

## Highlights

---

- Global equities delivered robust gains in the first quarter amid an upswing in global economic data. Emerging market equities were particularly strong while bond markets saw more mixed performance.
- US equities advanced to fresh all-time highs, supported by positive economic data and President Trump's plans to cut taxes and regulations. The Federal Reserve raised rates by a further 0.25%.
- Eurozone equities delivered robust gains amid upbeat economic releases and receding political worries following the win for the centre-right in the Dutch elections.
- UK equities gained, supported by solid corporate results and merger & acquisition activity. Article 50 was triggered at the end of the period, signalling the formal start of the process to leave the EU.
- Japanese stocks saw positive but muted returns with the yen gradually appreciating over the quarter.
- Emerging markets registered a robust return. An upturn in global growth and a lack of follow-through on protectionist trade policy from the Trump administration supported risk appetite.
- In bond markets, high yield corporate bonds performed particularly well, while government bonds were more mixed.

## US

---

US equities performed well as the S&P 500 advanced 6.1%. Macroeconomic data continued to be supportive. Non-farm payrolls<sup>1</sup> were robust and activity indicators buoyant. These included the Institute for Supply Management's manufacturing purchasing managers' index (PMI) and the Conference Board consumer confidence index – the latter rose to 125.6 in March, the highest level in more than 16 years.

Reflecting the improving outlook for growth and inflation the Federal Reserve (Fed) raised base rates by 0.25% at the March meeting of its Federal Open Market Committee. The market remained optimistic over Donald Trump's plans to cut taxes, boost infrastructure spend and reduce the regulatory burden on business. However, the failure at the period end to pass revisions to healthcare legislation did plant doubts about the administration's ability to implement some of its policies.

Information technology was the top-performing sector, followed by consumer discretionary and healthcare. The energy sector lagged the market, inline with the decline in crude oil prices. In a reversal of the performance patterns in the fourth quarter of 2016, small and mid-cap equities trailed large caps, with the Russell 2000 and Russell 2500 recording respective gains of 2.5% and 3.8% over the period.

## Eurozone

---

European equities were strong in Q1 with the MSCI EMU index returning 7.2%. The period started on a weak note, with negative returns in January, but stockmarkets picked up as the quarter progressed. Economic data released during the period was largely positive. Leading indicators showed gains with the flash composite purchasing managers' index

---

<sup>1</sup> Non-farm payrolls are a means of measuring employment in the US and represent the total number of people employed, excluding farm workers, private household employees and those employed by non-profit organisations.

reaching a near six-year high of 56.7 in March. Inflation, as measured by the consumer price index, picked up to 2.0% in February, albeit slipping back to 1.5% in March.

The ECB upgraded its 2017 and 2018 growth and inflation forecasts but pledged to keep existing stimulus in place until the end of the year.

Political worries receded as the centre-right won the Dutch elections in March, fending off the challenge from the anti-EU party led by Geert Wilders. Meanwhile, opinion polls suggested that the odds of a Marine Le Pen win in the French presidential election are low and diminishing.

The information technology sector was the top performer, followed by utilities and industrials. Energy was the only sector to register a negative return. The quarterly earnings season was a positive one for European equities, with many firms reporting double digit earnings growth and confident outlooks for 2017.

## UK

---

The FTSE All-Share index rose 4.0% amid further evidence of a recovery in the global economy. The UK domestic economy also proved more resilient than expected. The Bank of England upgraded its 2017 UK GDP growth projection (from 1.4% to 2.0%) due to stronger-than-expected consumer spending following the “leave” decision in the EU referendum.

Many cyclical<sup>2</sup> sectors continued to outperform, building on their very strong performances at the end of 2016. However, the so-called “reflation trade”<sup>3</sup> lost some momentum as President Trump failed to pass revisions to healthcare legislation.

Mergers & acquisitions (M&A) were an important theme: British American Tobacco agreed to acquire the outstanding stake in Reynolds American it does not already own; Unilever received a bid from US peer Kraft Heinz; and Reckitt Benckiser agreed to acquire American baby milk manufacturer Mead. Domestic M&A also picked up, such as Standard Life’s deal to acquire Aberdeen Asset Management.

Sterling strengthened over the period against a weaker US dollar. Prime Minister Theresa May suggested the UK was heading towards a harder variant of Brexit as she set out the government’s negotiating priorities in her Lancaster House speech in January. She triggered Article 50 in March to begin the two-year exit process.

## Japan

---

The Japanese stockmarket traded in a tight range throughout the quarter, registering a total return of just 0.6%. After weakening sharply at the end of 2016, the Japanese yen appreciated gradually in the past three months. From Japan’s perspective, the main political event was the meeting in February between Prime Minister Abe and President Trump in Washington and Florida. The meeting appeared to be surprisingly cordial despite the previous US rhetoric around trade imbalances and Japan’s foreign exchange policy.

A decision taken by the ruling Liberal Democratic party in early March has enabled Mr Abe to continue as the party’s leader for another term, if he wishes. However, recently Mr Abe has faced the first significant political scandal of his current tenure. This stemmed from the sale of public land in Osaka which was destined to be used as a kindergarten by an extreme-nationalist educational organisation. This issue has led to the first significant dent in Mr Abe’s public approval rating.

Meanwhile, the corporate results period for the quarter to December concluded in mid-February. Overall, the results were very solid with over 60% of companies reporting positive surprises compared to the consensus. Earnings revisions have been strongly positive in the early part of the year and, although profit trends remain favourable, forecasts now include much of the positive impact of the yen weakness seen in the second half of 2016.

---

<sup>2</sup> Cyclical stocks are those whose business performance and share prices are directly related to the economic or business cycle. Defensives are those whose business performance is not highly correlated with the larger economic cycle - these companies are often seen as good investments when the economy sours.

<sup>3</sup> Reflation is a fiscal or monetary policy designed to expand a country’s output and curb the effects of deflation.

Across the quarter, the stockmarket was led by cyclical sectors such as marine transportation, paper stocks and chemical companies as investors continued to discount the possibility of stronger global growth. Financial-related sectors, including banks and leasing companies, lagged the market although all of their underperformance accrued in a relatively brief period in March. Real estate stocks have shown a more consistent pattern of underperformance and were the weakest sector in the quarter.

## Asia (ex Japan)

---

Asia ex Japan equities rebounded strongly from the last quarter of 2016 to post strong positive returns in the first quarter of the new year, spurred on by the broader “Trump bump” rally seen in global stockmarkets. In China, stocks gained strongly and had their best first quarter in over 10 years, driven on by continued positive news for the world’s second-largest economy. Better-than-expected data and a stabilising Chinese yuan led to improved sentiment among investors. Ongoing restrictions on the property market and a tightening on capital outflows also saw liquidity diverted into equities.

In nearby Hong Kong, stocks tracked China markets higher on investor optimism as well as strong buying interest from Mainland Chinese investors via the Southbound Stock Connect scheme. Over the strait in Taiwan, stocks hit a near two-year high as foreign investors returned to the market while Korean equities also advanced strongly on the back of its technology sector.

In ASEAN, Indonesian, Thai and Philippine stocks all gained although the Philippines was the regional underperformer as concerns lingered over the weakness of its currency and the erratic policymaking of President Duterte. Meanwhile, Indian stocks led gains in Asia as its market finished strongly up on the back of investor optimism surrounding Prime Minister Modi’s reform agenda following a resounding victory for his party (the BJP) in state elections in March.

## Emerging markets

---

The MSCI Emerging Markets index posted a strong gain, with US dollar weakness providing a tailwind to returns. An upswing in global growth and a lack of follow-through on protectionist trade policy from the Trump administration supported risk appetite.

Korea, Mexico, Taiwan and China all benefited from these factors and outperformed. In China, the weaker US dollar also served to alleviate concerns over capital outflows while economic data stabilised. Indian equities rallied as GDP growth appeared to shrug off demonetisation concerns. The ruling BJP also performed well in state elections, reflecting support for ongoing reforms. Poland was the strongest index market as positive economic data increased expectations for growth this year.

By contrast, Russia posted a negative return and was the weakest index market. A decline in energy prices and reduced optimism towards a significant improvement in relations with the West were the key headwinds. Greece also recorded a negative return with banking stocks leading the market lower.

## Global bonds

---

Optimism over the strengthening global economy and potential pro-growth effects from President Trump’s fiscal stimulus plans continued to drive markets in Q1. Data showed real economic activity continuing to pick up with yet further evidence of synchronised global deflation underway. The shift toward monetary policy normalisation also continued. The Fed raised rates and the ECB signalled it sees less need for accommodative policy going forward. Detail over Trump’s fiscal plans remained generally thin, but significant doubts about his ability to implement reform were planted in March after a failure to pass healthcare legislation. Politics in Europe remained a worry for markets as nationalist politicians continued to command support, although concerns receded somewhat towards the end of the period.

Against the backdrop of strengthening growth, rising inflation and marginally more hawkish central banks, global credit, particularly high yield<sup>4</sup>, outperformed government bonds. Global high yield credit outperformed government bonds by 2.4% on an absolute return of 2.8%. UK high yield proved particularly strong with a return of 3.3% and outperformance of 2.8% above government bonds. Global investment grade corporate bonds rose 1.2% outperforming government bonds by 0.7%.

Among government bonds, European sovereigns came under pressure amid political concerns and markets starting to adjust to the prospect of monetary stimulus withdrawal. Spreads on French and Italian bonds over Bunds widened markedly reflecting political risk. French 10-year yields rose from 0.67% to 0.97% and Italian 10-year yields from 1.81% to 2.31%. Ten-year Bund yields rose from 0.21% to 0.33%. US and UK government bonds performed better. The US 10-year yield came in from 2.44% to 2.39% and the UK's from 1.24% to 1.14%.

Global equity markets continued with positive momentum into 2017. Global convertible bonds benefited from this rally with the Thomson Reuters Global Focus convertible bond index finishing Q1 with a strong 2.83% return in US dollar terms. Buoyant equity markets have moved the overall equity exposure of convertible bonds upwards. Above-average issuance, especially from US companies, meant a stable supply of balanced bonds. For the first quarter, \$24 billion of new convertibles came to the market, indicating a good chance of a growing convertible bond universe in 2017. Also, global convertible funds are seeing positive flows again, after bigger outflows from the asset class during 2016. On balance, our models signal that a large part of the global convertible market remains fairly valued, albeit bargains have become more difficult to find.

## Commodities

---

The Bloomberg Commodities index lost ground in Q1, largely due to a decline in the energy component. Brent crude fell -7% as oil inventories and production in the US increased at a faster rate than expected. Natural gas was down -14.3% and coal declined -8.7%. The agriculture component was also weaker, largely attributable to weakness from sugar and soybeans prices. By contrast, industrial metals generated a positive return. Iron ore rallied 5.7% while copper (+5.8%) and zinc (+7.5%) also rose on higher demand from China. Precious metals finished in positive territory, with gold (+8.3%) and silver (+14.2%) both posting gains.

---

<sup>4</sup> Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

## Overview: total returns (%) – to end of Q1 2017

Equities	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	5.06	6.53	5.27	23.00	15.44	32.68
MSCI World Value	2.99	4.43	3.20	25.70	17.97	35.60
MSCI World Growth	7.25	8.75	7.46	20.33	12.93	29.81
MSCI World Smaller Companies	3.91	5.36	4.11	26.13	18.37	36.06
MSCI Emerging Markets	9.95	11.49	10.17	25.36	17.65	35.23
MSCI AC Asia ex Japan	11.84	13.41	12.06	25.53	17.82	35.42
S&P500	4.60	6.07	4.81	24.85	17.17	34.68
MSCI EMU	7.22	8.72	7.43	20.80	13.38	30.32
FTSE Europe ex UK	7.24	8.74	7.45	18.54	11.26	27.88
FTSE All-Share	3.82	5.27	4.02	13.05	6.10	21.95
TOPIX*	3.81	5.27	4.02	23.26	15.68	32.97

Government bonds	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	-0.68	0.71	-0.48	4.94	-1.51	13.21
JPM GBI UK All Mats	1.41	2.83	1.61	-0.93	-7.02	6.87
JPM GBI Japan All Mats**	2.72	4.16	2.93	5.92	-0.59	14.26
JPM GBI Germany All Mats	-0.77	0.61	-0.58	-0.63	-6.74	7.20
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	0.29	1.70	0.50	7.90	1.27	16.40
BofA ML US Corporate Master	0.02	1.42	0.22	10.18	3.41	18.86
BofA ML EMU Corporate ex T1 (5-10Y)	0.41	1.82	0.61	3.24	-3.10	11.38
BofA ML £ Non-Gilts	1.62	3.04	1.82	1.33	-4.89	9.32
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	1.65	3.07	1.85	21.27	13.82	30.83
BofA ML Euro High Yield	1.68	3.11	1.89	8.99	2.29	17.58

Source: DataStream. Local currency returns in Q1 2017: \*0.57%, \*\*-0.49%.

Past performance is not a guide to future performance and may not be repeated.

Source: Schroders

The information is based on management forecasts and reflects prevailing conditions and our views as of this date, all of which are accordingly subject to change. In preparing this document, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources or which was provided to us by or on behalf of the potential investor or which was otherwise reviewed by us. No responsibility can be accepted for errors of fact or opinion.

The investments mentioned in this website may not be suitable to all investors. The information contained in this website is provided for reference only and does not constitute any investment advice. Investors are advised to seek independent advice before making any investment decision. Past performance is not indicative of future performance. Investment involves risk and investors may not get back the amount originally invested. Please read the relevant offering document carefully, in particular fund features and the risks involved in investing in the fund.

Schroder Investment Management (Hong Kong) Limited is regulated by the SFC. Non-Hong Kong residents are responsible for observing all applicable laws and regulations of their relevant jurisdictions before proceeding to access the information contained herein.

The document has not been reviewed by the SFC and may contain information of non-SFC authorized funds. Issued by Schroder Investment Management (Hong Kong) Limited.