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Equitable Life

Monthly Market Review
To 31 August 2017

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1. Equities

1.1 UK

The UK equity market made gains over the month. Companies in basic materials, utilities and consumer goods sectors were the best performers, while telecommunications and financials disappointed.

UK unemployment fell by 57,000 in the three months to June, bringing the official jobless rate down to 4.4% – its lowest level since 1975. Initially, this helped the pound to rebound from its seven-year low against the euro. However, this move was short-lived, and sterling continued to weaken, falling to an eight-year low against the euro. Better-than-expected Eurozone economic indicators and increasing political uncertainty for the UK surrounding Brexit were the main drivers for the divergence between the two currencies.

On a three-day visit to Japan, UK Prime Minister Theresa May confirmed that she would be leading the Conservative Party into the 2022 UK election. Despite June's poor election result and criticism of her premiership, she insisted that she was "in this for the long term".

In company news, PR and advertising giant WPP delivered its second sales warning of the year. WPP now expects sales growth to be between 0% and 1%, having previously forecast a 2% increase. Growing economic uncertainty was blamed, along with "digital disruption", as companies try to reach their customers in less traditional ways than via print and television.

Provident Financial and Royal Mail were ejected from the FTSE 100. Subprime lender, Provident had only entered the index in 2015 following success in its credit card and door-to-door loans business. However, a second profit warning in three months and the cancellation of an interim dividend led to the resignation of the CEO and a 66% fall in the company's share price. Royal Mail experienced a far steadier decline, driven by falling letter volumes and intense competition in the parcels market. They will be replaced by housebuilder Berkeley Group and NMC Health, a private healthcare provider based in the United Arab Emirates.

Summary

UK equities make gains in August

PM May "in this for the long term"

WPP delivers second sales warning

1.2 US

An eventful month in both domestic and international terms for the US was reflected in the volatility of its major equity indices. Nevertheless, the main measure of large-cap companies' share prices was almost flat over August as a whole, having displayed several intra-month peaks and troughs.

Better-than-expected jobs figures for July, published early in the month, were viewed as a positive indicator for the health of the US economy. Analysts had predicted that 183,000 new jobs would be created, but a government report revealed that 209,000 new roles were added. While this news was well received by investors, it was soon followed by a sell-off in US shares as market participants reacted to rising geopolitical tensions between the US and North Korea. President Donald Trump warned North Korean leader Kim Jong Un that threats of military action against the US would be met with "fire and fury". Later in August, after Pyongyang launched a missile over Japan and into the Pacific Ocean, Mr Trump said "all options are on the table" when it comes to dealing with North Korea.

Trump also made some controversial comments in response to a domestic incident. He said there was "blame on both sides" after a demonstration by white nationalist groups in Virginia led to violence. His words caused a backlash of stern criticism from politicians of both the major parties. Several members of two CEO councils – set up to help the Trump administration implement parts of its business agenda – stood down in the wake of the President's comments, forcing him to disband the committees. This heightened worries that the government will face difficulties in introducing its plans for US tax reform and increased infrastructure spending.

In other domestic news, Hurricane Harvey wrought havoc on the Gulf Coast of Texas for nearly a week. Severe flooding from the storm resulted in numerous fatalities and significant property damage. Several of the region's oil refineries had to be shut down, which could lead to gasoline shortages and higher oil prices. Unsurprisingly, energy companies were the worst performers at the sector level in August, while technology stocks performed relatively well.

Finally, it was revealed that the US economy grew more quickly than previously estimated in the second quarter of 2017. According to figures from the Commerce Department, gross domestic product (GDP) expanded at an annual rate of 3% over the April to June period.

Summary

Tensions rise between the US and North Korea

Hurricane Harvey batters the Gulf Coast of Texas

Indices finish flat after a volatile month

1.3 Europe

European equity markets were slightly down in local currency terms over August. At the country level, Belgium and Spain were among the worst performers, while Hungary and Poland did comparatively well. In terms of sectors, consumer services and telecoms turned in a disappointing performance, while utilities and healthcare headed the table.

In currency news, the euro continued to go from strength to strength, hitting its highest level in eight years against sterling. European Central Bank chief Mario Draghi elected not to talk down the currency during his remarks at the Jackson Hole economic symposium – an annual gathering of central bankers – in the US. The euro also touched its highest level against the US dollar since January 2015.

There have been concerns that the euro's power could have negative implications for the bloc's exporters, but inflation data released in late August suggests that the Eurozone is shrugging off its currency's strength on the domestic front. Consumer prices rose in Germany, France, Italy and Spain in August, led by energy and food costs. Meanwhile, regional manufacturing activity increased by the most since 2011, keeping the euro area on track to post healthy gross domestic product growth in the third quarter. This was also reflected in economic confidence data that reached a decade-long high.

In company news, generally strong European corporate earnings were met with a fairly lukewarm response from investors. According to data from Thomson Reuters, more than half of the companies on the MSCI Europe Index beat analysts' earnings expectations for the April to June period. But, in general, their share prices were flat over the days after making the reports.

Summary

European shares decline

Euro powers ahead

Investors underwhelmed by corporate earnings

1.4 Other regional equities

Japanese equities were almost flat over August, having dipped slightly towards the end of the month following North Korea's decision to fire a missile over the country to land in the Pacific Ocean. In economic news, the preliminary measure of Japan's second-quarter GDP rose 1% compared to the preceding three months, and 4% from the previous year. The figure outstripped economists' estimates and marked the longest consecutive quarterly economic growth since 2000.

Elsewhere in Asia, China imposed new sanctions against Pyongyang by banning imports of coal, iron ore and seafood from North Korea. The boycott is intended to increase economic pressure on the country's weapons programmes. Meanwhile, Chinese export figures for July missed analysts' expectations. They had anticipated an increase of 10.9%, but the reported gain was just 7.2% in US dollar terms. Some analysts attributed the slowdown to cooling producer price inflation.

As a group, emerging equity markets outperformed their developed counterparts. The strongest returns at the country level were produced by Peru, Hungary and Brazil. In contrast, Qatar, India and the Philippines lagged behind other regions. Russia found itself in the news on several fronts. Regulators are trying to rescue Otkritie, the country's largest privately-held lender, which is facing a liquidity crisis.

The country has refuted claims that its upcoming military exercise is a cover for military action. Separately, US envoy to Ukraine said that US relations with Russia will hinge on a solution to the Ukraine crisis.

Summary

Japanese economic growth improves

Emerging market equities perform well

Chinese export figures disappoint

2. Bonds

"Flight to safety" was the most prominent theme in global bond markets during August. Safe haven assets such as high quality government bonds were much sought after as a war of words between the United States and North Korea escalated. Responding to missile testing by the hermit kingdom which seemed to threaten America's allies, President Donald Trump threatened to meet further provocation with "fire and fury like the world has never seen". Unperturbed, Korean dictator Kim Jong Un revealed that he was weighing up whether to bomb the US territory of Guam.

US Federal Reserve chair Janet Yellen and European Central Bank president Mario Draghi both spoke at Jackson Hole, the annual gathering of central bankers and economists. But market observers were disappointed by a lack of clear guidance on future central bank monetary policy, and the timing of any moves towards normalisation. The devastation wrought by Hurricane Harvey – the first hurricane in 12 years to make landfall on the US mainland – added to the prevailing atmosphere of uncertainty. Meanwhile, in the UK, little progress was made with Brexit negotiations. Brexit minister David Davis was frequently at loggerheads with Michel Barnier, the European Union's chief negotiator.

As prices rose, yields on ten-year bonds were sharply lower in the 'core' government bond markets. The yield on the 10-year US Treasury moved from 2.29% to 2.12%, while the 10-year German Bund yield fell from 0.48% to 0.29%. The yield on the 10-year UK gilt fell to 1.08% by the end of August.

Corporate bond in euro and sterling markets underperformed, breaking a significant period of outperformance against government bonds. Markets have been supported by strong levels of demand in a very low yield environment. Some of the month's volatility was caused by heightened geopolitical concerns and in anticipation of potential actions from policymakers. Bonds issued by financial institutions, having previously outperformed materially in 2017, were among the weaker areas of the market in August.

3. Property

The UK property market has been more stable in recent months despite continued uncertainty over the UK's exit from the EU and what this will mean for investors. The industrial sector continues to be the stellar performer in the UK market, with capital growth well ahead of the wider market. There is rising demand for logistics space and rental growth looks set to remain above long-term trends, at least in the medium term.

The volume of transactions in the industrial sector has also been high. Around £1.9 billion of assets were traded during the second quarter of 2017 – the highest figure for nearly three years.

Overall, the property market remains very reliant on overseas investors. While their focus has been on central London offices, where they account for two-thirds of all acquisitions, they have also been active across other sectors: mainly alternatives, including residential and student accommodation, and increasingly across the regions. These purchasers are from a wide range of nationalities, but those from Hong Kong and mainland China have been most active this year.

There was some positive news for London offices in August when Deutsche bank signed a 25-year lease for its new London headquarters at
21 Moorfields in the City. The move was taken as evidence that Germany's largest lender is renewing its commitment to London as a financial centre, despite the uncertainties around Brexit. Deutsche Bank has committed to leasing 469,000 square feet at the new development, which will allow the German lender to consolidate its staff from different London locations.

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4. Commodities

The price of oil initially moved higher because of concerns that damage caused by Hurricane Harvey would disrupt US oil production. The US Gulf of Mexico is home to a large number of US oil refineries. As the storm hit, refining capacity was reduced by around three million barrels per day. However, the US government approved the release of emergency stockpiles of oil, with the result that the price of crude oil remained relatively stable over the month.

Gold benefited from rising fear among investors about North Korean missile tests. The metal is often popular when there is uncertainty about other asset classes. At the moment, investors are concerned about the rising prospect of a military conflict in the region, which is having a negative effect on equities. But bond yields are too low to be attractive to many investors, with the result that many are now looking towards gold. The rise in demand during August resulted in prices rising past $1,300 per ounce for the first time since November last year.

5. Currencies

The US dollar continued to chart new lows against a weighted basket of currencies, with the dollar index drifting to its lowest level since May 2016. Weaker than expected core inflation has continued to push back investors' expectations for interest rate rises, the result being that the greenback has now finished in negative territory for a sixth consecutive month. A flight to safe-haven assets such as the Japanese yen and the Swiss franc was fuelled by the terror attacks in Catalonia and escalating rhetoric over missile testing on the Korean peninsula. The euro continued to strengthen, reaching its highest level against the dollar since January 2015. Better-than-expected economic growth, greater political unanimity and some hints from the European Central Bank as to the timing of the 'tapering' of their version of quantitative easing all added to investor enthusiasm for the euro. Meanwhile, sterling was notably weaker against the dollar, and moved close to parity with the euro. UK currency weakness is rooted in continuing confusion over Brexit negotiations.

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