EQUITIES AND BONDS START THE YEAR STRONGLY

Following sharp falls in the fourth quarter of 2018, global equity markets rebounded strongly in the first quarter of 2019, recovering the losses experienced at the end of last year. Performance was driven by the dovish rhetoric from the US Federal Reserve (Fed) and other major central banks, growing optimism around a highly anticipated US-China trade deal and better-than-feared corporate earnings. Additionally, Eurozone sovereign bonds benefited from a combination of the more dovish policy stance of the European Central Bank (ECB), weak economic data across the region, persistent low inflation readings and political uncertainty related to Brexit.

Lenny McLoughlin
Chief Economist, Irish Life Investment Managers Limited (ILIM)

Key quarterly themes

- Equities recover and bonds continue to perform well
- The Fed ceases its monetary tightening cycle and indicates that it will discontinue its balance-sheet reduction in September
- Growing optimism around a US-China trade deal helps markets

Policy pivot: the Fed goes into reverse

In January, the Fed reversed its year-end guidance for two rate rises this year, citing the tightening of financial conditions and growing fears of a US recession. The central bank removed any mention of rate rises in its policy statement and suggested that any further rises will be data dependent. The pause in the tightening cycle was confirmed at its March policy meeting when it announced it plans to leave interest rates unchanged in 2019. Moreover, the Fed intends to cease the reduction of its balance sheet by $50 billion per month in September, and will begin to taper the current reduction of US Treasury holdings from $30 billion to $15 billion per month from May onwards.

Central banks adopt more supportive policy

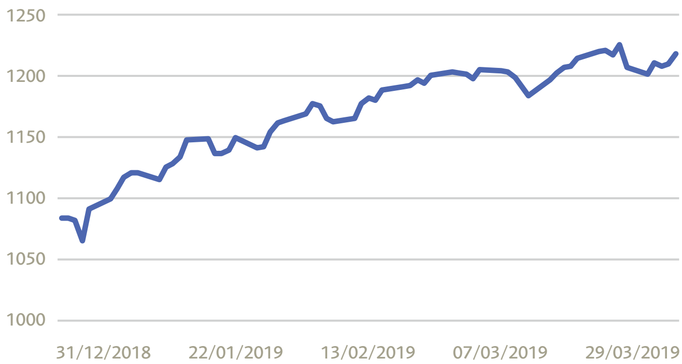
The ECB officially pushed out its guidance on interest rates at its March policy meeting, indicating that the next rate rise would not occur until at least the end of 2019. It also formally announced plans to launch new long-term refinancing operations to provide additional liquidity to banks in September. More significantly, the ECB lowered its inflation forecast to only 1.6% by 2021, well below its 2% target. Elsewhere, in the UK, the Bank of England also dampened expectations of rate rises in 2019 when it reduced its forecast for GDP growth for 2019 from 1.7% to 1.2% and downplayed near-term inflationary risks.

US-China trade discussions continue

Optimism grew throughout the first quarter that a highly anticipated US-China trade deal would be reached. There appeared to be a greater willingness on the part of both sides to reach an agreement, with five rounds of trade negotiations being held so far this year. Progress was made after China indicated its willingness to increase the level of imports from the US, which led to the indefinite extension of the previous deadline for the conclusion of negotiations and suspension of the threatened increase in tariffs from 10–25% on $200 billion of Chinese imports. Although a final agreement is yet to be reached, comments in late March that China had made some significant proposals on a number of issues suggested that a trade deal is still likely in the near future.

CHART OF THE QUARTER

MSCI AC World – Gross Total Return Local Index



Source: ILIM, Bloomberg. Data is accurate as at 31 March 2019

Will Brexit be extended?

Confusion and uncertainty over the eventual outcome of Brexit continued throughout the quarter. Ultimately, the existing Withdrawal Treaty failed to pass on three separate attempts, resulting in Article 50 being extended to allow the UK to formally leave the EU on 12 April. In order to avoid leaving with no deal, the UK has to present an alternative that offers a realistic prospect of progress; however, no alternative option has achieved an overall majority in Parliament. Despite the uncertainty and lack of clarity around the final outcome, markets appeared to discount a worst-case scenario of a 'no deal, hard Brexit' as being unlikely.

Bond yields fall

Global bond yields declined throughout the period as central banks, led by the Fed, adopted more dovish policy stances in response to recessionary fears evident at the end of last year. Despite global growth remaining positive in the first quarter, the moderation in growth and lingering fears of a further slowdown contributed to lower bond yields. Persistent low inflation also added to the downward pressure on bond yields. In the US, 10-year yields fell to 2.41% at quarter-end, while UK 10-year yields declined to 1.00%. Japanese 10-year yields were also down to -0.08% at quarter end, with the Bank of Japan indicating that policy will remain loose for the foreseeable future. Eurozone bonds also gained over the period, with German 10-year yields falling to -0.07%.

MARKET ROUND-UP

Better-than-expected earnings reporting season

Given the increasing concerns around global growth into the end of 2018, consensus forecasts for corporate earnings growth for both 2018 and 2019 were revised down. Following the downgrades to fourth-quarter earnings forecasts, final results were not as bad as initially feared, with earnings ultimately exceeding expectations by 3% in the US and Europe, and 1% in Japan. More recently, consensus earnings forecasts for 2019 have begun to find a floor around 5%, which appears realistic on the basis of global growth in 2019 being around 2.8–3.0%.

Equities

Over the quarter, the MSCI AC World equity benchmark rose 12.4% (14.4% in euro terms). The US rose 13.9% (16.0% in euro terms), following the policy reversal by the Fed and easing recessionary fears. Europe ex-UK equities rose 12.6% (12.7% in euro terms), similarly benefiting from the more dovish policy stance adopted by the ECB and growing hopes of a rebound in Chinese growth post any trade deal with the US, given Europe's sensitivity to the Chinese economy. Japan lagged, rising 7.8% (8.8% in euro terms) as economic data disappointed, while there were lingering concerns over the potential impact of the planned VAT increase scheduled for October. The UK also underperformed, rising 9.4% (13.9% in euro terms) due to the ongoing Brexit-related uncertainty.

Bond markets

The ICE BofA Merrill Lynch Eurozone > 5-year sovereign bond benchmark rose 3.8% during the quarter. The German 10-year yield fell back into negative territory, ending the quarter at -0.07%, as the ECB pushed out guidance in relation to the expected timing of its next interest-rate rise. Generally weak economic newsflow across the Eurozone, persistent low inflation readings and political uncertainty related to Brexit all contributed to the decline in yields. Having declined into year-end on the back of the budget compromise reached with the EU, Italian 10-year spreads against Germany traded in a narrower range throughout the first quarter, ending the period slightly higher at 256 basis points (bps). Spanish 10-year spreads were effectively flat at 117bps, while Portuguese spreads narrowed to 132bps at quarter-end.

Currencies and commodities

Following an initial bounce on the back of dovish Fed commentary at the beginning of the year, the euro generally drifted lower throughout the quarter, ending the period at 1.1218 against the US dollar. As with sovereign bond yields, weak economic data from the Eurozone, low inflation readings, a more accommodative ECB and Brexit uncertainty all contributed to the weaker euro throughout the period. Commodities rose 15.0% (17.0% in euro terms). West Texas Intermediate (WTI) oil rose 32.4%, as OPEC began to implement new production cuts announced at the end of 2018, tensions in Venezuela restricted oil supplies and production disruptions were evident across other regions.

MARKET SNAPSHOT

Market returns

Equity indices (€)	QTD % return	YTD % return	2018 % return
MSCI Ireland	13.59	13.59	-21.24
MSCI United Kingdom	13.94	13.94	-9.77
MSCI Europe ex UK	12.66	12.66	-10.10
MSCI North America	16.06	16.06	-0.41
MSCI Japan	8.78	8.78	-8.17
MSCI EM (Emerging Markets)	11.95	11.95	-9.92
MSCI AC World	14.36	14.36	-4.34
10-year sovereign bond yields (€)	**Yield last month (%)**	**2018 yield**	**2017 yield**
US	2.41	2.68	2.41
Germany	-0.07	0.24	0.43
UK	1.00	1.28	1.19
Japan	-0.08	0.00	0.05
Ireland	0.55	0.90	0.67
Italy	2.49	2.74	2.02
Greece	3.74	4.40	4.12
Portugal	1.25	1.72	1.57
Spain	1.10	1.42	1.57
Commodities ($)	**QTD % return**	**YTD % return**	**2018 % return**
Oil (WTI)	32.44	32.44	-24.84
Gold (Oz)	0.91	0.91	-2.14
S&P Goldman Sachs Commodity Index	14.97	14.97	-11.34
FX rates	**YTD**	**2018**	**2017**
U.S. dollar per euro	1.12	1.15	1.20
British pounds per euro	0.86	0.90	0.89
U.S. dollar per British pounds	1.30	1.28	1.35

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2019

ECONOMIC SNAPSHOT

Global economy
While the global economy grew around 3% in 2018, growth slowed noticeably in the second half of the year to an annualised rate of approximately 2.6%. Global growth in the first quarter of 2019 appears to have slowed slightly further to an annualised rate of roughly 2.5%. Some of this may relate to seasonal issues in the US, where first-quarter tended to lag in previous years, although Q1 2019 was also negatively impacted by the government shutdown. Global purchasing managers' indices (PMIs) have slipped in recent months to levels consistent with global growth of approximately 2.8%, with stronger readings in non-manufacturing offsetting weakness in manufacturing readings.

US
In the US, fourth-quarter GDP grew 2.2% (annualised), compared with 3.4% in the third quarter. The labour market generally remained strong, with non-farm payrolls rising 186,000 on average over the most recent three months, although the latest monthly reading was only 20,000. The unemployment rate rose to 3.8%, as the labour participation rate increased. Over the quarter, ISM manufacturing fell from 59.3 to 54.2, while non-manufacturing slipped from 60.7 to 59.7. Headline inflation rose 1.5% year on year, down from 2.2% at the end of the previous quarter, while the Fed's preferred rate of core PCE inflation was up 1.8% year on year, compared with 1.9% at the end of the fourth quarter.

Eurozone
Eurozone economic data was generally disappointing throughout the quarter. Fourth-quarter GDP grew 0.2% quarter on quarter (1.1% year on year). The Eurozone composite PMI rose slightly, from 51.1 to 51.3, although it was well below the recent high of 58.8 in January 2018. The manufacturing PMI was in contractionary territory at 47.5. Unemployment fell from 8.1% to 7.8% and industrial production was down -1.1% year on year at quarter-end. Headline inflation was running at 1.4% year on year at quarter-end, with core inflation remaining low at 0.8% year on year.

UK
Economic data was mixed, with Brexit-related uncertainty continuing to have an impact, particularly on business sentiment. Fourth-quarter GDP grew 0.2% quarter on quarter. The composite PMI rose from 50.8 to 51.5. Industrial production was up 0.6% month on month, but down -0.9% year on year at quarter-end. Retail sales were rising 0.4% month on month (4.0% year on year) at quarter-end and unemployment declined slightly from 4.1% to 3.9%. CPI was up 1.9% year on year from 2.3% at the end of the previous quarter.

Japan
Data was generally soft throughout the quarter. Fourth-quarter GDP rose 0.5% quarter on quarter (1.9% annualised), recovering from disruptions caused by severe weather in the third quarter. Industrial production rose 1.4% month on month, but was down -1.0% year on year at quarter-end. Retail sales rose 0.2% month on month (0.4% year on year) at the end of the period, while consumer confidence slipped from 42.9 to 41.5. The composite PMI fell from 52.4 to 50.7. Headline CPI rose 0.2% year on year, while core inflation was rising only 0.4% year on year by quarter-end.

China
Chinese data generally remained mixed, although there were some tentative signs at quarter-end of an improvement, driven by the stimulus measures announced over the last year. Fourth-quarter GDP grew 1.5% quarter on quarter, leaving growth up 6.4% year on year. Retail sales growth improved from 8.1% to 8.2% (year on year), while industrial production growth declined from 5.4% to 5.3% (year on year). Fixed-asset investment growth improved from 5.9% to 6.1% (year on year). The Caixin composite PMI slipped from 51.9 to 50.7.

Ireland
In Ireland, economic data generally remained firm, although fourth-quarter GDP disappointed as Brexit-related worries appeared to have some negative impact throughout the period. Fourth-quarter GDP rose 0.1% quarter on quarter, resulting in growth of 6.7% for 2018 as a whole. During the quarter, numbers on the Live Register fell 9,400 to a seasonally adjusted 196,500, while unemployment rose from 5.3% to 5.4% as the participation rate increased. Industrial production remained volatile and was up 15.3% month on month, but down -8.6% year on year at the end of the period. Overall, retail sales rose 5.1% year on year at quarter-end and were up 5.3% year on year (excluding autos).

THE ILIM VIEW – LOOKING AHEAD

Global equities recovered in the first quarter of 2019, as the US Fed announced a pause in interest-rate rises in 2019, thus reducing potential risks to growth from tighter monetary policy. Other global central banks also followed the Fed's lead and adopted more dovish policy stances in recent months. Growing hopes for a trade deal between the US and China also contributed to the easing of global growth concerns, which provided further support for equity markets during the first three months of the year.

Looking to the remainder of 2019, while global growth has probably peaked and is expected to slow compared to 2018, growth is still anticipated to remain positive, with both the US and global economies expected to avoid a recession. While risks to growth do remain, our sense is that these can be overcome in 2019. The recent suggestions of more accommodative monetary policy by the Fed and other global central banks should underpin the growth outlook for the US and global economy.

However, concerns continue to linger over the risk to growth associated with ongoing global trade disputes. The indefinite postponement of the previously threatened increase in tariffs on Chinese imports has increased hopes that a resolution to the trade dispute will shortly be reached. An additional boost to the global economy could also come from the planned increase in the levels of fiscal stimulus across various regions in 2019, which should help underpin the growth backdrop.

Closer to home, while uncertainty over the eventual outcome of Brexit remains, the probability of a 'no deal, hard Brexit' appears low and a longer extension of Article 50 beyond 12 April seems most likely. Other potential risks such as European politics, in general, the policy agenda of the US administration and slowing Chinese growth could also act as potential headwinds for the global economy and equity markets.

Following the recent gains in markets, valuation levels have risen from the extreme lows evident in late December. Equities are currently trading on a 12-month forward P/E multiple of 14.8x versus a long-term average of 15.6x. The current dividend yield of 2.60% is in line with the long-term average, while on a price-to-book basis, equities are trading slightly above the long-term average at 2.25x.

To generate further positive returns in 2019, equities need to see further evidence of a stabilisation in global growth and earnings expectations in coming months. Without this, equities could struggle once again if renewed concerns around economic and earnings growth re-emerge. However, we believe equities can generate further upside of 4–8% over the next twelve months. Risks around this, however, remain high with the large number of unresolved issues and general uncertainty meaning volatility may remain a feature. While our base case is for some further modest upside in equities, the current levels of uncertainty result in a potentially wide range of possible returns for the next twelve months.

THE MONTH AHEAD

Economic data and events to watch

1 April	China's Caixin manufacturing PMI US retail sales (month on month, February)
2 April	US durable goods orders (month on month, February)
3 April	US ISM non-manufacturing PMI (March)
5 April	US non-farm payrolls (March)
10 April	US inflation rate (year on year, March) UK GDP growth (month on month, year on year, February)
12 April	China balance of trade (March) Michigan consumer sentiment (preliminary, April)
16 April	Germany's ZEW economic sentiment index (April)
17 April	Japan balance of trade (March) UK inflation rate (year on year, March) US balance of trade (February)
18 April	German manufacturing: flash Markit PMI (April) US retail sales (month on month, March)
19 April	Japan inflation rate (year on year, March)
23 April	Eurozone consumer confidence (flash, April)
29 April	Eurozone business confidence (April)
30 April	China's NBS manufacturing PMI (April) German inflation rate (preliminary, year on year, April)

Political events

3 April	UK Parliament vote on seeking Article 50 extension
9 April	EU-China summit
10 April	European Council special meeting on Article 50 extension
11 April	India's general election begins

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2019

Irish Life

CONTACT US

PHONE: (01) 704 1200
FAX: (01) 704 1918
WEBSITE: www.ilim.com
WRITE TO: Irish Life Investment Managers, Beresford Court, Beresford Place, Dublin 1