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the tortoise & the hare

Q1 2018 Market Overview

Economic Overview

The Chinese were busy over the Easter holidays, confirming new trade tariffs on US imports in response to US tariffs on steel and aluminium announced by the Trump administration earlier in March. US markets reacted promptly to this news with the Dow sliding nearly 2%. The VIX has come down to a level of 20 versus its recent peak at 35 in early February, however, market volatility is still more than 60% higher than a year ago. The new Fed chairman, Jay Powell, delivered another interest rate hike, from 1.5% to 1.75%. This happened on the back of continued strong economic growth, as GDP increased 2.6% year over year. While inflation is a concern to some, given that low unemployment could lead to wage inflation, the rate hovers just above 2%. The USD continued to be weak throughout the first quarter, with the value of the greenback falling against all other major currencies.

In the latest string of European election results, Italian voters continued the trend to move away from established parties to those that have been recently formed. Meanwhile, the UK and the EU managed to agree on a transition period lasting from 'Brexit day' to the end of 2020. In return for accepting freedom of movement for EU citizens arriving in Britain, the UK is allowed to negotiate its own trade deals. The UK still trails the Eurozone in terms of economic performance, growing by an annual 1.4% versus 2.6%. It also faces higher inflation, which increased by 2.7% in the UK versus only 1.3% on the other side of the channel. On the bright side, the unemployment rate is only half of the Eurozone's 8.6%. The European Central Bank still maintains its very accommodative stance, keeping interest rates at zero percent and buying an additional €30bn in assets every month until at least September. The Bank of England also did not change the UK interest rate. Over the first three months of the year, sterling was strong against the US dollar but it continued to weaken slightly against the euro.

In Asia, the Chinese parliament with an almost unanimous vote approved changes to the constitution and lifted the presidential term limit, opening the door for president Xi to rule indefinitely. China has recently seen a spike in inflation but its GDP continues to grow steadily at a high level just shy of 7%. In Japan, inflation is now at 1.5%, the highest increase in nearly three years. Even Japanese annual GDP growth is now at 2% after eight straight quarters of expansion.

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The 10-year government bond yield is still targeted to be around zero percent. The yen was the strongest of all currencies, gaining nearly 6% against the US dollar.

Fixed Income

Bond investors had a negative start in 2018. Even short term treasuries (BBgBarc US Treasury 1-3 Yr TR USD) lost 0.3%, the broad BBgBarc US Aggregate Bond Index lost 1.5% and US Credit (Markit iBoxx USD Liquid Investment Grade TR USD) lost 2.9%. Investors in global government bonds (Citi World Government Bond Index USD) experienced a gain of 2.5% but largely because of the weakness of the US dollar. Again due to currency gains, local currency EM bonds were the best performing fixed income sector, registering a gain of 4.4%. Global High Yield as well as hard currency EM bonds however also finished the quarter in negative territory, down 0.9% and 1.7%.

Equity

For equity investors the return picture was equally glum, with MSCI ACWI down 1.9% for Q1. In local currency terms, only EM equities (MSCI EM NR USD) saw a gain of 0.7%. In comparison, Japanese equities (Nikkei 225) were down 5.1%, the FTSE All Share Index lost 3.4%, the STOXX Europe 600 Index was down 1.8% and the S&P 500 Index lost 0.8%.

Small Cap stocks fell less than the broad markets across the world, as US Small Cap (Russell 2000) fell 0.1% and the value of International Small Cap (MSCI World ex USA Small Cap) decreased by 0.5%. Value stocks did not hold up quite as well. The Russell 1000 Value Index fell by 2.8% and the MSCI World ex USA Value Index fell by 2.5% in the last 3 months.

Commodities and REITs

Commodities and REITs produced very different performance outcomes in the first quarter of 2018. Global REITs were the worst asset class, as the headline S&P Global REIT Index in USD lost 5.5% of its value. Broad commodity performance (Bloomberg Commodity Index) on the other hand was nearly flat in USD. Gold gained 2.5% in value and WTI Crude Oil rose by 8.8%, making it the best performing asset across the whole roster of indices we monitor.

Sources

Morningstar for index data, FT.com for foreign exchange and yield data, Yahoo Finance for VIX data, Trading Economics for economic data, all as of 31st March 2018.

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