Close Brothers Asset Management

08 '19

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Dovish dilemma

Markets

- Global equity market performance was mixed in GBP terms, primarily due to Sterling strength. Emerging Markets rose the most, up +0.99% followed by Japan (+0.21%), whilst the UK was down -0.16%, then Europe (-0.21%), followed by the US (-1.04%).
- Bonds were positive over the week. UK Gilts were up +0.06% as well as UK Corporates, which were up +0.24%. European and US government bonds both rose +0.09% and +0.04% respectively.
- GBP appreciated vs JPY, USD and EUR by +1.45%, +1.27% and +0.94%.
- In USD terms, the oil price rose +3.00% and gold rose by +0.95%.

Macro

- The FOMC minutes revealed the Fed continued its dovish stance on the US economy. The disclosure indicated that further reductions in the balance sheet would be limited. The central bank will be closely monitoring inflation, as strong wage growth could be passed onto consumers via higher prices. With the rhetoric from the FOMC minutes supported by softer global growth activity, the market's attention is back on trade, and whether a meaningful deal with China will occur.
- UK pay rose by 3.4% YoY in Q4 of 2018, as Britain's wage growth remained at its post-crisis high, whilst employment continued to grow, with 167,000 more jobs filled during the final quarter of 2018. A robust labour market has boosted government income tax revenues, a benefit that the OBR had not accounted for. However, wider employment contributed to a 0.2% decline in productivity in Q4 YoY. In the long-term, the UK will have to solve their productivity puzzle in order to facilitate further sustained wage growth.
- The Eurozone composite PMI struck a better tone, with the first estimate of 51.4 in February (against an expectation of 51.0). However, a contractionary manufacturing PMI of 49.2 has held back the composite figure. This view was supported by the ECB's dovish minutes, which also revealed that the central bank is considering another round of loans for banks, aimed at easing lending and bolstering activity growth, to steer the Eurozone economy back to a higher growth rate.

Our view

- Global growth has weakened somewhat from elevated levels. We expect earnings growth to remain positive but weaker inflationary pressure should cause more gradual interest rate rises.
- Despite elevated geopolitical risk, we believe this is an environment favouring equities over bonds.
- Within our regional equity allocation, we are cautious on UK equities and favour those regions most attractively positioned to benefit from the improvement in the global growth dynamic.

Performance to 22/02/2019	1 Week	YTD
Equity GBP Total Return %		
UK	-0.16	7.90
Europe	-0.21	6.28
US	-1.04	8.33
Japan	0.21	4.06
Emerging Markets	0.99	6.63
Bonds Local Total Return %		
UK Gov	0.06	1.76
UK Corp	0.24	2.64
Eur Gov	0.09	0.92
US Gov	0.04	0.48
Currency %		
GBP vs. USD	1.27	2.34
GBP vs. EUR	0.94	3.55
GBP vs. JPY	1.45	3.30
Commodities USD %		
Oil	3.00	26.10
Gold	0.95	3.91

Source: Bloomberg Finance L.P., Morningstar, data as at 25/02/2019.