ECONOMIC AND FINANCIAL MARKET REVIEW AND OUTLOOK

Q1 2018

PLATINUM FINANCIAL

NURTURING YOUR FINANCIAL FUTURE

ECONOMIC
AND FINANCIAL
MARKET REVIEW
AND OUTLOOK

Contents >

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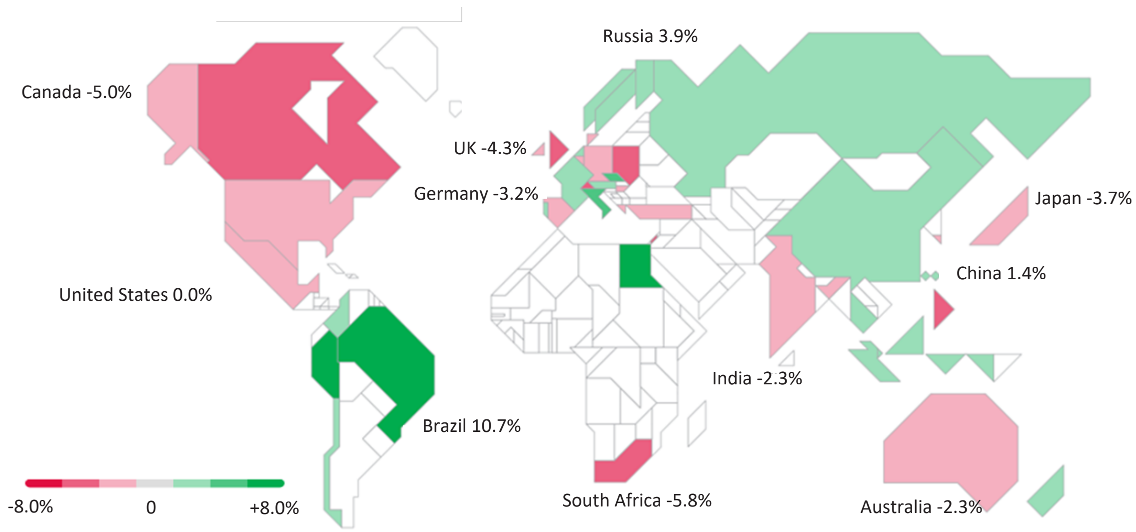
The start of 2018 has proven to be a behavioural minefield for investors. Like most of 2017, investors are grappling with a backdrop of trade tensions, political instability, rising interest rates, and a mature business cycle. Yet, perhaps of more importance, investors are now also questioning their own unbounded optimism and recognising that markets won't always go up.

This development is a meaningful change, and lessons abound. Unlike 2017, which saw a synchronised bull market and unheralded returns, the first quarter of 2018 has unwound some of the optimism and brought a sense of reality back into the equation. Somewhat paradoxically, it may be the threat of a trade war that brings the relationship between price and fundamentals back in line – reminding us just how expensive some assets have become.



Source: Morningstar Direct at 11/04/2018.

Figure 1: Year to date performance data for equities in 2018 (local currency terms).

What is interesting is that the market setback in the first quarter came at a time when the fundamentals largely remained intact. Corporate earnings continue to rise in the majority of instances and default rates remain low.

The unwinding of performance appears more complex than an unassuming turn in the business cycle – more likely to reflect a change in collective behaviour (i.e. the fear/greed cycle), especially against export-orientated markets in the developed world.

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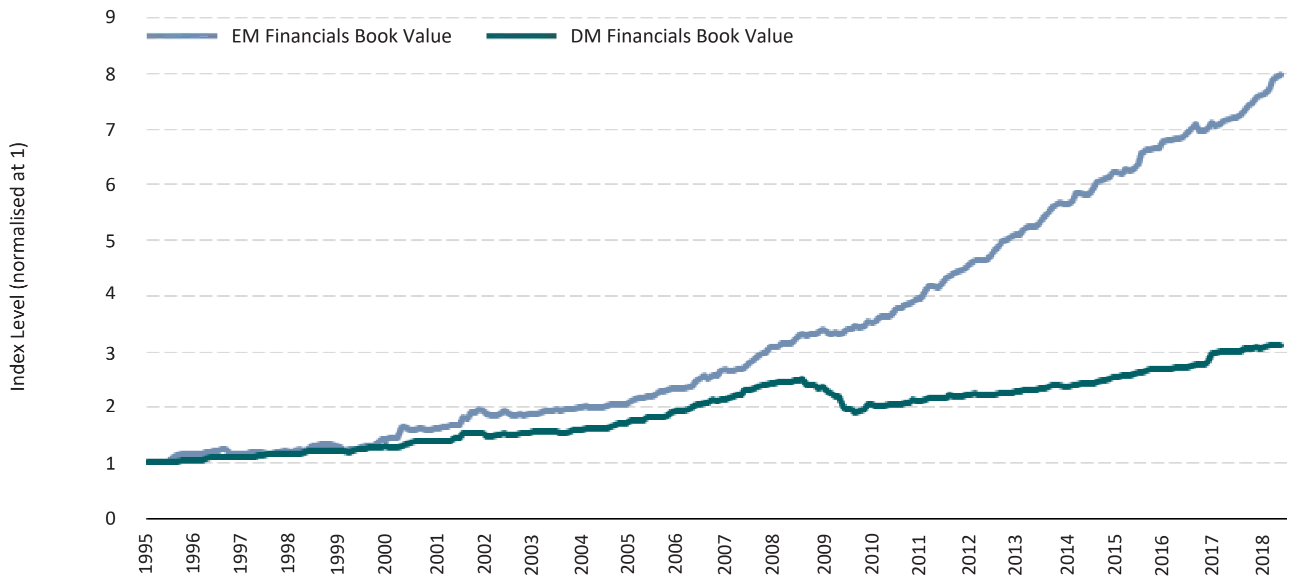
In this regard, fear-inducing headlines have not been hard to spot, with Donald Trump's threat of a trade war beginning to materialise.

Export-orientated markets began to suffer in the first quarter of 2018 alongside the US with multinational corporations in Germany, Japan and the UK selling off on the back of this news.

Interestingly, emerging markets were among the most resilient, presumably due to a combination of cheaper valuations and a market composition that is increasingly focused on domestic growth (especially among financials).



Source: Morningstar Investment Calculation, Morningstar Direct at 31/01/2018.
Figure 2: The Book Value Growth in Emerging Markets Financials has been stellar.

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Sector Performance (%)	3 Months	1 Year	3 Years	5 Years	10 Years
Consumer Discretionary	-0.28	13.34	24.39	83.86	172.94
Consumer Staples	-4.88	4.54	16.68	34.62	106.83
Energy	-4.26	3.35	4.89	4.32	7.73
Financial	-1.69	12.32	26.58	67.72	47.72
Health Care	-1.80	6.83	7.02	70.27	173.07
Industrials	-2.90	10.46	26.37	69.41	84.66
Information Technology	2.68	27.73	62.12	140.04	210.41
Materials	-4.91	10.27	23.39	36.55	20.59
Telecom Services	-6.97	-4.66	0.71	31.52	56.77
Utilities	-2.20	1.34	12.17	37.67	27.19

Source: Morningstar Direct at 31/03/2018.
Figure 3: Year to date performance at sector level in 2018 in local currency terms.

At a sector level globally, there has been little respite in 2018. The change in sentiment has resulted in deteriorating performance across the board, albeit from lofty heights in many cases.

Technology is one such sector that continues to face severe valuation pressures although it was buffered by a strong January. Rather ironically, energy companies suffered despite commodity prices generally rising (oil increased 8% in the first quarter).

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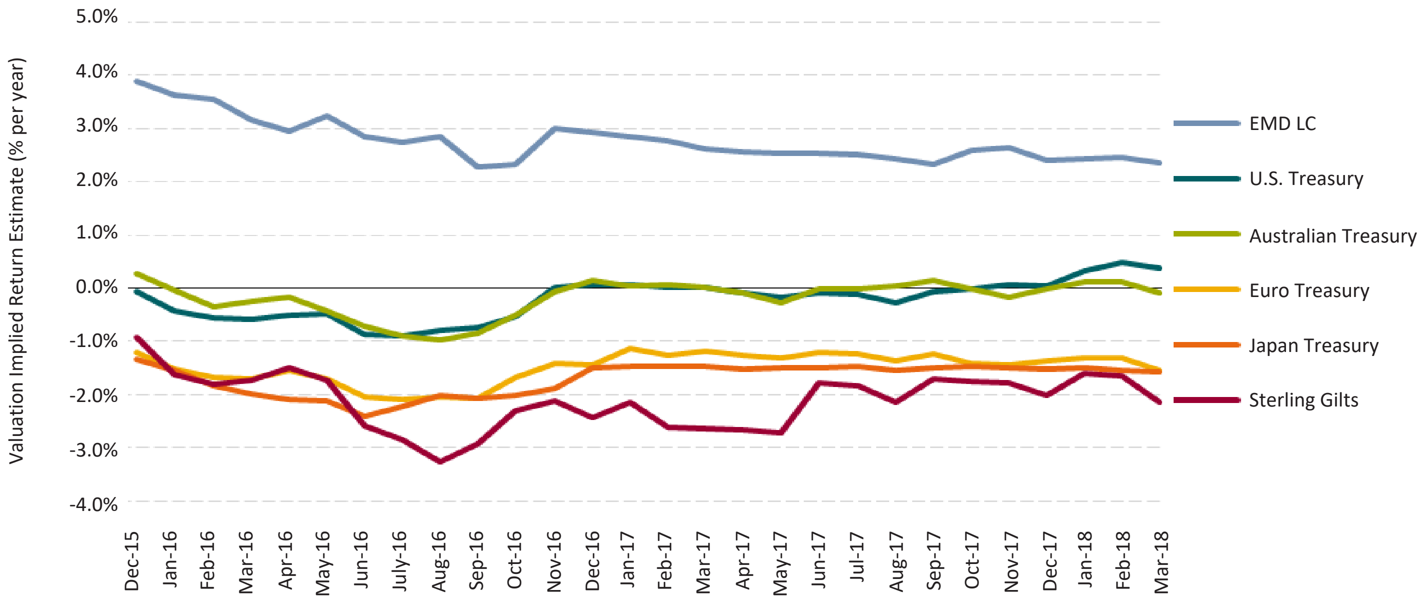
Economic Perspective and Market Review >

Morningstar continue to favour bonds at the lower end of the credit risk spectrum with US Treasuries looking the most attractive of the developed market opportunity set. Emerging market debt (local currency issuance) also continues to offer decent returns, although the reward-for-risk gap is diminishing relative to US Treasuries.

In contemplating the chain of events, the impact of currency hedging must also be considered.

For instance, the Japanese Yen has strengthened and the US Dollar weakened during the year to date (the currency differential was over 6% between them), meaning unhedged Japanese assets generally outperformed for offshore investors, and vice versa.

Under such a blanket of currency volatility, the hedging decision carries greater influence in risk management.



Source: Morningstar Investment Management Calculation, Morningstar Direct to 31/03/2018.

Figure 5: Morningstar's valuation-implied return expectations for fixed income over 10 years are largely uninspiring.

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Market Returns >

Total Returns to 31/03/2018	Q1	1 Yr	3 Yrs	5 Yrs
UK Equities				
FTSE 100	-7.21%	0.22%	17.10%	32.82%
FTSE ALL Share	-6.87%	1.25%	18.63%	37.57%
FTSE 250 Ex IT Index	-5.81%	5.64%	22.62%	60.19%
FTSE Small Cap Ex IT Index	-6.48%	2.21%	29.56%	73.39%
Global Equities				
FTSE World Index	-4.43%	2.55%	36.30%	74.27%
FTSE World Europe Ex UK Index	-4.68%	4.26%	27.77%	61.03%
S & P 500 Index	-4.75%	-0.37%	35.15%	82.17%
TOPIX Index	-2.62%	8.22%	41.42%	75.73%
MSCI AC Asia Pacific Ex Japan Index	-4.13%	7.60%	33.50%	48.71%
MSCI EM Emerging Markets Index	-2.20%	11.36%	36.33%	38.06%
Property & Property Shares				
IPD UK All Property Monthly Index	2.30%	11.26%	29.09%	74.50%
FTSE EPRA / NAREIT Developed Index	-7.94%	-7.99%	10.71%	32.32%
Fixed Income				
FTSE All Stocks Gilt Index	0.26%	0.46%	10.60%	22.76%
Markit iBoxx Sterling Non Gilts All Maturities	-1.15%	1.24%	11.10%	27.57%
BofA Merrill Lynch Sterling High Yield	-0.04%	0.82%	21.03%	43.19%

Source: FE Analytics. All returns are in Sterling Percentage growth terms, on a total retun basis.
3 years and 5 year figures are annualised.

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