Schroders

Monthly Markets Review
Overview of markets in July 2017

Highlights

- Global equity markets advanced in July. Prevailing trends in economic data continued, easing pressure on major central banks to alter policy trajectory.
- Despite ongoing political uncertainty in the US, the S&P 500 rose over the month amid supportive macroeconomic data, a robust start to the quarterly reporting season and further weakness in the dollar.
- Eurozone equities made narrow gains. Economic data remained positive but a stronger euro capped equity market progress.
- The UK's FTSE All-Share index rose in July. Resources and financial sectors led the market higher, with resources sectors benefiting from higher commodity prices.
- Japanese equities managed to eke out a positive return despite the yen strengthening late in the month.
- Emerging markets recorded a robust return, with dollar weakness a tailwind. Continued improvement in the outlook for global growth aided risk appetite.
- In bond markets, the late-June selloff initially continued in July but came to a halt as expectations of a more hawkish shift among central banks were reined in. Yields for US 10-year Treasuries were little changed over the month.

US

The S&P 500 recorded a total return of 2.1% over the month, reaching new all-time highs in the period. US equities were supported by a variety of factors including some positive macroeconomic data, a robust start to the quarterly reporting season and further weakness in the dollar. The market made further progress despite ongoing political uncertainty.

It was confirmed that the US economy had bounced back in the second quarter with GDP growth of 2.6% (annualised) while a number of forward-looking activity indicators regained some of their recently-lost momentum. The Institute for Supply Management's manufacturing purchasing managers' index (PMI) bounced back sharply in June, to a three-year high of 57.8, and the Conference Board consumer confidence Index rose to 121.1 in July from 117.3 in June.

Inflation data remained sluggish, with consumer price inflation continuing to head lower. At the July meeting of the Federal Open Market Committee the US central bank kept base rates on hold, although said plans to reduce its balance sheet would begin "relatively soon". This was read by the market as meaning September. Telecoms outperformed over the month, as did the technology sector, which bounced back following a poor performance in June.

Eurozone

Eurozone equities made narrow gains in July with the MSCI EMU index returning 0.3%. Economic data remained supportive. However, ongoing speculation over less expansionary policy from the European Central Bank (ECB) pushed the euro higher and capped equity market gains. The financials sector led the advance while healthcare was the biggest laggard.

Shares of banks and insurers were generally strong across the board. Within healthcare, conglomerate Bayer cuts its full-year sales forecasts after problems in both its crop protection and consumer health divisions. Carmakers were another focus during the month amid fresh allegations over illegal emissions controls. EU antitrust regulators said they were probing a possible car industry cartel.

The possibility that the ECB could reduce its stimulus measures continued to be a focus for the market. ECB President Mario Draghi said that the central bank would discuss potential changes to its bond-buying programme in the autumn. However, inflation remained contained with the consumer price index up 1.3% year-on-year in July.

Eurozone economic data continued to indicate further expansion. French and Spanish Q2 GDP data showed solid growth of 0.5% and 0.9% respectively (both quarter-on-quarter). The eurozone unemployment rate dipped to 9.1% in June from 9.2% in May. The German Ifo business climate index hit a new all-time high of 116.0 in July.

UK

UK equities bounced back over July following their poor performance in June, albeit the recovery was driven by a narrow band of sectors and stocks. The large-cap financial and resources companies were top contributors, due to a combination of robust corporate results and as sentiment towards emerging markets and commodities recovered. This was amid ongoing US dollar weakness and an improvement in Chinese economic data. The FTSE All-Share returned 1.2% over the period.

HSBC was a standout performer on the back of robust second-quarter results as investors welcomed news of further share buybacks. The large-cap resources sectors also produced some solid results, where a further improvement in balance sheet strength drew equally broad approval from market participants. Healthy cashflows reassured, both as to the sustainability of dividends (Royal Dutch Shell) and the potential for dividend growth – Anglo American resumed dividend payments six months ahead of schedule.

More generally, the resources sectors performed well as more supportive Chinese economic data drove a sharp recovery in industrial metal prices. Oil prices bounced back following a pledge from Saudi Arabia to reduce exports. However, outside of financials, resources and telecoms, large caps underperformed, which explains why the FTSE 100 rose only 0.9% versus a 2.5% gain in the FTSE 250 (ex investment trusts). The large tobacco groups performed very poorly after the US Food and Drug Administration proposed reducing nicotine content in cigarettes to non-addictive levels. In healthcare, AstraZeneca fell sharply after trials of a key cancer treatment failed to show superiority versus chemotherapy.

Japan

The Japanese market trended gently upwards during July to end the month 0.4% higher. Although the rise was modest it was nevertheless achieved despite the yen appreciating against the dollar in the second half of the month. The leading sectors were primarily cyclical areas, including steel, textile, automobiles and shipping companies. Banks were the weakest sector, reversing their strong performance in the previous month. Other financial-related sectors, including insurance and real estate, also underperformed.

Japanese companies began releasing results for the first quarter of the new financial year. By 1st August, roughly half of listed companies had reported and the early indications are positive, with profits growing and aggregate margins rising. Japanese companies are typically reluctant to revise up full-year forecasts at the Q1 stage but a higher proportion than usual is doing so this year.

Most of the economic numbers released in July were broadly in-line with expectations and the overall positive tone in Japan's data continued. Inflation data inched ahead, but the main focus remains on labour market tightness with the unemployment rate returning to the lowest level seen for more than 20 years.

The very poor showing by the ruling Liberal Democratic Party in the Tokyo Assembly elections at the beginning of July was subsequently reflected in a sharp drop in approval ratings for Prime Minister Abe. There are widespread expectations of a cabinet reshuffle in early August. Meanwhile, the Governor of the Bank of Japan, Mr Kuroda, was able to strengthen his hand as two frequent dissenters reached the end of their term on the Bank's policy committee and were replaced.

Asia (ex Japan)

Asia ex Japan equities climbed higher in July as a cautious policy statement from the US Federal Reserve and a spate of positive earnings releases across Asia propelled share prices upwards. Chinese stocks were the region's biggest winners with advances by larger caps in the financials, technology and resources-related spaces more than making up for a decline in smaller cap domestic equities. Sentiment was supported by better-than-expected growth data for the world's second-largest economy, with GDP expanding in the second quarter by 6.9% year-on-year. Recent gains in the Chinese yuan continued in July and allayed any fears of a potential rekindling of capital outflows, with the currency finishing the month up +0.8% against the US dollar.

In nearby Hong Kong, stocks also gained on strong buying from mainland Chinese investors. Over the strait in Taiwan, stocks rose on the back of continued strong foreign fund inflows with gains driven by financials and technology smartphone component makers. Korean stocks climbed in July to hit an all-time high as key technology and resources stocks spurred sentiment.

In ASEAN, the Philippines and Thailand finished ahead while Indonesia was broadly flat. Meanwhile, in India, stocks scaled record highs with strong corporate earnings and the possibility of a further interest rate cut by the central bank helping push stock prices higher.

Emerging markets

Emerging markets recorded a robust return, with US dollar weakness a tailwind. Continued improvement in the outlook for global growth, in combination with modest inflationary pressure also served to increase risk appetite.

China recorded a strong return as second quarter (Q2) GDP increased 6.9% year-on-year, showing little impact from the authorities' moves to selectively tighten liquidity. Other activity data was generally better than forecast. Commodity prices moved up in response which was beneficial for a number of Latin American equity markets. Brazil was the strongest index country, in part given a rebound in the real. The government successfully passed labour reforms during the month while inflation fell more than forecast to 3%, allowing the central bank to cut rates by 1%. Furthermore, former president Luiz Inácio Lula da Silva was convicted of corruption. This likely prohibits his participation in presidential 2018 elections and dims the chances of a return to power for the leftist Workers Party.

By contrast, Pakistan registered a negative return as the Supreme Court disqualified the prime minister from office. It followed a corruption investigation triggered by the leak of documents from a Panama law firm in 2015.

Global bonds

In bond markets, the late-June selloff initially continued in July, but came to a halt as growing expectations of a more hawkish shift among central banks were reined in. Federal Reserve (Fed) Chair Janet Yellen's testimony to congress was keenly observed by markets. Yellen's comments gave particular attention to low levels of inflation, seeming to dampen expectations of growing central bank hawkishness. The Fed chief also commented that the 2% inflation target is within reach over the next two years. President Trump and the US government remained a focal point. Aside from another failed attempt to pass healthcare legislation, there were further high profile personnel changes. In terms of policy developments, there was again no talk of fiscal or economic reform. In Europe, initial stages of Brexit talks gave little cause for confidence.

Positive economic trends continued. In particular, data from China helped boost the mood of the market as various measures of activity exceeded expectations. This gave a leg up to oil and commodities prices. Euro area activity remained strong and broad based with France and Spain showing solid growth.

US Treasury 10-year yields were one basis point (bps) lower at 2.29%, despite having reached 2.39% mid month. 10-year gilt yields were also little changed, down three bps to 1.23%. Shorter-dated gilts made more significant moves, the five-year yield falling from 0.70% to 0.59% and the two-year from 0.36% to 0.27%. Bund 10-year yields rose. From 0.47% at the start of the month, they reached an intra-month high of 0.60% before finishing at 0.54%. This would seem to reflect the market pricing better economic prospects for Europe and shifting central bank policy. The US dollar continued to decline over the month, the dollar spot index (DXY) finishing 2.9% lower, with the euro making good gains. Italian 10-year yields narrowed further from 2.16% to 2.09%. The French 10-year was little changed at 0.80%.

Corporate bonds performed well, rising ahead of government bonds. The BofA Merrill Lynch Global Corporate Bond Index rose 0.7% over the month, with the high yield[1] equivalent rising 1.1%. High yield was led by the energy sector, particularly in the US and UK, with strong performance seen from insurance in Europe. In sterling credit, investment grade and high yield performed in line with each other with the former led by strong performance from financials.

Convertible bonds, as measured by the Thompson Reuters focus' index, returned 0.77% in July, taking year-to-date performance to 5.2%. The majority of performance continues to come from equity participation, while rate increases in Europe and falling global equity market volatility were slight detractors. The current positive stockmarket trend has seen equity volatility fall to a multi-year low in July, which continues to weigh on the value of equity options. We calculate the convertible universe currently has a sensitivity of around 0.5% for every one percentage point gain in annualised stock volume, which would be a valuable source of future return should volatility levels normalise.

Commodities

The Bloomberg Commodities index posted a positive return in July, supported by dollar weakness. Industrial metals were boosted by a strong second quarter GDP growth print in China, easing concern over the impact of policy tightening. Iron ore (+29.1%) was up sharply while copper (+7.1%) was also firmly higher. Within the energy component, Brent crude (+9.9%) rebounded as US inventories fell at a faster-than-expected pace. The agricultural component registered a more modest gain. Coffee (+10.8%) was the standout soft commodity as prices increased sharply on concern over the upcoming harvest in Brazil. Precious metals in general were up, with gold rising 2%, as markets moved to price in no further rate hikes this year.

[1] 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 July 2017

	1 month			12 months		
Equities	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
MSCI World	-0.92	2.42	0.92	10.76	16.78	17.60
MSCI World Value	-1.04	2.30	0.79	11.78	17.85	18.68
MSCI World Growth	-0.79	2.55	1.04	9.74	15.70	16.52
MSCI World Smaller Companies	-1.05	2.29	0.78	11.65	17.71	18.55
MSCI Emerging Markets	2.58	6.04	4.48	18.84	25.30	26.19
MSCI AC Asia ex Japan	1.98	5.42	3.87	21.12	27.70	28.61
S&P500	-1.27	2.06	0.55	10.06	16.04	16.87
MSCI EMU	0.34	3.72	2.20	20.00	26.52	27.42
FTSE Europe ex UK	-0.04	3.33	1.81	17.38	23.75	24.63
FTSE All-Share	-0.67	2.68	1.17	8.21	14.09	14.90
TOPIX*	-1.21	2.12	0.62	10.01	15.99	16.81

	1 month			12 months		
Government bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
JPM GBI US All Mats	-3.13	0.14	-1.34	-7.78	-2.77	-2.08
JPM GBI UK All Mats	-1.48	1.84	0.34	-8.38	-3.40	-2.71
JPM GBI Japan All Mats**	-1.62	1.70	0.20	-14.96	-10.34	-9.70
JPM GBI Germany All Mats	-0.06	3.31	1.79	-4.71	0.47	1.18
Corporate bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
BofA ML Global Broad Market Corporate	-1.60	1.71	0.22	-2.67	2.62	3.35
BofA ML US Corporate Master	-2.54	0.75	-0.74	-3.60	1.64	2.36
BofA ML EMU Corporate ex T1 (5-10Y)	0.96	4.36	2.82	0.59	6.06	6.81
BofA ML £ Non-Gilts	-1.15	2.19	0.68	-4.08	1.13	1.85
Non-investment grade bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
BofA ML Global High Yield	-1.66	1.66	0.16	5.70	11.45	12.24
BofA ML Euro High Yield	0.89	4.29	2.75	8.23	14.11	14.92

Source: DataStream.

Local currency returns in July 2017: *0.42%, **0.01%.

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