Invesco Perpetual

Monthly Market Roundup – covering March 2017

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We review global market developments in March, highlighting the best and worst performing sectors globally.

Global market overview

- Global stocks enjoyed one of the strongest starts to a year since 2012, despite a modest pullback in equity markets
- Trump-inspired equity rally lost some steam as policy setbacks in March raised concerns about the US administration's ability to stimulate growth
- Resurgence in emerging market strength helped the region to outperformance versus developed equity markets

Global stocks continued to enjoy one of the strongest starts to a year since 2012 amid optimism that the US administration is likely to boost corporate profitability, despite its protectionist rhetoric. However, investors turned more cautious as the month drew to a close. This was in part due to President Donald Trump's healthcare policy setbacks in March, which raised concerns about his ability to successfully push through his tax reform, deregulation and infrastructure spending policies. Nonetheless, encouraging economic growth from across the US, Europe and Asia, improving employment data and strengthening manufacturing conditions globally saw the MSCI AC World index continue its run of positive monthly returns. The index returned 1.29% in March, up 7.05% (total return, sterling) for the first quarter of 2017. At the sector level, performances were mixed across regions. However, investors' confidence in higher oil prices continued to be capped by the prospect of faster growth in US oil production and rising US stockpiles, whereas natural gas prices rebounded strongly following February's sharp sell-off.

Although optimism about the US administration's ambitious agenda saw US equities start the month on a high, the lack of policy progress and rising market scepticism about President Trump's ability to push through his pro-growth agenda was reflected in the increased market volatility and a modest pullback in US equity markets. So-called 'Trump trades' in particular were impacted, with financials, which had done particularly well in the post-US election rally, bearing the brunt as investors took profit, while the oil and gas sector on aggregate continued to struggle on concerns about the potential growth in US oil production. This, coupled with mixed core economic data releases that pointed to a slowdown in the US growth momentum, led the S&P 500 to end the month essentially flat. However, mixed economic data in March likely understates the general health of the US economy. This was evidenced by the Fed's interest rate hike mid-March, which underlined the confidence in its economic outlook. For the first quarter of 2017, the S&P 500 index delivered a robust 4.8% (total return, sterling).

UK equity markets rose strongly through March, but closed out the month and first quarter of 2017 on a downbeat note as the Trump reflation trade continued to fade. In economic news, the Bank of England (BoE) kept UK interest rates unchanged at 0.25%, while UK inflation rose 2.3% in February, breaking the [illegible] inflation target for the first time in over three years. Into month-end, UK Prime Minister Theresa May triggered Article 50, initiating the nation's formal exit from the European Union. Unlike the massive sector rotation seen in markets post-Brexit last June, the event was met with a muted response.

In Europe, equity markets rose in March, as strong macroeconomic data in the eurozone underpinned gains. The FTSE World Europe ex-UK index returned 4.4% (total return, euro), posting the best monthly performance so far in 2017. On an industry level, the utilities sector was the strongest performer, while the financials sector also performed well. On the macroeconomic front, the eurozone economy continued to come out with solid data points and beat expectations. Unemployment fell to the lowest level in almost eight years, while the region's flash Composite Purchasing Manager's Index (PMI) maintained its upward trend in March. The positive data recorded across the region suggested an increasingly robust and broad-based upturn.

Turning to Japan, the country's equity market ended March lower, as confidence in the US administration's ability to stimulate growth faded. In economic news, unlike the Fed which implemented its first of three planned interest rate hikes in March, the Bank of Japan opted to retain its ultra-lax monetary stimulus. Against this backdrop, the yen strengthened relative to the US dollar. Less economically sensitive and domestic-demand driven sectors performed well, as financials and more cyclical sectors lagged. Japan's economy remains on a moderate recovery trend. Key manufacturing and service sector survey data reflected a balanced improvement in corporate confidence, a sign that the benefits of an export-driven economic recovery were broadening.

Across Asia, equity markets recorded decent gains in March. Many Asian currencies gained against the US dollar, with the Korean won and Taiwan dollar being among the region's best performing currencies. This was driven in part due to the fading conviction in the US administration's desire to impose trade sanctions. China's equity market made gains, reflecting solid economic data, strong industrial profits growth and fewer concerns surrounding capital outflows following better-than-expected foreign exchange reserve figures. Elsewhere, Korean and Indian equity markets also performed well, while Indonesia was one of the region's best performing equity markets.

Finally, emerging equity markets gained further ground in March. Mexico was the strongest performing country, but gains in the Latin American region were held back by disappointing returns from Brazil. Performance in the EMEA (Europe, Middle East and Africa) region varied. Apart from health care, all other emerging market sectors registered gains, with information technology being the top performer. Although US interest rates were raised, the US dollar struggled to advance against emerging market currencies. The Mexican peso rose by 7.4%.

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US Equities

- The S&P 500 index closed flat in March as the reflationary rally in stock markets paused
- Seasonally impacted consumer spending was offset by a surge in US consumer confidence and rising personal income
- Confidence in the US economic outlook and rising inflation saw the Fed apply its first of three announced interest rate hikes for 2017

Optimism about the US administration's ambitious agenda of tax reforms, deregulation and infrastructure spending saw US equities start the month on a high. The S&P 500 index reached a new milestone of 2400.98 on 1 March. However, market sentiment began to turn more cautious as the month progressed. Investors fretted over the potential knock-on effects of US President Donald Trump's failure to deliver on his much heralded campaign promise to replace the Affordable Healthcare Act. Although pulling the plug on the Republicans' healthcare reform appeared not to endanger Trump's policy ambitions, it highlighted the realities of Washington politics. The lack of policy progress and rising market scepticism was reflected in increased market volatility and a modest pullback in US equity markets. This was especially evident in so-called 'Trump trades', with financials, which had done particularly well in the post-US election rally, bearing the brunt, as investors took profit. This, coupled with mixed core economic data releases during March that pointed to a slowdown in the US growth momentum, led the S&P 500 to end the month essentially flat. While the S&P 500 index managed to extend its run of positive returns, returning 0.12% in March (total return, US dollar), it turned negative in sterling terms, returning -0.37%. Nonetheless, the S&P 500 index managed to deliver a robust 4.8% (total return, sterling) for the first quarter of 2017.

At the sector level, performances among stocks in information technology, consumer discretionary and materials helped the S&P 500 index to remain positive in March, offset by financials, telecommunications and energy, which led declining issues. In particular, the oil and gas sector on aggregate has lagged behind most others in the equity market so far in 2017. Oil prices gained some reprieves during the last week of March, as news of supply disruptions in Libya and expectations of an extension of the Organization of the Petroleum Exporting Countries-led output reduction were welcomed by markets. Additional support also came from the US, where the Energy Information Administration reported a smaller-than-expected build-up in crude oil inventory build. Nonetheless, the modest lift in oil prices masked a persistent worry, as investors have remained anxious about the growth in US shale oil production, and high US crude inventories will lead to lower oil prices in future. Overall, oil prices have remained in a tight price band for the first quarter of 2017.

In economic news, data released by the US Commerce Department in March showed that US real GDP for the fourth quarter of 2016 was slightly revised up, from a previous reading of 1.9% to an estimate-beating annual rate of 2.1%. Overall, US economic strength and a tighter labour market resulted in a modest rise in personal income, while core personal consumption expenditures (which discounts food and energy prices, and serves as a preferred inflation gauge of the US Federal Reserve) rose to 1.8% year-over-year, closing in on the Fed's inflation target of 2%. However, other economic data released through March showed activity moderated, suggesting the US economy struggled to regain momentum in the first quarter 2017. Hiring has slowed and business confidence remained below the level seen at the start of 2017, while consumer spending, which accounts for two-thirds of US economic activity, came in below expectations. The seasonally adjusted Markit Flash US Composite Purchasing Managers' Index (PMI) Output Index, recorded a 53.2 in March, down from 54.1 in February. The latest expansion of business activity was the weakest since last September, suggesting a modest loss of momentum following the 14-month peak recorded at the start of 2017. However, with the labour market almost at full employment, manufacturing business conditions improving and inflation rising, such data likely understates the general health of the US economy. This was evidenced by the Fed's mid-March interest rate hike, which underlined its confidence in its economic outlook.

In corporate news, merger and acquisition activity remained strong in March. Of note, US-based chemical giant, DuPont, announced its intention to buy nearly the entire health and nutrition business unit of FMC Corp, an American chemical manufacturing company, and sell its crop protection business to the company in return, to win European Union approval for its merger with Dow Chemical. The European Commission had been concerned that the US$130bn merger of two of the biggest US chemical producers would leave few incentives to produce new herbicides and pesticides in the future by others, such as Bayer and Monsanto. In other news, Dutch-based multinational chemical company Akzo Nobel rejected a second unsolicited €22.4bn offer from its US-based rival PPG, a global supplier of paints, coatings, specialty materials, and fiberglass. Towards month end, Canada's Cenovus Energy's made an unsolicited offer to purchase US-based ConocoPhillips' oil sands and natural gas assets for US$13.27bn. ConocoPhillips had already decided several of its Canadian conventional natural gas assets, but not its oil sands assets.

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European Equities

- European equity markets rose in March
- Debate around the European Central Bank's monetary policy outlook increased
- The eurozone unemployment rate fell to the lowest level in almost eight years

European equity markets rose in March. Strong macroeconomic data in the eurozone underpinned gains. The FTSE World Europe ex-UK index returned 4.4% (total return, euro), posting the best monthly performance so far in 2017.

On an industry level, the utilities sector was the strongest performer. Rebounding commodity prices and declining oversupply provided a lifeline to European utilities, raising earnings expectations in the sector. The financials sector was also another leading performer in March amid an intensifying debate around the future of quantitative easing and monetary policy in Europe. While the European Central Bank (ECB)'s governing council left policy unchanged in March, many market participants interpreted the press conference tone as being less dovish. This was enough to send financials' share prices higher, which are very sensitive to policy tightening (rising interest rates). Meanwhile, the healthcare sector was the biggest laggard relative to the broader market, yet it still recorded positive returns. It was followed by the oil and gas sector.

On a stock level, Spanish banks Banco de Sabadell and CaixaBank, large beneficiaries of any potential rise in interest rates, were among the best performers in European markets. Akzo Nobel, the Dutch paints and chemicals manufacturer, was another strong performer. The company's share price surged by around 23% in March amid two unsolicited takeover bids from US company PPG Industries. Activist shareholders mounted pressure on Akzo to start talks with PPG. Meanwhile, Zodiac Aerospace, the French aircraft equipment manufacturer, was among the largest detractors. The group's share price dropped after disappointing earnings and a cutback in end-of-year profit forecasts due to production issues and additional cost overruns. Marine Harvest, the Norwegian fish farming company, also performed poorly given weaker salmon prices.

On the macroeconomic front, despite the media's unwaveringly focus on European politics, the eurozone economy continued to come out with solid data points and beat expectations. Euro-area unemployment fell to the lowest level in almost eight years. The region's flash Composite Purchasing Manager's Index (PMI), a survey of private sector activity and a leading indicator for economic growth, maintained its upward trend, rising to a 71-month high in March. France's flash composite PMI reading was particularly impressive, rising to 57.6 from 55.9 in February and beating the 55.8 expectations (figures above 50 indicate expansion, below 50 indicate contraction). The positive data recorded across the region suggested an increasingly robust and broad-based upturn. On the inflation front, a weaker headline figure relative to the prior month reflected the retreat in global oil prices, while underlying core inflation gage remained subdued.

The ECB kept its monetary policy unchanged in March, but a slight change of tone was noticed in its outlook comments. The central bank dropped the sentence which refers to using 'all available instruments' in the policy arsenal, a sign that deflation risks have diminished. The central bank did not announce a new (third) round of TLTROs (targeted long-term refinancing operations) which provide cheap loans to financial institutions, and declared that a 'steadily firming recovery' was noticeable.

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UK Equities

- The move into risk assets cooled through the month, as doubts built over the Trump administration's ability to pass pro-growth measures
- The FTSE 100 index surged to an all-time trading high mid-month
- UK inflation rose 2.3% in February, breaking the Bank of England's 2% target for the first time in over three years

UK equity markets rose strongly through March, but closed out the month and quarter on a downbeat note as the Trump reflation trade continued to fade. Expectations of US fiscal stimulus and pro-growth policies have bolstered global equity markets since November's US election, spurring gains for cyclical sectors in anticipation of increased infrastructure and domestic spending. The move into risk assets cooled through the month, as doubts built over the Trump administration's ability to pass pro-growth measures.

The UK's blue chip FTSE 100 index surged to an all-time trading high mid-month, following dovish comments and an interest rate rise from the US Federal Reserve (Fed). The Bank of England (BoE) kept UK interest rates unchanged at 0.25%, although Monetary Policy Committee (MPC) member Kristin Forbes expressed concern about inflation, and voted to raise rates. UK inflation rose 2.3% in February, breaking the BoE's 2% target for the first time in over three years. Food prices increased 0.3% in the month, ending a three-year run of deflation in the segment. Into month-end, the UK Prime Minister, Theresa May, triggered Article 50, initiating the nation's formal exit from the European Union (EU). Unlike the massive sector rotation seen in markets post-Brexit, the initiation of the nation's formal exit from the EU was met with a muted response. North of the border, the Scottish Government voted in favour of a second Referendum on Scotland's future as part of the UK.

On the corporate news front, full-year results saw strong profit growth from life insurance groups Aviva and Legal & General. Next's share price rose as the company maintained its profit outlook for 2017, despite a challenging clothing market. International security group, G4S, confirmed strong growth, notably in the US.

Capita was relegated from the FTSE 100 index following a torrid quarter for the outsourcer; full-year results indicated a 33% decline in full-year profits, and chief executive, Andy Parker, announced his imminent departure. Parker expects 2017 to be a "transitional year" for the business, as its complete a number of disposals, embeds internal structural changes, and re-positions Capita for a return to growth in 2018.

BT Group was rarely out of the news through March; early in the month BT shares climbed on hopes that a settlement could be reached on the legal separation of its Openreach network. Following an Ofcom review into landline pricing, the company was instructed to reduce its bill to two million customers paying a landline only rental. Into month-end, the group was hit by a record £42m fine and £300m in compensation to competitors for cuts in broadband delay pay-outs. Ofcom also announced plans to cut the price BT's rivals will have to pay for use of Openreach; the cost of a superfast broadband line will be cut by 40% by 2021, with savings passed onto consumers.

Babcock reported a strong pipeline and structural realignment; the engineering group's £30.8bn order book includes a new €500 million contract with the French Air Force and the manufacture of 22 missile launch tube assemblies for the joint US-UK Trident nuclear submarine replacement programme. Into month end, however, the group announced the early termination of its contract with Britain's Nuclear Decommissioning Authority for the clean-up of 12 Magnox reactor sites. The move is expected to reduce the value of Babcock's pipeline by around £800m.

AstraZeneca and Circassia announced a new strategic collaboration in respiratory disease; the two businesses will combine forces on the development and commercialisation of inhaled respiratory medicines Tudorza and Duaklir, an initiative which underlines these businesses' commitment to R&D and drug innovation.

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Asian Equities

- Asian equities gained on positive earnings revisions, strong economic data and easing fears about US trade sanctions
- China sustained positive economic momentum
- Japan's equity market fell on concerns about the US administration's ability to stimulate growth

Asian equity markets recorded decent gains in March, partly due to a continuation of positive earnings revisions, strong economic data and easing fears about US trade sanctions. Furthermore, many Asian currencies strengthened against the US dollar, such as the Korean won, Indian Rupee and Taiwan dollar. A lack of conviction in Trump's ability to stimulate growth, combined with the release of a 'dovish' outlook for US interest rates by the Federal Reserve, led to the unwinding of bullish US dollar positions.

China's equity market made gains reflecting solid economic data and fewer concerns surrounding capital outflows following better-than-expected foreign exchange reserve figures. Meanwhile, the Chinese Government lowered the 2017 growth target to 6.5%, as it endeavours to reduce overcapacity, deleverage the corporate sector and destock the housing market. The People's Bank of China continued to tighten monetary conditions by increasing the market-based policy rates for the second time this year. Elsewhere, Korea's equity market was a strong performer, driven higher by the technology sector and expectations of an expansionary fiscal policy from the upcoming new leadership after the impeachment of President Park was upheld. In India, the equity market also made strong gains, as market sentiment was buoyed by the dominant victory of the ruling BJP in state elections and progress on the passage of the Goods & Services Tax legislation. After a weak start to the year, Indonesia was one of the region's best performing equity markets, partly helped by the conclusion of a successful tax amnesty program. Taiwan's equity market lagged but remained in positive territory as the Taiwanese tech stocks rose on anticipation that the new iPhone will drive the revenue growth of Apple's suppliers.

Japan's equity market ended March lower, as confidence in the US administration's ability to stimulate growth faded after the last minute withdrawal of President Trump's healthcare reform bill. The Bank of Japan opted to retain its ultra-lax monetary stimulus, while the US Federal Reserve raised interest rates as expected, although its outlook was perceived to be unexpectedly cautious. Against this backdrop, the yen strengthened relative to the US dollar. Less economically sensitive and domestic-demand driven sectors performed well, as financials and more cyclical sectors lagged.

Japan's economy remained on a moderate recovery trend, and macroeconomic data released during the month was stable. Key manufacturing and service sector survey data reflected a balanced improvement in corporate confidence – a sign that the benefits of an export-driven economic recovery were broadening. The companies surveyed also remained upbeat on their capital expenditure plans, offering hope that the economic recovery could gather momentum in coming months.

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Emerging Markets

- Emerging equity markets extended their winning ways in March
- Mexico topped the leader board, followed by Chile and India
- The US dollar lost ground against emerging market currencies despite a hike in US interest rates

Emerging equity markets gained further ground in March, making it the third month in a row of outperformance versus developed equity markets. The best performing region was emerging Asia, led by India and Korea. Mexico was the strongest performing country, but gains in the Latin American regi held back by disappointing returns from Brazil. Performance in the EMEA (Europe, Middle East an region varied, with strength in Eastern Europe being offset by weakness in some Middle East countri as Egypt and Qatar. Apart from health care, all other emerging market sectors registered gains, with information technology being the top performer. Although US interest rates were raised for only the third time since the Global Financial Crisis of 2008-2009, the US dollar struggled to advance against emerging market currencies – the Mexican peso rose by 7.4%. Rising US stockpiles had a dampening effect on oil prices, with Brent crude falling by 5.8%. However, natural gas prices rebounded strongly following February's sharp sell-off.

Mexico was the top performing equity market in Latin America during March, followed by Chile and Colombia. By contrast, Brazil stood out with negative returns, with sentiment soured by disappointing macroeconomic news – the economy contracted by 0.9% year-on-year in the fourth quarter of 2016, adding further pressure on policy makers to deliver growth/reforms. The Brazilian Government lowered its estimate for economic growth in 2017 to 0.5% from 1% previously. To anchor inflation expectations and taking into account higher US interest rates, Mexico's central bank raised interest rates by 25 basis points to 6.5%. By comparison, Chile and Colombia were both beneficiaries of 25 basis points rate cuts from their respective central banks.

Equity markets in emerging Europe advanced higher, with gains in the region led by Russia. In a surprise move, Russia's central bank cut interest rates for the first time in seven months, as the inflation rate fell to 4.6% last month – it's lowest for nearly five years. The central bank hinted of further reductions over coming quarters. Waning inflationary pressures have been helped by a strengthening rouble, which hit a 20-month high versus the US dollar in March. The currency has now gained more than 10% since Donald Trump's election victory last November. The Russian economy returned to growth at the end of 2016, with GDP growing by 0.3% from a year earlier in the fourth quarter. Economic data from Poland was generally upbeat, with a declining unemployment rate supporting a rise in retail sales. Turkey's equity market finished higher despite a diplomatic stand-off between the country and the Netherlands. South African stocks closed marginally lower, as political uncertainties rose following President Zuma's cabinet reshuffle, including that of Finance Minister Gordhan.

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Fixed Interest

- The US Federal Reserve were more dovish than expected at March's meeting
- The 'Trump Rally' dwindled due to doubts over the passing of pro-growth policies
- Political risk fell in the eurozone following the Dutch election and early French presidential election polls

March was a mixed month for bond markets. In general, bond yields (which move inversely to bond prices) rose during the first two weeks, before then falling in the second half of the month. Events in the US were an important influence on returns.

The bond market's initial focus was the US Federal Reserve (Fed) and its monthly meeting to decide US interest rate policy. In late February, statements from Fed officials took on a more hawkish tone. This continued into March, and so by the time of the Fed's meeting on 15 March, a 25 basis point hike was fully 'priced in' to financial markets. The statement accompanying the 25 basis point increase and official Fed forecasts, however, suggested a more gradual path of interest rate hikes than the tone of earlier communications had led parts of the market to expect. This shift in tone helped ease pressure on US Treasuries, which subsequently led other core government bond yields lower.

In recent months an important influence on financial market returns has been an expectation of significant pro-growth policies and tax reform in the US. This has helped push yields in some parts of the corporate bond market to very low levels. However, during March, the new US Government failed to get its flagship healthcare reform bill through Congress. This appears to have led the market to revise its expectations about the likelihood of the US Government's pro-growth policies passing. So-called risk-assets eased as a result, while government bonds were given further impetus.

In Europe, political risk lessened. In the Dutch election, far right candidate, Gert Wilders, was beaten into second place by the incumbent centre-right prime minister, Mark Rutte. Meanwhile, in the first debate among France's potential candidates for president, Emmanuel Macron was judged to have been the most convincing in a poll held after the debate. The result helped French Government borrowing costs to fall relative to Germany.

In the UK, the big news was the Government's triggering of Article 50 to leave the European Union. While this is clearly a very significant political development, its immediate impact on financial markets was negligible.

Merrill Lynch reports the following index returns. German Bunds -1%, French government bonds -0.7% and Gilts 0.3%. Sterling investment grade (IG) corporate bonds returned 0.3%, while euro IG corporate bonds lost 0.3%. Meanwhile, European currency high yield corporate bonds returned 0.1%. Euro financials were flat over the month while sterling financials were up 0.1%. Contingent Capital bonds (the lowest ranking form of bank debt) returned 0.8%.[1]

[1]All return data is sourced from Merrill Lynch and shows total local currency returns

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