

## *May 2018 Portfolio Review*

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Markets were again plagued by volatility in May, largely due to heightened political risks. The US administration's approach to global trade, North Korea and Iran remain uncertain, while Italy's new populist government added to market concerns. The risk-off rally in bond markets also contributed to a significant rise in the value of the US dollar, which strengthened 2% vs. a basket of major currencies. The release in the US of the minutes to the May FOMC meeting signalled a June hike to 1.625%, which is now 92.5% priced by the market. However, perhaps more surprisingly, the overall tone was dovish around inflation, the prospect of an inverted yield curve and the overall level of rates, with some members feeling that we are getting close to the neutral rate (the level at which monetary policy provides neither stimulates nor detracts from growth) suggesting that the FED could argue for the end of its current hiking cycle.

Despite the noise, the macro backdrop is still relatively supportive though somewhat cautious on labour market and wage developments. The ongoing strength of global growth was evident in many corporate earnings reports making it reasonable that investors should not let their longer-term investment decisions be overly influenced by short term political noise, given it is economic growth that determines corporate profitability and asset price valuations. However there is some challenge to this assertion, not least that the UK's economic progress has begun to show a drag on business activity levels and asset price valuations which are seen as directly linked to the lingering lack of clarity of Britain's post Brexit trading position. The Trump administration's imposition of tariffs on input factors and products from erstwhile close allies have so far been discounted by stock markets as mere pre-negotiation posturing which will not actually lead to a highly counterproductive trade-war but instead result in more open trade conditions before the imposed tariffs have caused lasting damage.

The result was a strong month for equity returns with continued momentum in US technology stocks also helped by the strong dollar and despite Trump beginning to put tariffs on to the UK (steel and aluminium), EU, Canada and Mexico, as mentioned above. UK shares were up about 2.25% and Japan 3.1%, whilst Europe was the only region down, on the back of Italy (protracted process to get a government in place) and Spain (Mariano Rajoy losing a vote of no-confidence that will see him replaced by the Socialist opposition leader Pedro Sanchez). Italian equities have been the worst hit but the impact has been felt across European stock markets. This might be markets expecting the worst, so they could recover if the situation improves.

Further fears that Italian voters will select a Eurosceptic government have caused the country's cost of borrowing to jump up sharply. Although the better than expected auction in new Italian government debt has stabilised the broader fixed income markets, the level of Italian debt means any significant increase in the cost of repayments could pose a real future risk to the European market as a whole.

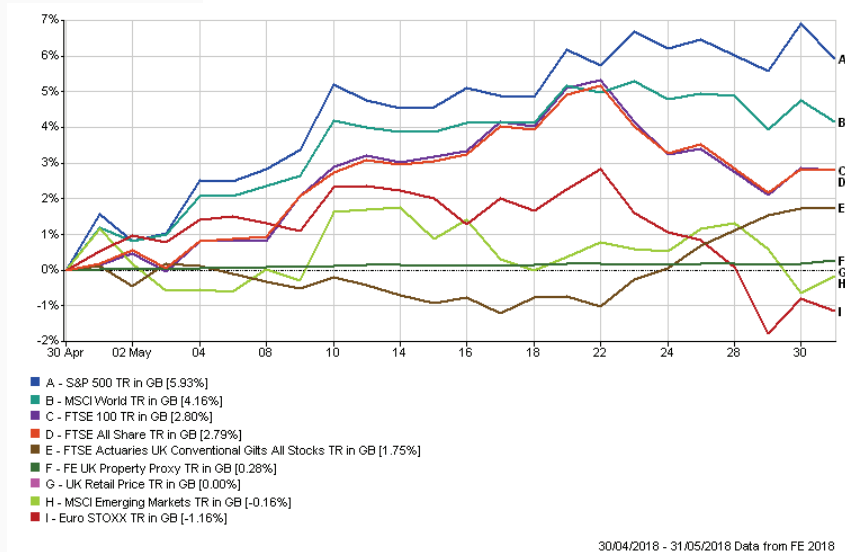
The move back into fixed interest bonds has on the one hand brought bond valuations more in line with the lower growth expectations that had already been reflected in the reduced equity valuations,

and on the other hand has lowered yields enough to ease much of the liquidity concerns that had of late entered the economic outlook 'worry agenda'. The downward pressure on the Euro versus the US-\$ will be a welcome stimulus for the Eurozone's exporters whose diminished price competitiveness from the strong Euro carried much of the blame for the sudden growth slowdown across Europe.

## Portfolios

The story behind portfolio movements continues to be dominated by the impact of exchange rate movements. As the dollar strengthened significantly, by just over 2%, over the month this translated into returns north of 6% for the US contingent within portfolios. As a result, the higher overseas equity portfolios made gains of between 2% to 2.5% gross to the end of May.

Most market indices took fright in the latter stages as concerns over Italian debt levels resonated and Spain's prime minister resigned.



One of the major European Indices (Euro Stoxx) fell just over 1% for the month, and yet our primary active European fund, Jupiter European, bucked the decline and surged to deliver a gross return also in excess of 6%.

With the exception of the US index tracker, May was certainly a month dominated by stock-selective, active managers.