UK Week in Markets

Week ending 4 August 2019

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Key news and events

US President Donald Trump threatened to impose a 10% tariff on the remaining $300bn worth of previously untaxed Chinese imports from the start of September. This would mean that essentially all Chinese exports to the US will be subjected to tariffs. President Trump suggested that China has failed to implement promises made at the G20 summit at the end of June, including pledges to purchase more US farm products and to restrict the flow of fentanyl to the US.

Amidst a slowing global economy and increasing geopolitical uncertainties, the US Federal Reserve (Fed) cut the target range for the federal funds rate by 25bps to 2.00-2.25%. Fed officials called the move a “mid-cycle adjustment”, disappointing expectations for a start of a new monetary easing cycle. Elsewhere, the Bank of England (BoE) kept its interest rates unchanged. The BoE slashed its growth forecast for the UK and warned of a one in three chance of a recession by early 2020.

In the UK, the government earmarked an additional £2 billion for a potential no-deal Brexit scenario. The fund will be used to mitigate potential disruptions, by upgrading transport infrastructure near ports and hiring additional border officers.

Political tension escalated in the Asia Pacific region as the Japanese government decided to remove South Korea from its export county ‘white list’, which South Korea retaliated by removing Japan from its own list.

Market moves

Global equities

- Global equity markets fell over the week as US-China trade tensions re-escalated.
- The MSCI AC World Index fell by 2.9% in local currency terms and fell by 0.9% in sterling terms.
- The Real Estate sector was the best performer, returning 2.8% in sterling terms.
- The Information & Technology sector was the worst performer, returning -2.2% in sterling terms.

Regional equities

- UK equities were the best performing region in local currency terms (-1.9%).
- Emerging Market equities were the worst performing region in local currency terms (-3.2%).
- Japanese equities were the best performing region in sterling terms (+1.9%).
- Emerging Market equities were the worst performing region in sterling terms (-2.1%).

Government bonds

- The 10-year gilt yield fell by 13bps to 0.56% and the 20-year gilt yield fell by 13bps to 1.10%.
- 10-year US treasury yield fell by 22bps to 1.86%.
- At the 10-year maturity, the German bund yield fell by 12bps to -0.49% and the French government bond yield fell by 11bps to -0.23%. The 30-year German bund yield briefly turned negative for the first time in history but ended the week at 0.01%.
- Spanish government bond yields fell by 12bps to 0.26%. The 10-year gilt yield rose by 9bps to 0.82% and the 20-year gilt yield rose by 7bps to 1.31%.

Inflation-linked bonds

- The UK Over 5-year real yield fell by 10bps to -2.00% and the UK 20-year real yield fell by 13bps to -2.23%.
- 20-year breakeven inflation was unchanged at 3.34%.

Credit

- US Investment Grade bonds rose over the week, returning 1.2%.
- The US high yield bond spread over US treasury yields rose by 30bps to 419bps over the week.
- The spread of USD denominated EM debt over US treasury yields rose by 11bps to 345bps over the week.
- The sterling non-gilt spread over UK gilt yields (based on the Merrill Lynch index) rose by 5bps to 123bps over the week.

Commodities

- The S&P GSCI index fell by 2.1% in USD terms over the week.
- The S&P GSCI Energy index fell by 1.5% as the price of Brent Crude oil fell by 2.5% to US$62/BBL.
- Industrial metal prices fell by 2.8% as copper prices fell by 3.0% to US$5,769/MT.
- Agricultural prices fell by 2.9% and gold prices rose by 1.5% to US$1,442/Oz.

Currencies

- Sterling weakened by 2.2% against the US dollar and fell by 1.9% against the euro, ending the week at $1.21/£ and €1.09/£. Sterling fell to its lowest levels against the US dollar since early 2017 on increasing fears of a potential no-deal Brexit.
- The US dollar decreased by 2.0% against the Japanese yen, ending the week at ¥106.57.

Economic releases

Highlighted last week releases

Region: US

FOMC Rate Decision

The US Federal Reserve (Fed) cut the target range for the federal funds rate by 25bps to 2.00-2.25%, cutting rates for the first time in a decade. However, the Fed was more hawkish than expected, with Fed Chair Jerome Powell indicating that it would not be the beginning of a long series of rate cuts, but rather a mid-cycle adjustment.

Region: US

Change in Nonfarm Payrolls

The US economy added 164,000 jobs in the month of July, with unemployment rates at a near record low of 3.7%. Whilst this was slower than the job growth recorded in the previous month, it suggests that labour market conditions have remained tight.

Region: UK

Bank of England Bank Rate

The Bank of England kept its benchmark interest rates on hold at 0.75%. The central bank reported stalling business investment amidst ongoing Brexit uncertainty and slowing global growth, and forecasted a 33% chance of a recession by early 2020 due to the impact from heightened uncertainty. The Bank also warned of a substantial instantaneous shock to the economy if Britain were to exit the EU without a deal.

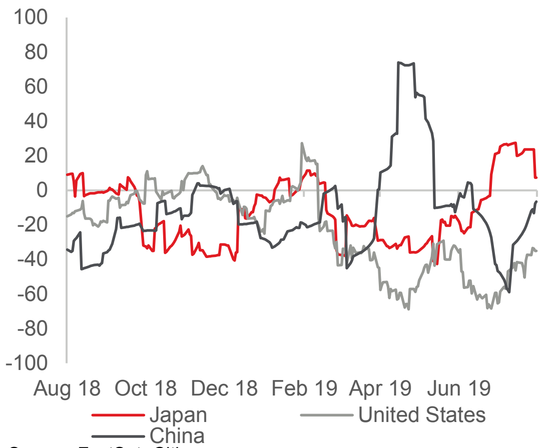
Region: Eurozone

GDP Growth

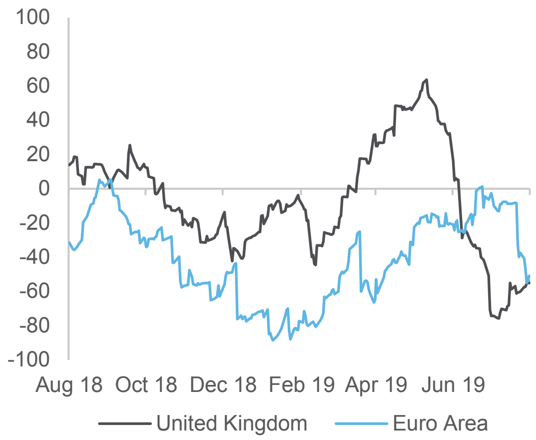
The Eurozone economy grew by 0.2% in Q2 2019, slowing from the 0.4% growth recorded previously but in line with market expectations. The sluggish growth reading comes as the region's manufacturing sector continued to struggle amidst slowing global growth and escalating trade tensions, and reinforced expectations that the European Central Bank will cut rates at their next meeting in September.

Economic surprise

The index measures economic data relative to expectations. A positive number indicates that economic data has outperformed expectations



Source: FactSet, Citi



Source: FactSet, Citi

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About Aon Global Asset Allocation

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With over 160 years of combined experience, the team is one of the strongest in UK investment consultancy today.

Our experts analyse market movements and economic conditions around the world, setting risk and return expectations for global capital markets.

The team use those expectations to help our clients set and, when it's right to do so, revise their long-term investment policies.

We believe that the medium-term (1–3 years) has been under exploited as a source of investment performance. Maintaining medium-term views that complement our long-term expectations, we help our clients to determine when to make changes to their investment strategy

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