July 2018 Portfolio Review

The unusually hot weather and the football World Cup provided plenty of excitement in July but markets were just as interesting. Trade tensions remained acute but ultimately the phenomenal strength of corporate earnings was enough to push equity markets higher across the developed world. Over the course of the month, the S&P 500 and European equities rose about 4% and are now up on the year. Good economic news also propelled the 10-year US Treasury yield to 3%.

In the UK, Brexit continues to dominate the UK headlines as the deadline for an agreement approaches. The prime minister Theresa May assembled her cabinet at her Chequers country house and a white paper, which sets out the UK's desired future relationship, aims for a customs partnership. The market clearly remains nervous about the prime minister's ability to strike a deal with Europe that will be sufficient to appease her own party. Whilst this is certainly a delicate tightrope for her to walk, our core assumption is that the threat of losing office ultimately holds the party together and that the EU will provide some concessions to support her. A 'no deal' scenario is risky for both sides given the economic ties.

The US continued to report above-trend economic data and markets responded to a raft of strong company earnings reports. Consumers remain optimistic about the future and are spending with gusto. Retail sales grew 6.6% year on year for the month of June. This is the fastest pace of spending growth since 2012. The strength of the labour market is undoubtedly playing a role in boosting household sentiment. 213,000 nonfarm jobs were created in June but because 601,000 people joined the labour market in the same month the unemployment rate rose to 4%. Businesses are similarly optimistic: the manufacturing purchasing managers' index (PMI) held strong for the month. GDP in the second quarter rose at an annualised pace of 4.1% over the previous quarter. Inflation rose to 2.9% in June, well above the Federal Reserve's (Fed's) target, though some of this strength is attributed to the rise in oil prices and should prove temporary. It is unlikely that growth will remain this strong, but given that both inflation and employment are near the Fed's target we expect it to continue normalising interest rates at a pace of roughly 25 basis points (bps) per quarter.

Europe's recovery appeared to falter in the spring as growth eased from the heady levels seen in the fourth quarter of last year. However, surveys in July suggest activity is stabilising at a level that is still consistent with growth of around 2%, which is above what we would consider to be trend.

The European Central Bank's (ECB's) Monetary Policy Committee meeting in July was uneventful. All key interest rates remained unchanged and the ECB reaffirmed its intention to end quantitative easing by the end of the year but hold interest rates at their current levels at least through the summer of 2019.

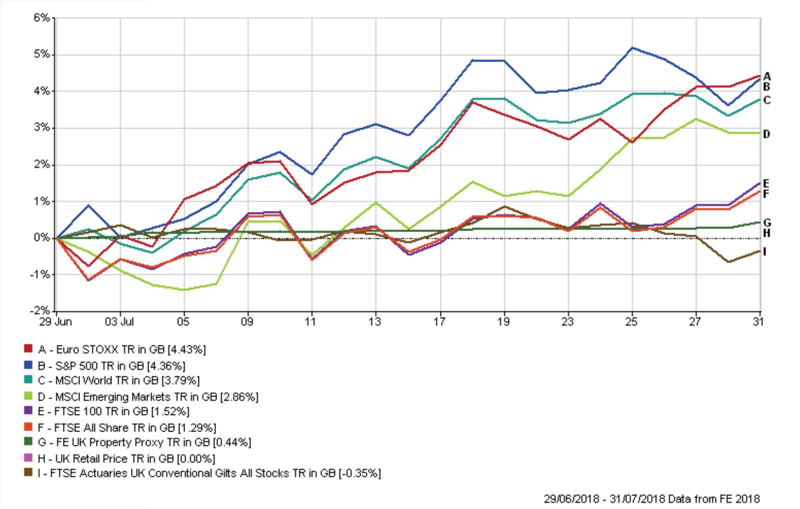
Trade tensions de-escalated between the US and EU after EU President Jean-Claude Juncker visited Washington. They agreed to work together "toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods". Plans for new tariffs on other EU goods – including autos – are on hold while talks take place. This is a step in the right direction, though we are mindful that efforts to negotiate between the US and China ultimately broke down. But for now European markets were cheered by the news, and the MSCI Europe ex-UK rallied after the announcement to end the month up.

Stubbornly low inflation and signs of a moderation in growth are once again posing a challenge for the Bank of Japan (BoJ). It is unclear what further ammunition the central bank has. Already there are concerns that negative policy rates and a 0% 10-year government bond yield target are proving counterproductive by damaging the profitability of the banks. There was some speculation that this policy would be altered at the July meeting but seemingly for want of alternatives the policy was held broadly in place.

Portfolios

July was another month punctuated by volatility in the middle, with little to report at either end. The Yen fell sharply against sterling and then recovered to c0.5% down, whilst the dollar rose sharply around Trump's whirlwind UK tour before settling back to approximately 0.5% higher than the pound.

Again, the European and US markets led performance data closely followed by other risk areas such as emerging markets, which highlighted that risk remained the order of the day throughout July. Talk of further trade sanctions, ongoing investigations into the Trump regime and a further poisoning on British soil did little to shake investor sentiment.



The value of units can fall as well as rise.
Past performance should not be seen as an indication of future performance

A new entrant into the growth portfolios, the Alquity Indian Subcontinent fund, led the portfolio constituent returns over the month with a gross return of 6.4%, with the European funds from HSBC, Jupiter and EdenTree (ethical portfolios) returning 4.9%, 4.85% and 4.33% respectively.

At the other end of the scale, there was little in the way of poor returns, though as we would expect given the surge in growth or risk-based assets, the elements designed to dampen volatility brought up the rear. Lacklustre performance, if any, came from the UK Equity Income sector with several funds showing slight negative performance due to lower exposure to oil, pharmaceuticals and financials than predominantly make up the index, and which had driven index returns throughout the month.

Overall, clients should have seen a relatively healthy gross return for the month of between 0.6% for lower risk models to c1.6% for higher risk portfolios.