SPRING OUTLOOK

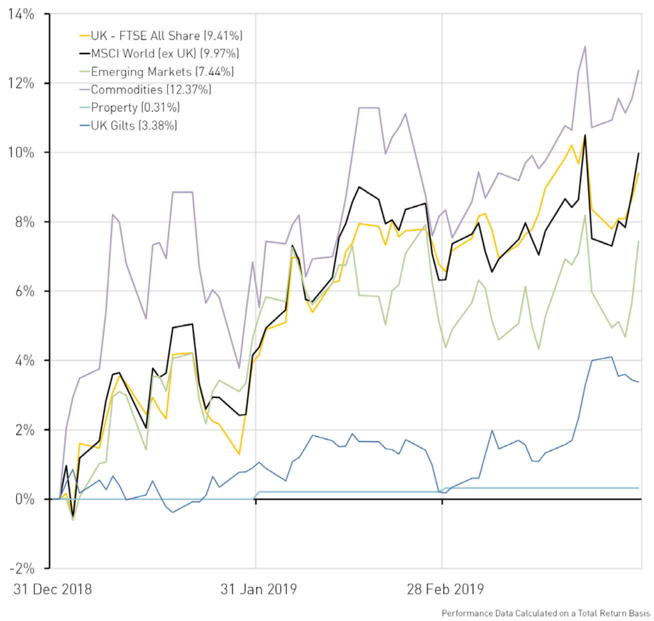
Westcourt Financial Services Ltd

REVIEW OF THE PAST QUARTER:

Markets have rebounded from last quarter's selloff as investor sentiment picked up. This has been driven by a perceived change of heart at the US Federal Reserve where it is expected they will stop hiking rates and become more cautious. In addition, thawing tensions between the US and China have helped boost hopes of a deal but key stumbling blocks, such as digital trade, remain and could yet see hostilities drag out.

Political uncertainty remains high in the UK, with there still being no clear plan on how to deliver Brexit, despite the two-year Article 50 deadline coming and going. Although the European Union have agreed to extend the deadline, there is a still a chance the country crashes out with no-deal, if it is unable to agree any alternative.

Meanwhile in commodities, both iron ore and oil prices have been surging, albeit for different reasons. A tragic dam collapse at an iron ore mine in Brazil led to concerns of a supply crisis, which in turn helped fuel iron ore prices to a peak of US$88/per tonne. Oil's resurgence was down to deliberate supply cuts by Opec (the Organisation of the Petroleum Exporting Countries) starting to materialise. In more worrisome news, prices have also been influenced by the deteriorating conditions in Venezuela.



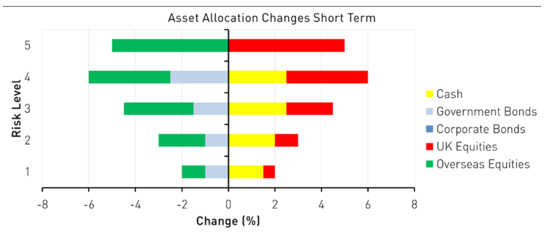
ASSET CLASS RETURNS

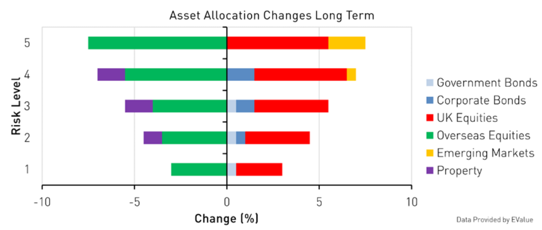
Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
-0.01%	+3.38%	+5.88%	+4.18%	+9.41%	+9.97%	+7.44%	+0.31%

THE ACTUARIAL VIEW:

A global economic slowdown has been on the horizon for a while now; recently however there has been evidence that a hard landing is in the offing. Much of this risk has been caused by politicians, whether it be over Brexit in the UK or US president Donald Trump and the ongoing US-Chinese trade war across the Atlantic. Not all the gloom is Anglo-American however, as Germany only narrowly avoiding a recession.

Globally, interest rates are down, making bonds look less attractive. In the UK the FTSE is forecast to pay out a 5 per cent yield this year, an astonishingly high amount with bond yields so low and illustrating the attractive valuation of the UK equity market. Doubtless Brexit uncertainty has been responsible for the low valuations. When combining the valuations with the preponderance of overseas revenue in the index, it is clear the UK market provides significant protection against all but the most severe scenarios. With this in mind there has been a significant increase in the UK allocations into the models at the expense of global equities. In short-term portfolios there has been a move into cash and away from bonds – this is due to the increased downside in bonds and better relative returns from higher risk assets.





WHAT TO LOOK FOR IN Q2:

- **UK:** The Monetary Policy Committee (MPC) announcements and minutes, along with an inflation report, are to be released on 2 May. Brexit timelines have been extended until 12 April at the minimum.
- **US:** There will be interest rate decisions from the Federal Open Market Committee on 30 April-1 May. Minutes will be published three weeks after each decision. Year-on-year core inflation rate is published on April 10. Non-farm payrolls, which indicate wage growth, are set to be released on 5 April.
- **Europe:** Quarterly GDP data is set to published on 30 April. A European Central Bank Monetary Policy meeting has been arranged for 10 April.
- **Other:** India's general election is set to start on 11 April in seven phases and end on 23 May, whereupon a new prime minister will be elected. South Africa's general election is set for 8 May.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: With three deals rejected and the Democratic Unionist Party's (DUP's) lack of support for a fourth, the path forward is unclear. If the government can't find some compromise that can attract support, they have until 12 April to decide on either a longer extension to Article 50, or no deal. Under pressure to avoid a no-deal scenario, a longer extension period is agreed. Avoiding a no deal will be reprieve enough to spark a relief rally for equities and UK sterling, though this may not be long lasting given the underlying uncertainty about the UK's future that will still prevail.

Worst Case: During the extended Article 50 period May buckles under pressure from hard-line Brexiteers who are averse to a longer extension and gives in to no deal, which remains the worst outcome for UK equities and Sterling, both of which would see a broad sell-off with multiple long-term headwinds.

Best Case: Parliament approves a deal. The avoidance of a no-deal scenario, combined with clarity on what Britain's future looks like, will be positive for both UK sterling and UK equities, outweighing the headwind to large caps from the stronger pound.

GLOBAL EQUITY

Most Likely: As the US Federal Reserve isn't planning to hike rates through 2019 we expect investors to make the most of the last legs of the bull run, particularly as the trade tensions seem to have eased (for now) between the US and China. This back and forth from the US Federal Reserve, Brexit and trade spats will likely bring further volatility in the quarter to come.

Worst Case: The trade spat between China and the US reignites and adds downward pressure to markets. The populist parties take the lead in the European parliamentary elections and either nothing gets done as they can't agree, or they push forward with their populist promises, which could hurt sentiment towards European equities. On top of this, as the tax cut benefit wears off and the likelihood of disappointment from earnings increases, the downside potential for US equities rises.

Best Case: Despite the 'gilets jaunes' protests in France, financial markets recovered from the turmoil of Q4 2018 in Q1 2019; however, the European Central Bank is unlikely to shift from its easy monetary policy, as inflation remains below target. Trade tensions keep to a minimum and the world keeps on turning – despite US president Trump's best efforts to the contrary.

EMERGING MARKET EQUITY

Most Likely: Sentiment towards emerging markets is likely to improve further and equities could end the quarter in positive territory as the US Federal Reserve has signalled a pause in rate rises. While US president Donald Trump delayed the 1 March tariff deadline, the consensus appears to suggest that a trade deal will go ahead; however, until it is reached there could be some volatility.

Worst Case: If a US-China trade deal is not reached, emerging markets and in particular the more sensitive regions to global trade are likely to reverse their strong upward advance. This quarter will see general elections in India, and the rupee has traded high on optimism that the government, led by Indian prime minister Narendra Modi, will be re-elected. Any disappointment is likely to surprise on the downside.

Best Case: Sentiment is likely to continue to improve for emerging markets and a US-China trade deal would be the cherry on top. The pause in US rate rises should be most beneficial for those countries that have a high proportion of US dollar-denominated debt, such as Brazil, Turkey and Argentina.

CASH

Most Likely: Following the signal sent by the US Federal Reserve to financial markets, the Bank of England has also signaled its intention to maintain its interest rate policy for a while. Core inflation should remain within the 2 per cent to 2.5 per cent range, which means returns from cash remain negative. Headline inflation is unlikely to come down significantly over the coming quarter due to cost pressures from a range-bound oil price.

Worst Case: The worst-case scenario for cash savers is that inflation continues to rise with cost-push pressures at the fore. Another likely headwind is UK sterling weakness as Brexit negotiations turn sour and imported inflation compounds woes, with the Bank of England refraining from further tightening for the already weakened consumer.

Best Case: Any progress in Brexit negotiations could well be taken by the Bank of England as a signal to continue tightening, especially if wage growth surprises to the upside. In such a scenario, returns to cash would improve despite staying negative. Similarly to government bonds, cash could also act a safe haven, with recession kicking in for the US.

FIXED INCOME

Most Likely: The highlight of central banks' meetings last month was the indication of a more patient approach to any future adjustments to the interest rate levels in the world. The returns on bond markets are likely to stay volatile as investors will wait for any indication of a recession or late-stage cycle. With the duration risk being limited, credit markets might outperform if companies keep on improving their balance sheets.

Worst Case: After several years of monetary stimulus, we might have reverted to a normal situation where any sign of wage growth and inflation is bad news for bond markets. Markets have quickly interpreted the US Federal Reserve's recent decisions as an indication a recession is coming soon. Any sign that global economies are nowhere near recession could bring yields up, which will drag both government and corporate bond markets.

Best Case: Bond markets might have already priced in negative news – as such, the downside is now limited. But political uncertainty will continue to act as a drag on bond yields, anchoring investors' expectations to lower levels from current ones. Companies might further delay their capital expenditure decisions and lower their debt level. The low level of debt supply relative to demand from institutions might drag yields lower.

PROPERTY

Most Likely: European real estate investment trusts (REITs) remain attractive due to the European Central Bank maintaining ultra-low interest rates, ensuring a favourable environment for consumer and business spending. The UK continues to be the least attractive region, given the continued lack of clarity around Brexit. In the US, the Federal Reserve has continued to refrain from further rate hikes, ensuring the yield gap between bonds and US REITs remains attractive to investors.

Worst Case: In the UK, Brexit talks dominate investor sentiment with a number of direct property funds switching to bid pricing in a bid to deter outflows. An accidental no deal would be harmful for both UK growth and, subsequently, the property market. Similarly, a scenario of trade war escalation could potentially see selloff contagion spill over as investors exit riskier asset classes.

Best Case: A resolution to trade tensions between the US and China. Key central banks refraining from rate hikes this year would help global REITs, which had cheap valuations this year due to rising rates in 2018. An end to the Brexit uncertainty and an outcome that is favourable for UK companies will help drive prices in this region.