

Quarterly Review

June 2018

	Q2 2018 Stats	Return	Level
Equity	MSCI AW Index	-0.1%	505
	S&P 500 Index	2.9%	2,718
	MSCI EM Index	-8.5%	1,070
	MSCI CH Index	-4.4%	87
	FTSE 100 Index	8.2%	7,637
Debt	BBARC GA Index	-2.8%	478
	US G10Y Index	4.4%	2.86%
	US G2Y Index	11.6%	2.53%
	UK G10Y Index	-5.3%	1.28%
Infrastructure	S&P GI Index	1.1%	2,498

(Source: Bloomberg)

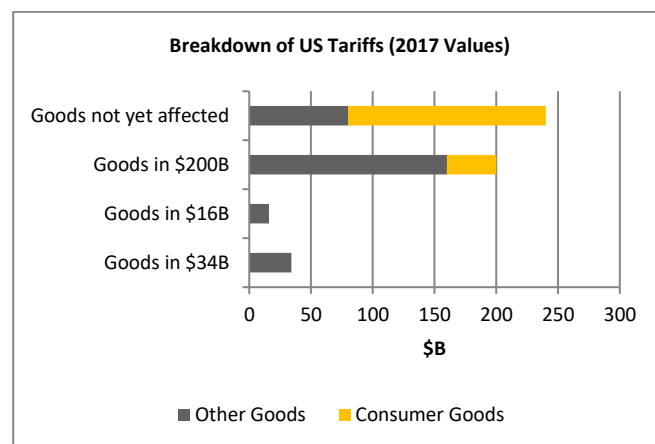
Concerns over trade wars and central bank's policy weighed on the markets during the quarter. With both global equities and global aggregate bonds failing to impress, and the volatility index closed down 7.53points. Q1 saw a major spike in volatility, which has now settled to a higher number than trailing year.

The Fed signalled hawkish shift in June with fed funds target range raised to 1.75%-2.00%. US 10 year yield crossed the 3% psychological barrier briefly in May and now is at around 2.86%. The dot-plot shows that a majority of officials now support four rate hikes during this year, to the shorter end of the curve. There are concerns that the shorter end of the yield curve is increasing at a speed greater than the longer end, hence we see flattening of the yield curve. The swap curve is pointing to further reduction in the long end of the yield curve that should further flatten the curve. This could be signalling a downturn in the near future, especially with the decrease in 10Y and 2Y Treasury yield spread to 33 basis points as at the end of Q2.

Whilst the mood at the FOMC remains positive for

now, the core inflation is trending upward. With stable GDP growth and the labour market tightening, imposition of tariffs has resulted in price pressure impacted further from the Chinese imports.

Sentiment about China's growth has had a few dents since the start of trade tensions. With no sign of resolution so far and President Trump's directive to add another \$200bn at 10% to the list, this may impact the economic growth with a total of £250bn exports to US captures under the tariff regime. The additional \$200bn tariffs are to capture goods where China has market dominance, such as consumer goods. For example, China produced 80% of the mobiles phones imported into the US last year and 93% of the laptops.



Source: UNCTAD, Capital Economics

Q2 GDP growth looked stable with good domestic demand with little tariff's impact on the exports so far and a weakening renminbi. PBOC's lack of action to support the Renminbi suggests that it is willing to allow currency depreciation to help offset the impact of US tariffs. Coupled with this they revised

Quarterly Review (Continued)

June 2018

the Required Reserves Ratio for most banks since April and lowered the Repo rate to support economic growth. Slowdown in trade volumes will be amplified in the headline value data by price movements. Second order effect of this can be on the highly leveraged companies and the corporate debt in China. For this reason we expect POBC to continue expansionary monetary policy.

Leading indicators for the US and China show a positive readings through the quarter with exception to US's June reading being slightly negative. All PMIs remain over 50.

Rate of Change (PMI)	6/30	5/31	4/30	3/31	2/28	1/31
China	1.3%	0.0%	1.0%	-2.8%	-0.7%	1.3%
UK	1.5%	2.3%	1.5%	-3.9%	2.1%	2.6%
US	-0.7%	3.1%	1.3%	-2.9%	3.7%	0.6%

(Source: MarkIt, Bloomberg)

Strong domestic demand, in the short term, kept the PMIs in green. However, if the proposed additional tariffs were to go ahead, there is an expectation that China's GDP forecast will be 0.5% lower at 4.5%. We expect China to respond in kind and limit US companies access to the Chinese market. We do not expect a full blown trade war between the largest economies as that would be a move to a full protectionism and can raise costs across the world. We expect trade to be used as a tool to try and contain China's geopolitical ambitions in the long run.

Second order effects of these trade wars can be seen in the Emerging markets via their integration into Chinese supply chains. Emerging markets can see some offset boost in the future if both US and China

shift import demand away from each other and to the Emerging Markets. However, in the short term this is not the case. Emerging markets have struggled during the quarter due to dollar strength and increase in oil prices. Inflationary pressures now seem to be building in many Emerging Markets. In response to inflationary pressure we expect central banks in Emerging Markets to tighten monetary policy and raise interest rates. We expect this to support strong earnings and the stocks in Emerging Markets.

We anticipate equity markets to remaining volatile in the short term, in reaction to trade war "news". Developed markets equities are exhibiting consolidation pattern amid the yield curve concerns in the US, we expect this to carry on throughout 2018. Impact of tariffs on the Chinese economy is minimal and has not resulted in material capital outflow from the Chinese markets. Long term slow down due to structural issues is of more concern, as is the Chinese domestic debt situation on which we are keeping a close watch.



Shahid Chaudhri
Chief Investment Officer



Asim Javed, CFA
Quant Investment Manager