

Quarterly investment commentary – July 2019

It was a topsy-turvy period for stock markets during the second quarter. Despite getting off to a strong start, concerns about slower global growth and the threat of trade wars caused markets to fall in May. Faced with weaker economic data and low inflation, central banks soon came to the rescue with signals that further monetary stimulus was to come, a move that caused both equities and bonds to rally.

Over the quarter, global stock markets delivered a mixed performance. Equities in developed markets such as the US, UK and Europe finished the quarter in positive territory. However, Japan and the emerging markets slipped into negative territory as concerns about global trade data dented investor sentiment.

At a global level, the story for 2019 is of slower growth than previous years as the global economy moves towards the later stages of the cycle. China has seen its economic growth decline as a result of tighter financial regulations and a trade dispute with the US, while Europe lost momentum as a result of weaker consumer and business sentiment. These factors, along with the global fallout of the US-China trade dispute, prompted the International Monetary Fund to revise its forecast for global growth in 2019 down to 3.3% from its previous level of 3.5%, with the expectation that it will return to 3.6% in 2020.

UK economic update

There was bad news for the UK economy over the quarter as gross domestic product (GDP) growth, inflation and industrial output all fell. In April, GDP fell by 0.4% from the month before, while inflation, as measured by the consumer prices index (CPI), fell to 2% in May (from 2.1% in April). The manufacturing sector contracted as companies reduced stockpiles and car production plummeted after the UK was given an extension to its departure from the European Union.

Throughout the quarter, much of the news flow in the UK was focused on the Conservative Party leadership race, with many polls suggesting that Boris Johnson was the frontrunner to become the next prime minister. While Johnson has pledged to leave the EU with or without a deal on 31 October, Parliament is still likely to prevent a no-deal scenario.

Despite the weaker economic data, the Bank of England has not signalled that it will loosen monetary policy in the same way as the US Federal Reserve. Much of this may be down to limited spare capacity in the UK economy and strong wage growth. However, if economic data weakens further, the BoE may well need to prop up the economy by cutting interest rates.

UK equity markets delivered solid positive returns over the quarter, with companies in sectors such as technology and consumer goods being the main drivers, while domestically exposed companies that face Brexit uncertainty underperformed.

What's happened around the world?

Europe

There was bad news for Europe over the quarter as slower growth, lower industrial activity and ongoing political risk continued to dominate. While GDP growth in the eurozone accelerated to 1.2% in the first quarter, reversing the decline seen in the second half of 2018, storm clouds were brewing in the second quarter. Factory

orders in Germany declined by 2.2% in May compared with April, a much deeper fall than expected, and this translated into an 8.6% drop in orders compared to the previous year.

With Germany being a major driver of the eurozone economy, concerns are mounting that it may fall into recession, dragging the rest of Europe with it. Germany's factory orders are significant because they reflect global demand, with many observers believing that the US-China trade dispute is affecting the global economy.

European equities performed well over the quarter, being lifted by the prospect of interest rate cuts by the US Federal Reserve and European Central Bank (ECB), as well as the prospect of more quantitative easing from the ECB.

United States

In the US, while gross domestic product (GDP) for the first quarter came in at a robust 3.1%, the news was mixed during the second quarter. The good news was that unemployment remains near all-time lows, but inflation was muted, growth in the manufacturing sector was slower and consumer confidence fell, with some of this blame being laid on the trade war with China. At the same time, business confidence weakened and business activity slowed down.

Much of the focus during the quarter was on the ongoing trade dispute between the US and China. After a long standoff, the quarter finished on a positive note when the two countries agreed to resume talks towards a trade deal.

During the period, equity markets performed well and hit all-time highs, driven largely by promising signals on monetary policy from the US Federal Reserve.

Asia Pacific

There was little doubt Asia Pacific felt the full force of the US-China trade dispute over the quarter. Japanese equities were in negative territory, much of this influenced by slower global growth and geopolitics. GDP growth for the first quarter came in at an annualised rate of 2.2%, higher than previously expected. Nevertheless, there are concerns about the economy's momentum as it is subject to the vagaries of the global economy, including the US-China trade dispute, weaker demand for manufactured goods, and slower growth.

Elsewhere, Korea is facing slower growth in 2019 against a backdrop of weaker demand for exports owing to trade disputes and a downturn in the global tech market. Similarly, Taiwan's central bank cut its growth forecasts for the year as the country also faces a more challenging export environment.

Equity markets in Asia Pacific struggled over the quarter as trade wars and slower global growth dented investor confidence.

Emerging Markets

It was a volatile quarter for emerging markets. In China, there are growing concerns about the health of its economy. Industrial output posted its slowest growth in 17 years in May, suggesting a decline in activity, while the IMF estimates that GDP growth for 2019 will come in at 6.3%, down from 6.6% in 2018. China's stock market, which had a strong rally to start the year, followed a downward trend over the quarter, driven by weaker than expected economic data and continued uncertainty around trade.

Other emerging markets have also struggled amid trade disputes. India continues to experience a sharp economic slowdown and in June cut its benchmark interest rate for the third time this year to prop up the economy. The Reserve Bank of India cuts its GDP forecast from 7.2% to 7% for its current financial year.

Overall, emerging markets equities encountered a challenging period, having been hit hard by trade tensions and slower global growth. As a whole, emerging markets delivered a small positive return, well behind developed markets.

Outlook for the third quarter

Looking ahead, it is clear that global growth is slowing, demand is falling and there is a greater likelihood that central banks will need to cut interest rates to foster growth. All eyes will be on the US and China, which agreed to rekindle trade talks and sign a deal. Where markets go from here depends on whether the US and China can agree a deal, and whether central banks will have enough firepower to stimulate growth and support markets.

We continue to be in an environment where the global economy is growing, but is gradually slowing down. Weaker manufacturing activity remains a key concern, particularly in countries such as Germany and Japan, as this suggests a broader global trend.

There is still room for equity markets to grow against this backdrop, but this will depend on the ability of central banks to use accommodative monetary policy.

Market performance

This table shows how different indices, representing different geographical regions, have performed over various time periods to 30th June 2019.

	1 year	2 years	3 years	4 years	5 years	10 years
FTSE All Share	0.57%	9.64%	29.51%	32.37%	35.81%	167.11%
FTSE USA	14.28%	28.83%	56.71%	90.24%	121.89%	408.36%
FTSE World Asia Pacific	2.82%	10.42%	39.06%	51.71%	66.49%	166.97%
FTSE World Europe ex. UK	7.93%	10.65%	42.79%	51.42%	53.11%	173.50%

We've sourced these index figures, in sterling terms, from Financial Express to 30th June 2019. The indices mentioned above are measures of the markets they represent. For example, the FTSE All-Share Index represents 98-99% of the UK market. It is the aggregation of the FTSE 100, FTSE 250 and FTSE Small Cap Indices.

You shouldn't take past performance as a guide to future performance or as the main or sole reason for deciding to invest. It may have been achieved in a more favourable economic period that may not happen again, and tax conditions are unlikely to be the same. We don't guarantee the value of your investment and any income you take from it, both of which can go down as well as up.

A long-term commitment

We believe it's important, where possible, to take a long-term view when investing. Looking back over the years, volatility has always been a feature of world stock markets, with each setback followed by a recovery – some taking longer than others. The usual way to deal with volatility is to invest for the medium to long term – a period of at least five to ten years.

It's important to find the right product and invest in the right funds, and this depends on your investment objectives and attitude to risk. If either has changed, your adviser will help you review your investment to make sure it continues to meet your needs. Although we don't give investment advice, we do offer a wide range of funds suitable for almost all investment objectives and attitudes to risk.

We strongly recommend you speak to your adviser before making any changes to your plan.