CAERUS
Portfolio Management

CAERUS Market Commentary – February 2017

Market overview

February saw equity markets continue to climb, new highs being hit on a monotonous basis by the S&P 500. Markets progressed under the shadow of Trump and, to a lesser extent, Brexit and European elections. Despite the inflammatory unknowns unravelling around us, the VIX (a measure of implied volatility in the S&P 500) began the year securely tethered to levels implying complete apathy to risk, and February only saw this head lower.

The US led the way for major indices in February, up over 5%, but was followed in hot pursuit by most major markets. The FTSE 100 was up 3.09% (24% for 12 months), Europe was up nearly 2% and Emerging Markets 4.4%. Despite the equity positivity, bond markets were far less synchronised. The 10yr Treasury Yield (TSY) remained relatively flat at 2.36% while the 10yr Gilt yield dropped 26bp to finish the month at 1.15%. Equally, in Europe, we saw the bund yield contract by 23bp but of more interest was the relative popularity of the German 2yr over the French 2yr bond – the yield differential widening by 20bp as Investors gravitated to the relative safety of Germany given the increased credibility of a Le Pen presidential challenge.

	February Return
FTSE World Index	4.02%
FTSE USA TR GBP	5.07%
FTSE Europe ex-UK TR GBP	1.86%
FTSE Japan TR GBP	2.53%
FTSE 100	3.09%
FTSE all share	3.11%
FTSE EM	4.40%
FE UK property Proxy TR in GB	0.64%
10yr US TSY	-9bp
10yr UK Gilt	-26.7bp
10Yr Bund	-22.9bp
10yr French	-14.6bp
10yr Italian	-17.4bp
10yr JGB	-4bp
Corporate bond index TR GBP	1.17%
HY bond index TR GBP	1.38%
Global inflation index TR GBP	1.09%
£/$	-1.58%
$/£	0%
Dollar index	1.6%

Past performance is not an indication of future returns. The value of Investments and any income from them is not guaranteed and can go down as well as up.*

United States

Stock markets continue their march upwards while the world watches with a mixture of anticipation and trepidation as to the impact of ensuing policy changes promised by the Trump administration. While approval ratings have fallen further for the commander in chief, business and consumer confidence has taken a dramatic shift upwards. Much of the economic prosperity that has seen expectations for a March rate rise increase from 20% to 69%, was embedded well before Trump's victory, with ISM manufacturing and the Citi Surprise index positive for some time, and unemployment hovering around the theoretical natural rate. Inflation and growth are also feeding into the economy with Q4 GDP revised to 3.1% and current inflation measures knocking at the 2% level. With Trump's policies in addition to this, and FED action also likely, look out for volatility over the coming year as stagnation unravels and previously benign economic inputs spice up expectations.

United Kingdom

Over the month, the second estimate of Q4 GDP improved from 0.6% to 0.7%, further highlighting the as yet anaemic impact on economic growth from the expected impacts of our future divorce from Europe. What can be seen, however, is the actual impact from the decision, as the subsequent fall in the currency continues to accelerate inflation, CPI coming in at 1.8% in the February report. While the economy remains robust for now, there are certainly risks still to take effect and how business confidence and consumer spending look through the conjecture will largely shape the hand that Carney has to play while managing inflation. Currently, the Gilt markets are not pricing in any central bank action, with only a 10% implied probability for a rate rise this year. With inflation accelerating to its highest level in two years and drivers embedded to support this further, dramatic swings in both the fixed income and equity markets are by no means unlikely.

Europe

Last month's jump in inflation for the Eurozone's largest economy to 2.2% provided ballast to the hawks calling for the ECB's ultra-loose monetary policy to be addressed. Rising oil prices and positive economic signals from most of the union imply momentum is building, even if from a low base. With Eurozone manufacturers reporting their best level of activity last month since the depths of the sovereign crisis, the economic signs are encouraging. Money supply remains accommodative and private loans are strong. Economic sentiment has improved on last year but interestingly remains at sanguine levels, and this leads us seamlessly to the issue of politics. With the current wave of political change spreading to upcoming European elections in Holland, France and Germany, we nervously wait on results given the blindfold created from recent poll success.

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Japan

Currency moves were negligible for February, negating an often strong driver for Japanese equities. Despite this, stock markets reacted in tandem with world equities, rising 2.5% over the month. Of interest to Investors will be the impact of FED tightening on the Yen and potential trade tariffs with the US. Domestically, the Bank of Japan's policy to control the shape of the yield curve has caused confusion in the bond markets, who are sceptical in their ability to hold the Japanese Govt. Bond yield at the stated 0% target rate.

Emerging Markets

Despite concerns over trade wars and tariffs from the Trump twitter account, and the rhetoric around currency manipulation, Emerging Markets participated in the equity rally we saw across the developed indexes. Further concerns of the impact on budget deficits from impending FED rate rises were also shrugged off. Emerging Markets have recovered well since the rebound that began 12 months ago and still offer good value. There is huge variation across the index in what drives growth, but comparatively stable commodity prices and a conservative interest rate programme from the FED (for now), have helped build confidence in Emerging Market equities. Risks remain as ever, particularly across the Chinese debt spectrum, and from a hawkish change in the US interest rate programme, but equally strong US growth drives Emerging Market growth as well.

**All performance data quoted in this article is derived from FE Analytics*

CAERUS Sentiment Indicator