro area manufacturing and service sectors. A reading above 50 indicates expansion.

Economic data released during May was slightly mixed, but generally supported the consensus view that the economy is returning to its previously improving trend. Housing statistics and labour market data were strong but the rebound in industrial production was less pronounced than expected.

Asia (ex Japan)

Asia ex Japan equities finished in negative territory in May. Pakistan was the weakest index market. In ASEAN, markets were broadly weaker. Malaysia declined amid uncertainty following the unexpected election victory of Mahathir Mohamad's Harapan alliance. Singapore, where banking stocks saw some weakness, Thailand and the Philippines also underperformed.

Korean equities fell as expectations for a resolution to tensions on the Korean peninsula diminished. Although both sides remained in dialogue, US President Trump cancelled a planned meeting with North Korean leader Kim Jong-un.

Conversely, China and Hong Kong posted positive returns and outperformed as macroeconomic data remained firm. Taiwan and Indonesia, where the central bank raised interest rates by a total of 50bps over the month, also held up better than wider index markets despite finishing in negative territory.

Emerging markets

Emerging markets equities recorded a negative return in May, with US dollar strength a headwind amid concern over a potential de-synchronisation of global growth. Political uncertainty in Italy and the risk of eurozone contagion exacerbated these concerns. The timing of a resolution to ongoing US-China trade negotiations also remained unclear. The MSCI Emerging Markets Index decreased in value and underperformed the MSCI World.

Emerging European countries were among the weakest index markets given strong eurozone trade linkages. Countries with high exposure to global liquidity tightening also fell sharply, notably Turkey. Elsewhere, Brazilian equities were heavily down as a truck driver strike paralysed the economy and amplified political uncertainty. Mexico lagged as the prospect of an imminent resolution to NAFTA renegotiations receded and an anti-establishment candidate consolidated his lead ahead of July's presidential election.

By contrast, China recorded a positive return as macroeconomic data remained firm. Russia was the only other index market to finish in positive territory, with oil price strength proving supportive.

Global bonds

Bond yields reflected increased risk aversion over the month, driven by political developments in Italy where the populist Five Star Movement and the League parties formed a coalition government. Both parties promise economic policies which would likely contravene European Union financial strictures. In a turbulent final week of May, it briefly appeared that the coalition would be blocked, raising the spectre of fresh elections, but it was then confirmed by month-end.

Italian 10-year yields increased from 1.79% to 2.79%, with two-year yields rising from -0.30% to 1.07%. Spanish 10-years also lurched higher from 1.28% to 1.50%. Spain too experienced political turmoil. The opposition party filed a no-confidence motion against Prime Minister Rajoy, after it emerged his party had been taking illegal payments, and he left office on 1 June.

US 10-year Treasury yields dropped from 2.95% to 2.86%. They rose at first, briefly reaching a seven-year high, but declined in the second half of the month as investors sought safe havens. UK and core European yields moved significantly lower. Gilt 10-year yields declined from 1.42% to 1.23%, while Bund 10-year yields were down from 0.56% to 0.34% and French 10-year yields dropped from 0.79% to 0.67%.

Corporate bonds lagged government bonds. European corporates were weak given the renewed risk in the region, with banking and insurance issuers particularly affected, especially in high yield². US dollar investment

² Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

grade saw positive total returns. Emerging market (EM) bonds declined further, especially local currency, as the US dollar rallied and some countries saw sharp currency weakness.

Turning to convertibles, regional stockmarkets painted a very mixed picture in May. Convertible bonds as measured by the Thomson Reuters Global Focus Convertible Index returned 0.4% in US dollar terms. European convertibles came down in value, but US convertible bond gained and are now trading significantly above their fair value. Asian and Japanese convertibles remain fairly priced to borderline cheap.

Commodities

The Bloomberg Commodities index recorded a positive return in May. The energy component registered the strongest return. Brent crude rallied as President Trump announced the withdrawal of the US from the Iran nuclear agreement. Natural gas (+6.8%) and thermal coal (+10.8%) also made solid gains. In the industrial metals segment, nickel (+11.5%) was the standout metal as supply tightened. Copper (+1.1%) and aluminium (+1.5%) also finished in positive territory. In precious metals, gold was down 1.4% while silver returned +0.6%.

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested

Overview

Total returns (net) % – to end May 2018

Equities	1 month			12 months		
	USD	EUR	GBP	USD	EUR	GBP
MSCI World	0.6	4.2	4.2	11.57	7.5	8.2
MSCI World Value	-1.4	2.1	2.1	7.2	3.2	4.0
MSCI World Growth	2.5	6.1	6.1	15.9	11.7	12.5
MSCI World Smaller Companies	2.7	6.3	6.3	17.0	12.7	13.5
MSCI Emerging Markets	-3.5	-0.2	-0.2	14.0	9.9	10.6
MSCI AC Asia ex Japan	-1.3	2.1	2.1	17.3	13.0	13.8
S&P500	2.4	6.0	6.0	14.4	10.2	11.0
MSCI EMU	-4.7	-1.4	-1.4	5.4	1.6	2.3
FTSE Europe ex UK	-4.3	-0.9	-0.9	4.0	0.2	0.9
FTSE All-Share	-0.7	2.8	2.8	9.8	5.8	6.5
TOPIX*	-1.0	2.5	2.5	15.8	11.6	12.4

Government bonds	1 month			12 months		
	USD	EUR	GBP	USD	EUR	GBP
JPM GBI US All Mats	0.9	4.5	4.5	-0.8	-4.4	-3.8
JPM GBI UK All Mats	-1.7	1.8	1.8	3.7	-0.1	0.6
JPM GBI Japan All Mats**	1.0	4.5	4.5	2.7	-1.0	-0.3
JPM GBI Germany All Traded	-1.8	1.7	1.7	4.6	0.7	1.5
Corporate bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global Broad Market Corporate	-0.8	2.7	2.7	1.4	-2.3	-1.6
BofA ML US Corporate Master	0.5	4.0	4.0	0.1	-3.6	-2.9
BofA ML EMU Corporate ex T1 (5-10Y)	-3.8	-0.4	-0.4	4.6	0.8	1.5
BofA ML £ Non-Gilts	-3.1	0.3	0.4	3.0	-0.7	-0.0
Non-investment grade bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global High Yield	-1.2	2.3	2.3	2.6	-1.2	-0.5
BofA ML Euro High Yield	-5.0	-1.6	-1.6	5.3	1.4	2.1

Source: DataStream.

Local currency returns in May 2018: *-1.7%, **0.3%.

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