CAERUS Portfolio Management

CAERUS Market Commentary – May 2017

Market overview

Globally, equities continue to churn higher with volatility conspicuously absent. Fundamentals remain in the most part on a quiet recovery helped by the continued central bank support. Politics, however, continues to take centre stage with Trump's misjudgements, Macron's success and Corbyn's surprising revival in the UK election polls and, as we go to press, the UK is coming to terms with yet another 'unexpected' election result.

May Indices

Index	May Return (£ base)
FTSE World Index	2.48%
FTSE USA TR GBP	1.59%
FTSE Europe ex-UK TR GBP	5.17%
FTSE Japan TR GBP	3.26%
FTSE 100	4.92%
FTSE all share	4.36%
FTSE EM	1.80%

Source FE June 2017

Past performance is not an indication of future returns. The value of investments and any income from them is not guaranteed and can go down as well as up.

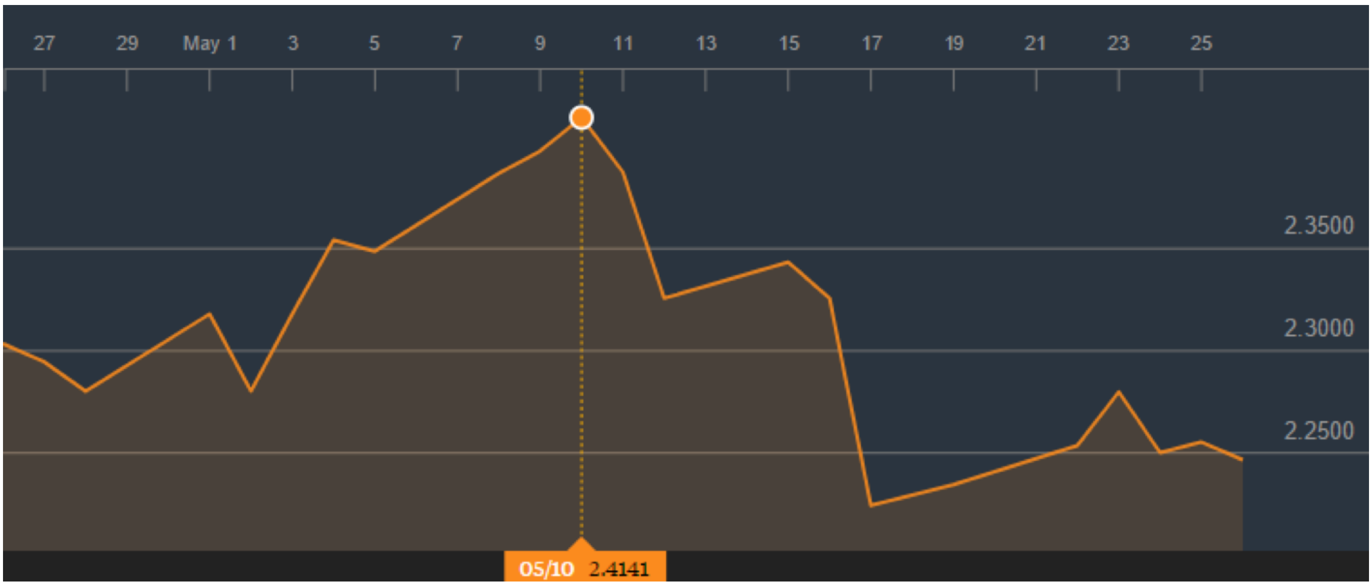
United States

Treasuries rallied and equities sold off on the 17th May, driven by increased potential for only the third impeachment in American political history. The US constitution states only the most serious offences should be pursued under this mechanism, specifically "treason, bribery, or other high crimes and misdemeanours".

The S&P 500 fell almost 2%, which was a large move given the lack of volatility present in markets. In fact, it was the largest daily fall since September.

Even so, the wall of money continues to exert its pressure and we saw a recovery in markets – closing at new highs by month end. Conversely, the bond market paints a slightly different picture, where yields remained depressed as we close the month. White House success in re-packaging the deal to repeal Obamacare in such a way as to garner sufficient approval from the House of Representatives, was initially received well by the bond market, with 10bps added to the 10 year yield. However, all gains were reversed and more, by month end, suggesting a more gloomy outlook than the story painted by the stock market.

This has all unfolded under a steadying and strong, if slightly less improving fundamental picture. However, one positive enough for the Fed to continue their rhetoric of a further rate rise in June. Unemployment remains at lows with many other signs of strength in the labour market, while ISM non-manufacturing Purchasing Manager's Index indicators continue to improve. The more important ISM manufacturing PMI disappointed early in the month while inflation was a little 'soggy', but the Fed points to idiosyncratic factors that will be transitory in their impact, curtailing positive price appreciation.



Source Bloomberg.com May 2017

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S&P 500 Index

Source FT.com May 2017

United Kingdom

The FTSE 100 finished the month strongly as an opinion poll implying Jeremy Corbyn had cut the Tories lead to 5 points pressured sterling in combination with signs of an economic slowdown. Having previously rallied to above 1.3 on expectation of a Tory landslide and strong mandate for Brexit negotiations, the recent narrowing of Theresa May's lead has been a boost to the large cap exporters from the currency translation effect. Conversely, the prospect of real wage cuts, as the weak currency imports cost push inflation, is a burden on domestically-focused corporates. Having said that, the labour market remained healthy and retail sales published in May were very positive even if the manufacturing production disappointed.

Europe

Europe began the month with an important victory for the centrists as Macron defeated Le Pen by two to one. Publically, much of the political risk has been lifted and another vote against extremist politics (after the Dutch election) has helped lift European stocks consistently across 2017. Macron has the ambition to make large waves across France, with labour reform, reductions in corporate tax and an ambitious combination of spending cuts and government stimulus. While his fledgling party – La Republique En Marche – may have mirrored its leader in its remarkable rise, for Macron to succeed it needs success in the parliamentary elections scheduled for June.

The election will clearly matter, not least for Macron's labour market reforms, but it should also help highlight the popularity of the European project in France, more so than what could be implied from the presidential contest. Europe-domiciled actively managed funds held more than 162bn in French assets at the end of last year, 45bn more than Germany, emphasising the importance the presidential, and now future parliamentary elections will have on this asset class. Further, average daily flows into ETFs that track European equities have surged to more than $570M since Macron won the first round election, compared to daily outflows of $130M over the past 12 months. Flows imply investors feel the risks have dissipated and are buying into Macron's reform agenda. However, like Trump, he faces many hurdles to success which must moderate our optimism.

Japan

The Japanese labour market continues to tighten, as highlighted last month, overtaking the bubble peak of 1990 for job openings to applicants during May. While Abe's economic stimulus now has companies looking for workers, there is still little upward pressure on wages. One difference to 1990 needs to be pointed out. Back in the boom years, it was a rapid growth in jobs creating the labour market tightness, whereas today it is a lack of supply. More clearly positive news for the administration was an unexpected increase in Preliminary GDP growth for Q1, up to 0.5% from 0.3% the previous quarter.

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Emerging Markets

Less than two weeks after China said it would open up its domestic market to US rating agencies, Moody's has cut the country's credit rating for the first time in 25 years, given the financial and economic risks they observe. While this has had little immediate impact – domestic investors paying little attention to this foreign ratings agency – the medium term impact could be larger, given many sovereign wealth funds have explicit mandates that require bonds above a certain rating. The downgrade leaves China on a par with Israel, the Saudis and the Czech Republic. Elsewhere, Brazilian stocks fell over 8%, alongside currency depreciation, as the story broke that President Michel Temer had endorsed bribe payments. Constitutional constraints make a general election unlikely before 2018, implying any form of exit from office by the president will freeze economic reforms, leaving growth potential in hiatus.

** All performance data quoted in this article is derived from FE Analytics*

CAERUS Sentiment Indicator