Market Update

July | 2018

Economic review

	GDP Latest Growth Rate %	GDP 2018 Economist %	CPI Latest %	CPI Year Ago Economist %	Unemployment rate %	Current Account Balance % GDP	Budget Balance % GDP 2018
UK	1.2	1.4	2.4	2.9	4.2	-3.8	-1.8
US	2.8	2.8	2.8	1.9	3.8	-2.6	-4.6
Euro Area	2.5	2.3	2.0	1.3	8.4	3.2	-0.7
Japan	1.1	1.3	0.6	0.4	2.2	3.9	-4.7
China	6.8	6.6	1.8	1.5	3.9	1.1	-3.5

As at 30th June 2018

Source FE Analytics and Square Mile

Markets review

	3 Month %	1 Year %	3 Year %	5 Year %
Equity (Local Currency)				
FTSE All Share	9.2	9.0	31.6	52.8
FTSE Small Cap (ex IT)	7.0	6.4	31.6	78.7
S&P 500	3.3	13.7	37.6	82.0
TSE TOPIX	1.1	9.7	13.2	69.1
MSCI EUROPE ex UK	2.1	2.7	12.9	54.9
MSCI EM (EMERGING MARKETS)	-3.5	10.5	24.2	50.0
MSCI AC ASIA PACIFIC ex JAPAN	-1.1	10.5	25.3	55.5
MSCI WORLD	3.6	10.9	28.2	69.2
Fixed Interest (GBP)				
FTSE Actuaries UK Gilts All Stocks	0.2	1.9	14.7	27.8
FTSE Actuaries UK Index Linked All Stocks	-1.0	1.8	24.8	48.1
The BofA ML BBB Euro Non Sovereign Hedge GBP	-0.5	2.0	11.7	26.4
The BofA ML BB B Global High Yield Hedge GBP	-0.8	0.2	13.7	29.1
Currency				
Euros in GB	0.9	0.7	24.8	3.2
Japanese Yen in GB	2.0	-0.2	31.6	3.0
Swiss Francs in GB	2.5	-5.1	12.1	9.5
US Dollars in GB	6.3	-1.6	19.1	14.9

As at 30th June 2018

Performance figures are calculated with net income (dividends) reinvested

In contrast to the turbulence of the first quarter, markets made steady gains through much of the second. Stockmarkets were led higher by the US, principally driven by the stronger dollar and also aided by a generally positive series of company trading updates, as the benefits of Trump's tax cuts begin to feed through. For the moment, the launch of the US trade war has not had a material impact on developed markets.

The billions of dollars in new tariffs may sound alarming but these are actually small sums in relation to the entirety of the huge US and Chinese economies. Roughly speaking, these economies are around a thousand times larger than the additional costs created by the tariffs introduced so far. What tariffs do represent is a change of direction. For decades, the global economy has benefited from the freer movement of goods, capital and labour. This has helped spur growth and kept prices low. This tailwind now seems to be turning into something of a headwind. Although it may take time for the effects of this subtle shift to be fully felt, it is a negative for long term investors.

Trump's policies have distinct risks

President Trump has become increasingly aggressive ahead of the important US mid-term elections that will determine which party controls Congress. Many of his policies come with very significant associated risks. For example, the tax cuts are unfunded and leave the government's budget in a vulnerable position. The tax cuts are designed to accelerate America's growth rate, in contrast, the US central bank is lifting rates in an attempt to moderate growth to prevent inflation emerging. This could still work if productivity can be improved, which would be great for investors, but we have our doubts. If it fails, it will leave the US over the medium term with a very unpleasant economic conundrum of how to address a gaping budget deficit.

The portfolios have made progress over the quarter, though we are somewhat disappointed that performance has not been a little better. The Polar Capital Global Insurance fund price was essentially unchanged for reasons not entirely obvious to us since the underlying companies seem to be trading well. Markets sometimes behave like this and we are encouraged to learn that the managers have recently topped up their own personal positions in the fund. We will be meeting them shortly, as we do regularly with all the managers of funds in the portfolios.

Secondly, investments in emerging markets have fallen in value in an otherwise profitable quarter. The portfolios' positions in emerging market equities and bonds suffered as a consequence. Emerging markets tend to do better when the supply of dollars is plentiful and cheap. At the moment demand for dollars is high and the cost is climbing as interest rates rise. We believe that more important is the outlook for global growth, which we still view positively despite the threat that a trade war brings. Emerging markets are also priced cheaper than developed nations and we view this as an opportunity given their stronger growth trajectories. The recent sell off may have uncovered some specific opportunities and we shall be working over the summer examining whether these merit additional investment.

Overall, we think that Trump's tax cuts will act to extend this period of economic expansion and possibly the bull run in markets. However, we have serious reservations whether these and some other new policies will have a beneficial long term impact on global business. We think the risks of an economic mishap are increasing and this would leave the fully valued markets vulnerable. We have made no changes to the portfolios over the quarter though we are considering closely whether some of the recent market moves have opened up investment opportunities. In particular, we shall be looking closely at Chinese shares following their recent sell off. So while we continue to enjoy the ongoing run in markets and aim to participate in a prudent manner, we remain very conscious of potential risks that exist and at this juncture have no wish to position the portfolios aggressively.

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