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To 28 February 2019

Monthly Market Review

Aberdeen Standard Investments

February highlights

- Global equity markets rebound
- Expectations for interest rate rises diminish in tandem across the globe
- Oil prices move steadily higher, as supply constraints take effect

Equities

UK

UK enjoyed a positive February, with the main equity index returning 3.4%.

The pound climbed against other major currencies over the month, as markets grew more confident that a 'no-deal' Brexit would be avoided. The general consensus is that an extension to Article 50 and a delay to Brexit are now more probable as the deadline approaches.

The price of Brent crude oil rose steadily over the course of February, ending at US$66 a barrel from roughly US$62 at the start of the month. This benefited oil and gas stocks in the main FTSE 100 Index.

The UK service industry cited Brexit uncertainty as a reason for weak demand, as reflected in the Purchasing Managers' Index released in February. Meanwhile, in a monthly manufacturing industry survey, 27% of respondents reported increased production during February. However, this positive movement can be attributed to pre-Brexit stockpiling.

In corporate news, UK engineering giant Rolls-Royce reported a pre-tax loss of £2.9 billion for 2018. The firm cited ongoing issues with an engine it produces for Boeing. Many aircraft have had to be grounded and the problems are proving costly.

Elsewhere, shares in online estate agency PurpleBricks collapsed, following a profits warning. The firm has been a success story over recent years, and the warning came as a shock to many investors. The company blamed the challenging UK property market, as well as headwinds for its Australian business.

Summary

- UK shares rise in February
- Sterling climbs against other major currencies
- The oil prices rise, boosting energy stocks

US

Building on January's strong performance, shares in large US companies made gains in the second month of 2019. The S&P 500 Index climbed 3.2% in dollar terms. At the sector level, technology and industrials companies did particularly well, but gains were less pronounced for consumer discretionary stocks.

The main topic holding investors' attention was the progress of trade discussions between the US and China. At the end of February, tariffs on $200 billion of Chinese imports to the US were set to rise from 10% to 25%. Initially, a hint from US President Donald Trump that he would delay the increase provided a boost for US stocks. Later in the month, when Mr Trump confirmed the tariff hike would be postponed, share prices surged further ahead. Other international relations were less positive, as Trump's meeting with Kim Jong Un in Vietnam ended abruptly, with no agreement to lift sanctions on North Korea.

In other political news, Democrats and Republicans in the House of Representatives agreed on a bill to provide funding for US border security, avoiding another government shutdown. Crucially, however, it provides less than a quarter of the $5.7 billion that Mr Trump wants to spend on building a wall on the US-Mexico border. Asked how he felt about the deal and before giving it his official seal of approval, his response was "…not happy." Later, as Congress also ratified the funding deal, he announced plans to declare a national emergency. If the declaration stands (it may be challenged in Congress and US courts) it could be used to divert funds and resources to the barrier.

The US retail industry was also in the spotlight, with JC Penney announcing an annual loss and Macy's and Home Depot giving a weak outlook for sales. By contrast, shares in Best Buy surged after the electronics retailer beat expectations for fourth-quarter profits.

Finally, although economic growth for the October to December period slowed compared to the three months before, it still came in ahead of expectations. An official report showed annualised growth was 2.6%, ahead of analysts' predictions of 2.2%.

Summary

- Trump delays increased tariffs on Chinese goods
- Funding bill prevents second government shutdown
- Economic growth beats expectations

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Europe

European equities delivered robust returns for February, with all major indices finishing in positive territory. A raft of good corporate results and optimism over a US-China trade deal lifted sentiment. But markets eventually ran out of steam, with disappointing economic data and further banking woes to blame.

US-China trade talks restarted this month. Shares in Europe (and the rest of the world) climbed on hopes that both parties were inching towards an agreement. This peaked when President Trump said he would delay tariff increases on $200 billion of Chinese exports. However, the abrupt end of the US/North Korea summit tempered hopes that a trade deal could be reached after all.

On the corporate front, tyremaker Michelin said it expected profits to rise in 2019. This helped soothe concerns that trade disputes were putting the brakes on the autos sector. Dutch brewer Heineken found its shares in demand after announcing better-than-expected results. Elsewhere, asset manager Amundi confirmed its profits targets for 2020. This came despite challenging market conditions. Additional highlights included Ingenico, Kindred Group and Swedish Match. Meanwhile, shares in Germany's Wirecard surged after lawyers found no criminal wrongdoing by the company's employees.

The banking sector was less fortunate. Danske Bank's money-laundering scandal deepened after Estonian regulators ordered it to close its Tallinn branch. The US Securities and Exchange Commission are also set to investigate the Danish lender. Trouble was brewing for Swedbank too. It faces allegations of more than $4 billion of suspect transfers to Danske in the region. Elsewhere, regulators fined UBS €4.5 billion for illegally soliciting clients in France and laundering the proceeds of tax evasion.

Economic data continued to disappoint. Fourth-quarter Eurozone GDP grew by a paltry 0.2%, with Italy slumping into recession and Germany stagnant. Factory orders for Europe's largest economy fell by 1.6% in December, missing expectations of a 0.3% increase. Lastly, Spain's parliament rejected a draft 2019 budget. This added to the political mire and raised the prospect of yet another general election.

Summary

- European markets up for February
- Economic picture deteriorates
- A number of businesses announce good results

Other regional equities

Most emerging and Asian markets continued their bright start to the year, delivering positive returns for February. Mounting hopes of a trade deal between the US and China was the main driver of returns. However, the month ended on a sour note, as geopolitical tensions mounted.

China was the standout market. Stocks soared after US President Donald Trump postponed the planned 1 March deadline for increasing tariffs on Chinese goods. Commentators speculated that this could pave the way for an eventual trade deal. Share prices across Asia, including Japan, climbed in response. Chinese stocks were also in demand after MSCI announced it would quadruple China's weighting in its main emerging market (EM) index. This means equity funds that track the MSCI EM Index will have to buy the underlying shares. Forecasts estimate US$125 billion will flow into China this year as a result.

It wasn't all good news for China. Factory activity hit a three-year low in February, as export orders contracted at the fastest pace since the financial crisis. The official Purchasing Managers' Index dropped to 49.2, down from 49.5 in January. A number below 50 shows a sector in contraction. Many have blamed the ongoing US-China trade war for the disappointing results. However, the week-long Lunar New Year holiday – a time when most businesses close – probably played a part.

Brazilian markets struggled. Shares fell after newly elected President Bolsonaro fired his secretary general following accusations of misusing campaign funds. The scandal cast doubt on the fledgling government's ability to pass much-needed pension reforms. Equities in Argentina, Chile and Mexico also fell.

Geopolitics grabbed the headlines at the close of the month. Hostilities between India and Pakistan mounted following a deadly bombing in Kashmir. India retaliated with airstrikes inside the Pakistan border, drawing the ire of Prime Minister Kahn. Both sides then claimed to have shot down each other's aircraft. Meanwhile, the much-vaunted talks between the US and North Korea collapsed without agreement. Both sides blamed the other for the impasse.

Summary

- Markets finish in positive territory
- Hopes of a US/China trade deal lift sentiment
- Geopolitics temper returns

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Bonds

Global government bonds traded within a limited range. On the one hand, they came under downward pressure from improving risk appetite. On the other, expectations for interest rate rises diminished in tandem across the globe, which supported government bonds. The 10-year US Treasury yield moved between 2.6% and 2.7% before finishing the month at 2.72%. The yield on the 10-year UK gilt moved from 1.22% to 1.31%, and that of the 10-year German bund from 0.10% to 0.19%. Elsewhere, Italian government bonds were boosted by the decision of ratings agency Fitch not to downgrade the country's sovereign rating.

Corporate bond markets performed well (yields fell). However, what looked like a broad-based UK rally was primarily focused on a few names in some key sectors. There was also an element of catch-up with the healthy year-to-date performance of US and European corporate bonds. Additionally, it seemed increasingly likely the UK would avoid a 'no-deal' Brexit, which also supported UK corporate bonds. Much of the catching up was focused in the banking sector, which outperformed the rest of the market. There was also a marked recovery in some of the bonds that had underperformed most severely in the fourth quarter of 2018. These included index heavyweight GE and Italian road-toll operator Atlantia.

Property

In a similar trend to recent months, UK commercial real estate had a weak start to the year. Data for January (the latest numbers available) recorded the lowest monthly return since August 2016. The slowdown over the month was broad-based. Offices and industrials returned their lowest monthly figures since just after the EU referendum in 2016.

According to Property Data, total investment volumes for 2018 were £62.3 billion, which was a 5% decline from the previous year. The current political gridlock has caused substantial uncertainty for the real estate market. This is resulting in weaker levels of liquidity for direct real estate assets. All sectors, except leisure and alternatives, experienced declining investment over the year. Alternatives and mixed-use assets accounted for 29% of the investment volumes, which was the highest on record.

Occupational markets continue to behave quite differently across the sectors. Structural changes in the market are driving the trend, particularly in retail and industrials. The familiar pattern of falling retail rents, modest upticks in office rents and robust growth in industrials is little-changed. The risk of more serious declines in the retail sector is palpable and is affecting investor sentiment.

The industrial sector continues to be the standout performer in the UK real estate market. Although data suggests that rental growth is beginning to moderate, vacancy rates remain low, and interest in available space is healthy. As such, the necessary drivers are still in place to support further rental value growth for the sector.

More recent data is now reflecting the long-term structural challenges facing the retail sector. The outlook for retail tenants has become more challenging over time, and this is now weighing on performance. All forms of retail are now experiencing declining rental values. Aside from the value operators, few retailers are expanding, and further distress in the sector is widely anticipated.

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Commodities

Commodity prices made progress in February. The S&P GSCI, a global commodity index, rose 3%. An increase in the price of oil contributed to the rise, with Brent crude closing the month 8% higher, at US$66 a barrel. The upward move was primarily the result of further supply cuts by OPEC (Organisation of Petroleum Exporting Countries). Countries including Russia and Saudi Arabia have vowed to deepen supply cuts in the coming weeks. This suggests that, in the near term, the oil price could move higher. Beyond that, however, surging US production is likely to keep prices in check.

After performing strongly in December and January, iron ore prices started to fall from mid-February. Iron ore is used worldwide to make steel for buildings, cars, white goods and other items. One reason suggested for the decline was the imposition of tougher environmental restrictions in China. The country is the world's largest consumer of metals. The stricter rules discouraged steelmakers from buying iron ore. Also, it appears that markets overestimated the disruption to supply caused by the Vale disaster in Brazil in January. By contrast, copper, nickel and aluminium moved higher. Prices were boosted by expectations that the Chinese authorities would shortly introduce another stimulus package.

Gold prices slipped around 2% to $991 per troy ounce, the first monthly loss in five months. Gold is seen as a 'safe-haven' asset. Its drop partly reflected investors' renewed appetite for riskier asset classes. This followed the release of data showing that the US economy had grown faster than expected in 2018.

Currencies

There were no major currency movements in February, and exchange rates remained largely range-bound. This was because expectations for interest rate rises diminished in tandem across the globe (typically, the prospect of an interest rate rise in a country will push up the value of its currency).

The US dollar weakened against the British pound. This followed signals from the Federal Reserve that it would be more patient about future interest rate hikes. At the same time, the falling likelihood of a 'no-deal' Brexit bolstered the pound. Sterling also gained against the euro. The European Central Bank warned that the slowdown in the Eurozone had been "broader and more persistent" than expected. The Bank said it will consider new support measures for Europe's banks at its March meeting.

Meanwhile, the US dollar remained virtually unchanged against China's renminbi, as investors held their breath for a resolution to US-China trade talks. The Japanese yen lost ground against other major currencies. Japan's economy remains sluggish and inflation is stubbornly low. Therefore, Japanese interest rates are unlikely to rise any time soon. Additionally, the yen is perceived as a 'safe-haven' currency. Investors' appetite for risk improved during February, and they shunned defensive assets like the yen.

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