



VIEWPOINT

Newsflash

A new month and the 128th issue of Viewpoint from **Financial Partners**.

This document will be made available on our website www.f-p.hk

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Market Commentary

The changes in tone from central banks drove global financial markets in June. The Bank of England and the European Central Bank appear unlikely to follow the path of the Federal Reserve in hiking rates this year. Political uncertainties in the UK grew in June following the Conservative party failing to achieve a majority just weeks before the beginning of already uncertain Brexit negotiations. In addition, questions linger over US economic policy and the ability to implement legislation.

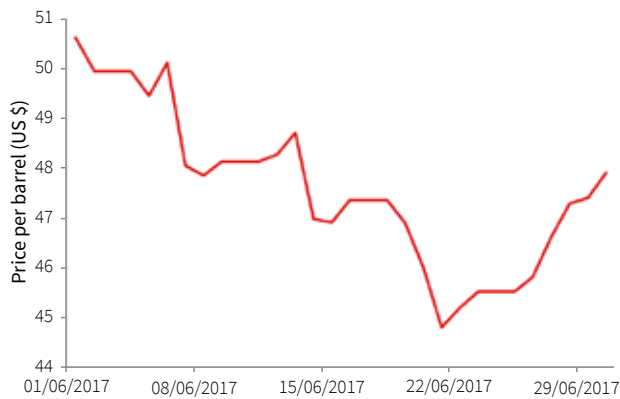
Economic prospects in the Euro Area appear to be improving with GDP growth up to 2% this year, although inflation remains below target. The US has continued to grow, with an annual GDP growth rate of around 2%, whilst the UK has outperformed post-Brexit expectations, albeit with signs of a slowdown ahead. Emerging markets have benefitted from loose global monetary policy conditions and accelerating growth. In turn this has benefitted corporate profits, with earnings rising above the stagnant conditions of the past 2 years, up over 10% year-to-date in the US, and beyond this in Europe and Japan.

During the month, equity market returns have been markedly subdued in the UK and Continental Europe falling 2.5% and 2.2% respectively. Japan and Asia Pacific built upon strong performances last month to return 3.0% and 1.8% respectively in local currency terms. The MSCI World index of developed equities returned 0.4% during June, led by Japan and Asia-Pacific, whilst emerging markets returned 1.0%, also driven by Asia. Bond market returns were on average negative during the month with US Treasuries posting a fall of 0.1%, although US corporate bonds were positive, mostly in the range of 0.1% to 0.3%.

The most notable moves during the month were in currencies and commodity markets. Brent Crude oil fell 4.8% in June, taking its fall to over 20% from its peak earlier in the year. Large efficiency gains in US shale oil production have cut breakeven costs to below \$50 per barrel, leading to a surge in production. At the same time OPEC members exempt from cuts have been increasing production. During this month and the quarter it became clear OPEC production cuts in

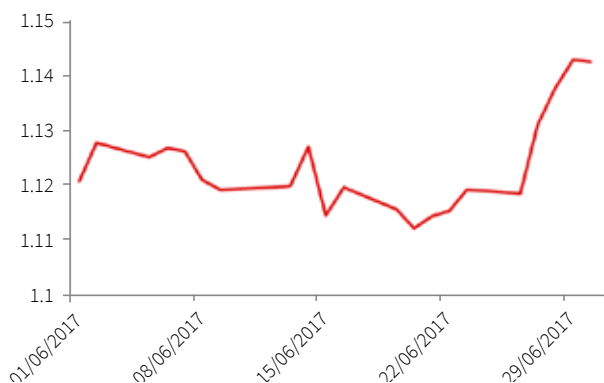
November 2016 have been unsuccessful in rebalancing supply and demand. A 9 month extension to the cuts has been agreed by OPEC and some non-OPEC members, notably Russia, but the effects so far have been muted.

Figure 1: Brent crude price



The weakness in US Dollar during May continued into June and on a trade weighted basis the US Dollar has fallen over 7% since its peak in late 2016, taking it back to early 2015 trading ranges. The US Dollar fell particularly sharply in the last week of June. Conversely, the Euro rose 1.6% versus the US Dollar in June, ending the quarter up 7.3% following a combination of rising growth, improving economic forecasts and a more favourable political backdrop.

Figure 2: EUR/USD spot price



Politics maintained a contrasting role in driving markets. In the US the Trump reflation trade agenda continued to unwind as it became clearer Trump's big policy initiatives, tax cuts, infrastructure spending and regulatory reform were becoming more distant and facing substantial political hurdles in Washington. Any fiscal boost to growth now seems very unlikely this year and will be considerably smaller than expected in the years ahead.

In contrast, the rising fears of an EU and Euro bloc break-up, exacerbated by the UK's Brexit decision and by the rise of anti-EU political factions in major EU states, were once again quashed as France elected President Macron, leader of the newly formed pro-EU party 'En Marche!' with a substantial majority. In addition, risks

of adverse political developments in Italy receded whilst troubled European banks were bolstered by state intervention. It appears any risks of a slow EU break-up have been pushed aside for the foreseeable future.

Conversely, the UK was plunged into political turmoil when Theresa May's attempt to secure a larger parliamentary majority by calling a snap election resulted in a hung parliament following an unsuccessful and unappealing Conservative campaign. The consequent failure to achieve a parliamentary majority has served to weaken the authority of the government, creating further uncertainty in Brexit negotiations, casting doubt around Fiscal management, and raising the risk of a socialist government led by Jeremy Corbyn within the next few years. Following this, it comes as no surprise UK assets performed poorly in June.

With global economic growth improving, central banks have entertained the process of monetary policy normalisation following almost a decade of ultra-loose policy. The US Federal Reserve has been at the forefront of this process, increasing target rates by 25 basis points in June; the fourth rise in this cycle. The Federal Reserve also gave a clear outline for its balance sheet normalisation plans, posing a critical test of markets as liquidity is gradually and progressively withdrawn. The impending phase of policy normalisation creates new challenges for central banks with policy missteps posing grave threats to markets, at least on a short-term basis.

Despite the turbulent month for UK and Continental European equities, the broad global environment remains favourable for risk assets; the synchronised expansion at present appears sustainable with few signs of excess credit, whilst deflationary forces are being replaced by subdued reflationary forces. The 20% fall in oil prices during Q2 will help to sustain this non-inflationary expansion.

The fundamentals for the global economy are good and the economic recovery is broadening on a sustainable basis. In addition, the tightening of monetary policy from the very loose levels of present will be gradual. The tightening moves to date have not been a hurdle for markets and central banks are adopting an extremely cautious, gradualist approach to policy changes. We therefore expect this cycle to be sustained for some considerable time ahead. Opportunities for returns outweigh the risks and we expect equities to continue to outperform bonds as the cycle progresses, hence periodic bouts of weakness in markets will present buying opportunities for risk assets.

Source: Bloomberg. Returns in US dollars unless otherwise stated. June 2017.

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	0.6%	9.0%
United Kingdom	MSCI UK NR	GBP	-2.5%	4.6%
Continental Europe	MSCI Europe ex UK NR	EUR	-2.2%	8.7%
Japan	Topix TR	JPY	3.0%	7.4%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	1.8%	19.8%
Global	MSCI World NR	USD	0.4%	10.7%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	-0.5%	3.8%
Emerging Asia	MSCI EM Asia NR	USD	1.7%	23.2%
Emerging Latin America	MSCI EM Latin America NR	USD	0.7%	10.1%
BRICs	MSCI BRIC NR	USD	0.7%	16.8%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	USD	1.0%	18.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.1%	2.0%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-1.0%	0.9%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.3%	3.8%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.1%	4.9%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-2.0%	0.2%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-1.2%	2.3%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-0.5%	-1.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.6%	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	0.3%	4.2%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.3%	-0.4%
Australian Government	JP Morgan Australia GBI TR	AUD	-1.1%	2.4%
Global Government Bonds	JP Morgan Global GBI	USD	-0.2%	4.1%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.0%	4.3%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-0.4%	6.9%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-0.4%	6.3%

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	2.0%	2.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-6.3%	-6.0%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-0.4%	15.8%
Global Property Securities	S&P Global Property USD TR	USD	1.0%	8.0%
Currencies				
Euro		USD	1.6%	8.6%
UK Pound Sterling		USD	1.1%	5.4%
Japanese Yen		USD	-1.4%	4.2%
Australian Dollar		USD	3.4%	6.8%
South African Rand		USD	0.1%	4.6%
Commodities & Alternatives				
Commodities	RICI TR	USD	-0.4%	-5.8%
Agricultural Commodities	RICI Agriculture TR	USD	3.4%	1.4%
Oil	Brent Crude Oil	USD	-4.8%	-15.7%
Gold	Gold Spot	USD	-2.2%	7.7%
Hedge funds	HFRX Global Hedge Fund	USD	0.2%	2.6%
Interest rates				
United States			1.25%	
United Kingdom			0.25%	
Eurozone			0.00%	
Japan			0.10%	
Australia			1.50%	
South Africa			7.00%	

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Developed markets equities				
UK - All Cap	MSCI UK NR	GBP	-2.5%	4.6%
UK - Large Cap	MSCI UK Large Cap NR	GBP	-2.3%	4.3%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	-4.0%	3.8%
UK - Small Cap	MSCI Small Cap NR	GBP	-2.9%	9.0%
United States	S&P500NR	USD	-0.3%	3.5%
Continental Europe	MSCI Europe ex UK NR	EUR	-1.5%	11.6%
Japan	Topix TR	JPY	0.5%	5.8%
Asia Pacific (ex Japan)	MSCIACAsia Pacificex Japan NR	USD	0.9%	13.7%
Global developed markets	MSCI World NR	GBP	-0.5%	5.0%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	GBP	0.1%	12.4%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	-2.1%	0.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	-0.5%	-0.2%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	-1.6%	0.7%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	-3.2%	0.3%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-3.1%	-0.5%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	-1.4%	0.2%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	-3.8%	-0.8%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-1.2%	2.3%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-1.0%	-3.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.6%	-1.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-0.8%	-0.4%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.1%	1.7%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.1%	3.3%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	0.9%	7.0%
Global Government Bonds	JP Morgan Global GBI	GBP	-1.1%	-1.2%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	-0.9%	-1.0%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	-1.3%	1.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	-1.3%	0.9%

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 June 2017		
		Currency	1 Month	Year to date
Property				
UK Direct Property	UK IPD All Property TR	GBP	0.0%*	3.8%*
Global Property Securities	S&P Global Property USD TR	GBP	0.1%	2.5%
Currencies				
Euro		GBP	0.6%	2.8%
US Dollar		GBP	-1.0%	-5.2%
Japanese Yen		GBP	-2.4%	-1.4%
Commodities & Alternatives				
Commodities	RICI TR	GBP	-1.3%	-10.6%
Agricultural Commodities	RICI Agriculture TR	GBP	2.4%	-3.7%
Oil	Brent Crude Oil	GBP	-5.6%	-20.0%
Gold	Gold Spot	GBP	-3.0%	2.3%
Interest rates				
United Kingdom			0.25%	
United States			1.25%	
Eurozone			0.00%	
Japan			0.10%	

Asset Allocation Dashboard
■ Positive ■ Neutral ■ Negative

Asset class	View
Equities	
Developed equities	●
UK equities (relative to developed)	●
European equities (relative to developed)	●
US equities (relative to developed)	●
Japan equities (relative to developed)	●
Emerging market equities	●
Fixed Income	
Government	●
Index-linked (relative to government)	●
Investment grade (relative to government)	●
High yield	●
Loans	●
Emerging market debt	●
Convertible bonds	●
Alternatives	
Commodities	●
Property (UK)	●
Currencies	
GBP	●
Euro	●
Yen	●

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