

# the tortoise & the hare



## | Q2 2018 Economic Overview

The US economy continued to grow, delivering GDP growth of 2.8% over the same quarter of the previous year. Inflation has been of the same magnitude, the highest it has been since 2012. Unemployment, now at a mere 3.8%, is at its lowest level since April 2000. Against that backdrop, the Federal Reserve (FED) raised the US interest rate by 25 bps to 2%, as widely expected.

This is a stark contrast to rates in the Eurozone, which are still at a 0% level. The European Central Bank (ECB) expects rates to stay at this level until summer 2019. The ECB recently announced that while the FED is reducing its balance sheet, it will continue to buy bonds but at a reduced rate until the end of the year. Such differences in monetary policy provided a strong tailwind for the US Dollar to appreciate against the Euro, helping it to gain more than 5% over the second quarter. Despite GDP growth of 2.5% and inflation of 2% it remains to be seen if the ECB will raise rates next year. This is due to volatility in Italian bonds at the time the country's new coalition was formed in May.

Last quarter UK interest rates were left on hold, at 0.5%. However, if the inflation rate, which is currently at 2.4%, continues to stay above the Bank of England's (BoE) target of 2%, that may change in the coming quarter. Annual GDP growth has dropped to 1.2%, a near 6-year low.

The US Dollar also appreciated strongly against the UK Pound, gaining 6.2% over the last three months.

The US Dollar also gained ground against the Yen, appreciating 4.2%. The Japanese economy contracted in the most recent quarter, pulling the annual GDP growth rate down to 1.2%. The Bank of Japan (BoJ) declared in its most recent meeting that it intends to make further purchases of bonds, ETFs and REITs.

For China, one of the most significant pieces of news was the fact that the MSCI, the biggest global index provider, confirmed that starting May 31st a small percentage (5%) of domestic China A shares were included in its Emerging Markets index. Eventually, A-shares exposure within the MSCI EM Index could increase much further, considering the total size of the A-shares market. Unexpectedly, as the People's Bank of China (PBoC) did not follow the US Fed in raising rates, GDP only grew 1.4% quarter over quarter compared to 1.8% a year ago.

### **Fixed Income**

Making money through fixed income investments continues to be difficult this year. At all ends of the risk spectrum investors experienced negative returns in Q2.

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Widening credit spreads, increasing interest rates and yields as well as a strong dollar against most other currencies all contributed to this outcome. Global sovereign bonds (FTSE WGBI) lost 0.1%, adding currency impact US investors lost 3.4%. In EM, hard currency bonds lost 3.5% (JPM EMBI), while in the US both IG credit as well as high yield dropped -1.4% (Markit iBoxx USD Liquid Investment Grade TR USD).

## Equities

Global equities made a comeback in Q2, gaining 2.7% (MSCI ACWI). However, the dispersion of results in local currency was wide, with UK stocks (FTSE All Share) up approximately 9% and EM equities (MSCI EM) falling 3.5%. Again we saw that US investors suffered from currency exposure and worsening results for both developed as well as emerging markets - as performance dropped by 0.7% and 8% respectively (MSCI World ex USA and MSCI EM). Tilts into small cap paid off in the US, adding 4.4% (Russell 2000 vs S&P 500) but relative performance was slightly negative in the rest of the world. The story was worse for value stocks, as in all three regions they underperformed core markets.

## Commodities and REITs

Global REITs recovered from their poor performance in Q1, adding 6.4% in the most recent quarter. Commodities were flat as an asset class. However, gold was down 5.5% while crude oil had a stellar quarter, with a price increase of 13.2%.

## Total Return

All total return strategies we pursue underperformed cash in the 2nd quarter. The multi asset style strategies fell the most, circa 6-9%. Our multi asset trend following strategies lost 2-3% in value and the fixed income total return strategies suffered between 3-5%.

## 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 30th of June 2018

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## Asset Class Indices

Fixed Income Summary (%)									
Index	Q2 2018	YTD 2018	2017	2016	2015	2014	2013	3 Yr (Annualised)	5 Yr (Annualised)
FTSE World Government Bond Index LCL	-0.2	0.1	1.2	3.0	1.3	8.5	0.2	2.1	2.9
FTSE World Government Bond Index USD	-3.4	-0.9	7.5	1.6	-3.6	-0.5	-4.0	2.8	1.1
Markit iBoxx USD Liquid Investment Grade TR USD	-1.4	-4.3	7.3	6.4	-0.7	8.7	-2.4	3.2	3.9
ICE BofAML Global High Yield TR USD	-1.3	-1.5	10.2	14.8	-4.2	-0.1	8.0	5.5	5.1
JPM Emerging Market Bond Index GD TR USD	-3.5	-5.2	10.3	10.2	1.2	7.4	-5.3	4.6	5.1

Source: Morningstar as of 30th June 2018

Equity summary (%)									
Index	Q2 2018	YTD 2018	2017	2016	2015	2014	2013	3 Yr (Annualised)	5 Yr (Annualised)
S&P 500 TR USD	3.4	2.6	21.8	12.0	1.4	13.7	32.4	11.9	13.4
Russell 1000 Value TR USD	1.2	-1.7	13.7	17.3	-3.8	13.5	32.5	8.3	10.3
Russell 2000 TR USD	7.8	7.7	14.6	21.3	-4.4	4.9	38.8	11.0	12.5
MSCI EMU NR EUR	2.5	-0.4	12.5	4.4	9.8	4.3	23.4	4.4	10.0
FTSE AllSh TR GBP	9.2	1.7	13.1	16.8	1.0	1.2	20.8	9.6	8.8
MSCI World ex USA NR LCL	3.8	-0.7	14.6	6.4	4.0	6.3	25.5	5.3	8.9
MSCI World ex USA NR USD	-0.7	-2.8	24.2	2.7	-3.0	-4.3	21.0	4.9	6.2
MSCI World ex USA Value NR USD	-2.1	-4.5	21.0	7.4	-7.7	-5.4	21.5	3.7	5.3
MSCI World ex USA Small Cap NR USD	-0.9	-1.4	31.0	4.3	5.5	-5.3	25.6	9.5	10.3
MSCI EM NR LCL	-3.5	-2.8	30.6	9.7	-5.8	5.2	3.4	7.5	8.4
MSCI EM NR USD	-8.0	-6.7	37.3	11.2	-14.9	-2.2	-2.6	5.6	5.0
MSCI EM Value NR USD	-8.9	-7.5	28.1	14.9	-18.6	-4.1	-5.1	2.8	2.8
MSCI EM Small NR USD	-8.6	-8.5	33.8	2.3	-6.8	1.0	1.0	2.5	4.3
MSCI ACWI NR LCL	2.7	0.8	19.8	9.0	1.3	9.3	25.5	8.5	10.8
MSCI ACWI NR USD	0.5	-0.4	24.0	7.9	-2.4	4.2	22.8	8.2	9.4

Source: Morningstar as of 30th June 2018

Real Assets (%)									
Index	Q2 2018	YTD 2018	2017	2016	2015	2014	2013	3 Yr (Annualised)	5 Yr (Annualised)
S&P Global REIT TR USD	6.4	0.5	8.6	6.9	0.6	22.8	2.8	7.0	7.5
Bloomberg Commodity TR USD	0.4	0.0	1.7	11.8	-24.7	-17.0	-9.5	-4.5	-6.4
LBMA Gold Price PM USD	-5.5	-3.1	12.7	8.1	-12.1	0.1	-27.3	2.2	1.0
Bloomberg Sub WTI Crude Oil TR USD	13.2	23.2	5.1	7.1	-44.3	-41.7	6.8	-8.3	-14.0

Source: Morningstar as of 30th June 2018

## Risk Warnings

Past performance is not a reliable indicator of future results.

The illustrations are in US Dollars unless otherwise stated. Currency fluctuations may increase or decrease the returns of any investments.

There can be no guarantee or assurance that a client's portfolio will not incur a loss over any particular time period. Fees and charges do not apply in respect of any index, indices are unmanaged, do not incur fees and cannot be invested in directly.

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## Quarterly Indicators

Economic Indicators				
Index	Unemployment rate (%)	Current A/C Balance*	Budget Balance*	Industrial Production (%)**
US	3.8	-2.6	-4.6	3.5
UK	4.2	-3.8	-1.8	1.8
Eurozone	8.5	3.2	-0.7	1.7
Japan	2.2	3.9	-4.7	4.2

\*% of GDP 2018 estimate change on 1 year ago

Source: Economist (2nd July 2018)

GDP annual growth (%)			
	2016	2017	Latest quarter
US	1.8	2.6	2.8
UK	1.7	1.3	1.2
Eurozone	2.0	2.8	2.5
Japan	1.5	1.9	1.1

Source: Trading Economics

Yields (%) - Government bonds				
	1 month	3 month	2 years	10 years
US	1.8	1.9	2.5	2.8
UK	0.5	0.6	0.7	1.3
Eurozone (DE)	0.0	-0.6	-0.7	0.3
Japan	-	-0.1	-0.1	0.0

Source: FT.com (2nd July 2018)

Inflation (%)			
	2016	2017	Latest Months
US	2.1	2.1	2.8
UK	1.6	3.0	2.4
Eurozone	1.8	1.4	2.0
Japan	0.3	1.0	0.7

Source: Trading Economics

Foreign exchange	Current Qtr End	Current Qtr End	Year End	Qtr % change*	YTD % change**
	30/06/2018	31/03/2018	31/12/2017		
USD/JPY	110.8	106.4	112.7	4.2%	-1.7%
USD/GBP	0.76	0.71	0.74	6.2%	2.5%
USD/EUR	0.86	0.81	0.83	5.3%	2.8%
GBP/JPY	146.2	149.2	152.4	-2.0%	-4.0%
GBP/EUR	1.13	1.14	1.13	-0.9%	0.4%
EUR/JPY	129.3	130.8	135.3	-1.1%	-4.4%

\*Quarter % Change from 31/03/2018 to 30/06/2018

\*\*YTD % Change from 31/12/2017 to 30/06/2018

Source: FT.com (30th June 2018)

Volatility Index (%)				
Index	Current	1 year change	52 week high	52 week low
VIX	16.1	43.4%	37.3	9.1

Source: Yahoo Finance (30th June 2018)

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