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Investment Commentary

May 2019

Recent economic developments

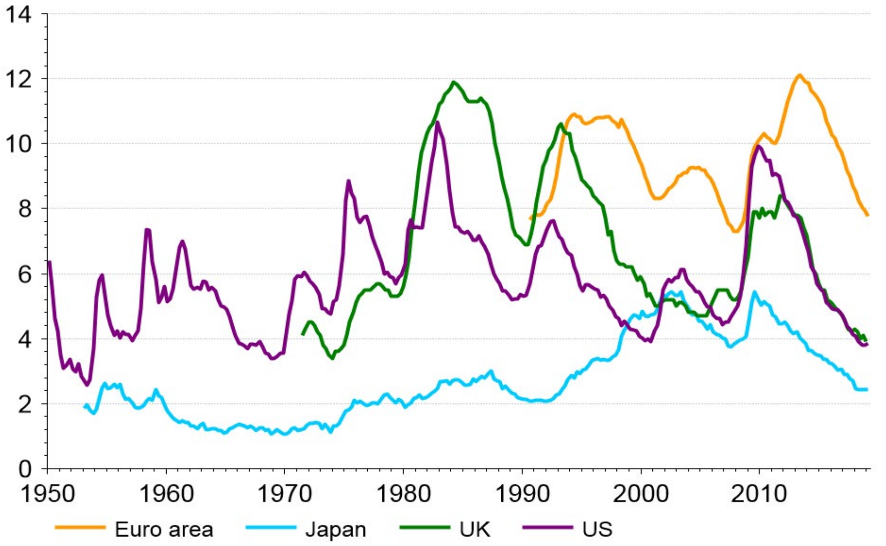
- In the US, reports published over the past month have provided mixed signals on the health of the economy. For instance retail sales unexpectedly fell in April as data showed a month-on-month decline of -0.2% versus consensus expectations of a gain of 0.2% (and a gain of 1.7% in the previous month). That marked the second monthly decline in three months, following a dip in February, and suggests that consumer spending remains subdued. In further downbeat news, data showed that US factory production fell in April for the third time in four months.

- However, continuing the long stretch of positive reports on the US labour market, recent reports showed that the number of Americans filing for unemployment (Initial jobless claims) fell by more than expected in the week ended May 11th 2019. Meanwhile, earlier in the month, the US Labour department reported that job growth rose at a faster than expected rate and the headline unemployment rate declined to 3.6% in April. That marked the lowest level for the jobless rate since December 1969.

- Multi-decade labour market strength has also been a key theme in the UK where the unemployment rate recently fell to 3.8% in the first quarter of 2019. That marked the lowest level since late 1974. Although the pace of wage growth eased from 3.5% to 3.2% in April, it remained above the Bank of England's (BOE) forecast of 3%.

- The ongoing strength in the labour market, in addition to signs of resilience elsewhere in the UK economy, has led the BOE to worry about the outlook for inflation. In response, Mark Carney, the BOE's governor, has suggested that markets may be underpricing the probability of interest rate hikes by the BOE later in 2019. Nevertheless, with leading economic indicators pointing to weak growth momentum, while the short term resilience has been supported by Brexit-related stockpiling, there is little fundamental support for higher UK interest rates at this point.

Figure 1: G4 Unemployment Rates (% of labour force)



Source: Thomson Reuters Datastream / Fathom Consulting

Financial markets & investment strategy summary

- Turning to the financial markets, equity markets maintained their solid start to the year as April marked the fourth straight month of positive returns for stocks. On the whole, developed market equities performed better than their emerging market counterparts. In local currency terms, gains for the month were led by financial stocks, with the S&P 500 Financials index and Europe's DJ Stoxx 600 Banks index up 9.0% and 8.4% respectively. The broader S&P 500 index gained 4% for the month. The UK's FTSE 100 index and Germany's DAX index gained 2.3% and 7.1% respectively in local currency terms. In the fixed income markets, corporate bonds outperformed government bonds in April (extending the year-to-date outperformance) as investors favoured lower rated credit.

- Overall, government bonds should continue to benefit from the safe-haven demand triggered by a combination of modest growth, weak inflation, supportive monetary policy and elevated geo-political and policy risks. This does not preclude periodic bouts of rate spikes as markets reach short term extremes. In the equity markets, weaker corporate earnings and political uncertainty will weigh on sentiment but lower rates should support valuations. Taking these factors together leads to a slightly cautious stance on balance. In the currency markets, the US Dollar's strength should moderate as growth and policy differentials narrow across the major developed economies.

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