Schroders

Marketing material

Monthly Markets Review
Overview of markets in November 2018

Please note any past performance mentioned in this document is not a guide to future performance and may not be repeated.

Highlights

- After October's sharp falls, global equity markets regained some of their poise to post modest gains in November. Government bond yields were broadly lower.
- US equities moved higher. Concerns over trade and slowing earnings persisted but were offset by Federal Reserve (Fed) comments suggesting that it is unlikely to increase the pace of rate hikes.
- Eurozone equities declined. Worries over economic growth and trade wars persisted, as did nervousness surrounding the Italian 2019 budget proposal.
- UK equities performed poorly, with lower crude oil prices weighing heavily on the large cap integrated oil and gas companies. Brexit uncertainty also pulled down sectors with significant domestic UK exposure.
- Japanese equities saw positive returns, helped by the comments from the US Fed and a rebound in economic data from the previous month's natural disaster-induced weakness.
- Emerging markets (EM) equities rallied on the Fed's more moderate policy stance. A fall in crude prices supported countries that are net importers of oil.
- In bond markets, the US 10-year Treasury yield fell (i.e. prices rose) from 3.14% to 2.99% over the month.

US

US equities closed higher in November. Shares climbed early in the month before giving up much of the gain in the second half. Economic data remained encouraging and the labour market remains especially strong. US payrolls added 250,000 jobs in October, more than consensus expectations. The gain also suggests that the employment trends remain solid, and that the weakness registered in September was only temporary. The unemployment rate held steady at 3.7% and average hourly earnings grew to 3.1% year-on-year, the strongest pace of wage gains seen since 2009.

Even so, Federal Reserve (Fed) Chairman Powell struck a more dovish tone than he did in October, suggesting additional interest rate hikes may be limited. The Fed left rates unchanged, as expected. As a result, although trade concerns persist and a number of high profile tech firms warned on profits, markets made modest progress. The Q3 results season was, overall, very positive.

Most market sectors gained ground, with healthcare and real estate companies sectors amongst the best performers. Technology firms – notably Apple - were weaker as investors digested the prospect of slower earnings. Energy firms were hurt by the sharply lower oil price, which fell on a supply glut driven by Saudi Arabia and the US.

The midterm elections were largely as expected with the Democrats taking the House of Representatives while the Republicans held the Senate. This could mean less fiscal support for the economy as Democrats are unlikely to back further tax cuts.

Eurozone

Eurozone equities experienced another disappointing month. The MSCI EMU index returned -0.9%. Worries around the sustainability of global growth, trade wars and corporate profits continued to build. Economically sensitive sectors such as materials and information technology were among the worst performers while defensive sectors – such as communication services, utilities and consumer staples – registered the best returns.

Economic data within the eurozone continued to indicate slower growth. The flash composite purchasing managers' index[1] for November came in at 52.4, a 47-month low. Data showed the German economy contracted by 0.2% in the third quarter of 2018, largely due to a trade slowdown as car manufacturers struggled to prove that vehicles met new emissions standards.

The dispute over Italy's 2019 budget continued. The European Commission rejected the draft plans and recommended putting disciplinary procedures in place, which could lead to Italy being fined for non-compliance with budget rules. Brexit remained an important political focus. The EU approved the draft Withdrawal Agreement negotiated with the UK. However, uncertainty remains as the deal could be rejected by the UK parliament in a vote planned for 11 December.

UK

UK equities performed poorly, with lower crude oil prices and broader concerns around the global macroeconomic outlook weighing heavily on the large cap resources sectors. Brexit uncertainty also negatively impacted sentiment towards those areas with significant UK domestic exposure.

With the notable exception of the tobacco sector, a number of the market's defensive sectors extended their recent strong run. The tobacco companies performed very poorly amid growing concerns around a possible US regulatory crackdown, including tough restrictions on menthol cigarettes.

The UK government finalised a "withdrawal agreement" with the EU. However, the agreement received fierce push-back and several senior and junior ministers resigned in protest, posing significant uncertainty over the prime minister's leadership and the final parliamentary passage of the deal.

UK Q3 GDP growth came in at 0.6% quarter-on-quarter as expected, up from 0.4% in Q2 and the fastest pace since Q4 2016. The latest labour market report contained mixed surprises, with a rise in the unemployment rate from 4.0% to 4.1% alongside a further acceleration in year-on-year pay growth from 3.1% to 3.2% in the three months to September, the fastest rate since December 2008. More recent data, however, pointed to slowing momentum in Q4: UK retail sales disappointed in October, falling -0.5% month on month after a buoyant summer.

Japan

Equity markets continued to be volatile in November but a late rally left the Japanese stock market 1.3% higher for the month. There were no strong trends in major currencies, with the yen weakening slightly against the dollar. Sector performance was very mixed. Financial stocks, including banks, underperformed sharply, returning to the relative lows seen in June. Value[2] stocks more broadly also underperformed, reversing the upward move seen in the previous month.

Markets were somewhat directionless in the first part of the month. There was then a more consistent rally into month-end, as some change was detected in the likely pattern of US interest rate rises. Economic data released in November clearly showed a rebound from the previous month's weakness, which was largely related to a succession of natural disasters. There are now some signs that the rate of improvement in the labour market may be peaking. The economy has effectively been operating at full employment for some time, and we continue to see evidence of this flowing though to higher wage growth.

[1] The eurozone purchasing managers' index is produced by IHS Markit and based on survey data from around 5,000 companies based in the euro area manufacturing and service sectors. A reading above 50 indicates expansion.
[2] Value stocks are those that are perceived to be undervalued compared to their fundamentals, such as earnings, dividends or sales.

On the corporate front, Nissan grabbed the headlines following the arrest of Carlos Ghosn and his subsequent removal from his position as chairman of the company. Away from the spotlight, however, Japanese companies announced record levels of share buybacks in the wake of their interim results, as the trend towards better shareholder returns continues. A buyback, also known as a share repurchase, is when a company buys its own outstanding shares to reduce the number of shares available on the open market.

Asia (ex Japan)

Asia ex Japan equities rebounded in November amid optimism over a more gradual pace of interest rate hikes in the US. Positive corporate earnings news also provided support, while the plunge in crude oil prices boosted net oil importers. Trade negotiations between the US and China continued to dominate sentiment.

Across the region, Indonesia and India, both major oil importers, recorded the strongest gains as oil prices slumped and their currencies strengthened. The Indonesian rupiah was further buoyed by Bank Indonesia's surprise interest rate increase to 6%, from 5.75%. Hong Kong and Chinese stocks outperformed the benchmark amid mixed economic data from China. Chinese exports rose 15.6% year-on-year in October, while imports grew 21.4%. Industrial production and fixed-asset investment accelerated, though retail sales growth slowed. The official purchasing managers' index also missed market expectations in November.

Conversely, markets in Malaysia and Thailand retreated. Taiwanese stocks were dragged lower by declines in the healthcare sector and technology heavyweights. Separately, Taiwan's president resigned as leader of the ruling Democratic Progressive Party following losses in local elections. South Korean stocks also lagged. The Bank of Korea raised its benchmark interest rate by 25 basis points to 1.75%, the first hike in a year, on concerns over capital flight (i.e. investors moving money out of the country), high household debt and Seoul's property boom. Elsewhere, the Philippine central bank also lifted borrowing rates to rein in rising inflationary pressures.

Emerging markets

Emerging markets equities rallied on the prospect of a more moderate outlook for US monetary policy. A correction in crude oil prices was supportive of those emerging markets that are net importers of oil. The MSCI Emerging Markets Index posted a positive return and outperformed the MSCI World.

Those markets most sensitive to external pressures recorded the strongest gains, led by Turkey. Indonesia, India and South Africa, and the Philippines also outperformed, with currency appreciation amplifying returns in all five markets.

Chinese equities rebounded in anticipation of some form of positive outcome from the Trump-Xi meeting at the G20 summit in Argentina at the end of the month. US tariff hikes scheduled for 1 January have since been delayed. Meanwhile, domestic activity indicators remained relatively weak and the authorities announced further support measures.

On the negative side, Mexico recorded a negative return with domestic economic policy concerns weighing on sentiment.

Global bonds

In bond markets, the US 10-year Treasury yield fell from 3.14% to 2.99% over the month on Fed chair Jerome Powell's comments on the path for interest rates. The mid-term election results effectively also made further pro-growth measures less likely. German Bund 10-year yields fell from 0.39% to 0.31% as regional data remained soft. UK gilt yields were down from 1.44% to 1.36%.

Tensions between Brussels and Italy persisted regarding budget plans. The spread (or difference) between Italian and German 10-year government bond yields fell back below 300 basis points towards month end, having peaked earlier in the month at above 320bps.

Corporate bonds saw further negative total returns and underperformed government bonds as risk sentiment remained subdued. Emerging market (EM) hard currency and corporate bonds registered modest negative returns. Local currency EM performed well as the US dollar softened and various currencies, notably Turkish lira, Indonesian rupiah and South African rand, rallied. The Indian rupee performed well, benefiting from the decline in the oil price.

Global stock markets bounced a little after the heavy set-back in October. Convertible bonds benefited from the tailwind and returned 0.6%, as measured by the Thomson Reuters Global Focus Convertible index. The current set up of the balanced convertible universe looks protective compared to history. The overall credit rating is a stable BBB+ average, which gives comfort these companies will survive in more difficult conditions. The expensive valuation levels in the US and in Europe have come down significantly while Japan and Asia ex Japan continue to trade below fair value.

Commodities

The S&P GSCI Spot Index declined in November, owing to a sharp fall in the energy component. Brent crude prices declined amid ongoing oversupply concerns, and deterioration in the outlook for demand. The industrial metals component recorded a positive return; rising expectations for some easing in US-China trade tensions proved supportive of spot prices. Copper prices bounced back following recent weakness, while zinc and lead posted modest gains. The soft commodities component recorded a small gain. A rise in soybean prices was supportive, while coffee prices were down. In precious metals, gold generated a slight gain while silver prices were weaker.

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested

Overview

Total returns (net) % – to end November 2018

	1 month			12 months		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	1.1	1.2	1.3	0.1	5.5	6.2
MSCI World Value	1.6	1.7	1.8	-1.9	3.3	4.1
MSCI World Growth	0.7	0.7	0.8	2.0	7.5	8.3
MSCI World Smaller Companies	0.6	0.7	0.8	-3.6	1.5	2.2
MSCI Emerging Markets	4.1	4.2	4.3	-9.1	-4.3	-3.6
MSCI AC Asia ex Japan	5.3	5.4	5.5	-9.6	-4.8	-4.1
S&P500	2.0	2.1	2.2	6.3	11.9	12.8
MSCI EMU	-0.9	-0.9	-0.8	-12.7	-8.1	-7.4
FTSE Europe ex UK	-0.6	-0.5	-0.5	-10.0	-5.3	-5.5
FTSE All-Share	-1.8	-1.7	-1.6	-7.1	-2.2	-1.5
TOPIX*	0.7	0.8	0.8	-6.3	-1.4	-0.6

	1 month			12 months		
Government bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.9	1.0	1.1	-1.1	4.2	5.0
JPM GBI UK All Mats	-1.5	-1.4	-1.3	-6.1	-1.1	-0.4
JPM GBI Japan All Mats**	-0.1	-0.0	0.1	-1.2	4.1	4.9
JPM GBI Germany All Traded	0.4	-1.8	-1.8	-8.1	-3.3	-2.6
Corporate bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.4	-0.3	-0.2	-3.9	1.2	1.9
BofA ML US Corporate Master	-0.2	-0.1	-0.1	-2.9	2.3	3.1
BofA ML EMU Corporate ex T1 (5-10Y)	-0.8	-0.8	-0.7	-7.3	-2.4	-1.7
BofA ML £ Non-Gilts	-1.6	-1.5	-1.4	-6.8	-1.9	-1.2
Non-investment grade bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-1.0	-0.9	-0.9	-1.9	3.3	4.1
BofA ML Euro High Yield	-1.9	-1.8	-1.8	-8.1	-3.3	-2.6

Source: DataStream.

Local currency returns in November 2018: *1.3%, **0.5%.

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