PRUDENTIAL **INSIGHTS**

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Market Overview: June 2018

ARTICLE SUMMARY

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Rising US interest rates and continuing risk-averse sentiment on the part of global investors saw the US dollar gain more ground in June, while emerging market (EM) currencies, equities and bonds suffered further losses. Also weighing on equity markets were fears of an escalating global trade war as the US, China and EU (and others) ratcheted up tariff threats, as did a continuing high oil price. In South Africa, the rand depreciated sharply and bonds were caught up in the adverse EM environment, but resources shares were buoyed by the stronger US dollar. The positive sentiment around President Cyril Ramaphosa’s election appeared to wane after a spate of weaker-than-expected local economic data.

In the US, signs of accelerating inflation amid exceptionally low unemployment (at 3.8% in May) and a robust economy saw the US Federal Reserve turn more hawkish. At its 16 June FOMC meeting it hiked the federal funds rate by 25bps, as widely expected, while also forecasting an extra 25bp hike in 2018. While equities bore the brunt of fears over global growth and corporate profits being hit by a trade war, bonds were also marginally weaker on the back of rising interest rate and inflation fears, but supported by the “risk-off” sentiment. The yield on the benchmark 10-year US Treasury bond ended the month around the 2.9% level, from 2.83% at the start of the month.

Elsewhere, the European Central Bank (ECB) kept its benchmark interest rate unchanged at its June meeting, as had been expected, while also ruling out prospects of a rate hike until mid-2019 at the earliest. This had been increasingly anticipated as the ECB shrugged off evidence of slowing growth in the Eurozone as temporary. However, it did vote to end its bond-buying programme at the end of the year. In the UK, the BOE also kept its rate unchanged as inflation steadied at 2.4% y/y in May (unchanged from April) and the pound sterling strengthened somewhat. The central bank has been reluctant to hike rates while Brexit uncertainty remains high. In China, the IMF maintained the country's 2018 growth forecast at 6.6% despite slower-than-expected May data for industrial output, retail sales and investment. Growing concerns that US tariffs could considerably dent economic growth prospects (some forecasts show a decline of up to 0.5% of GDP) also helped push Chinese stocks weaker over the month.

Looking at global equity market returns (all in US$), the MSCI All Country World Index returned -0.5% in June. Emerging markets delivered -4.1% (MSCI Emerging Markets Index), while the MSCI World Index (for developed markets) returned -0.1%. Among developed markets, the S&P 500 produced 0.6% and the Dow Jones Industrial 30 -0.5%, while the technology-heavy Nasdaq posted 1.1%. In Europe, the Dow Jones EuroStoxx 50 delivered -0.2%, while the UK’s FTSE 100 lost 1.0% and Japan’s Nikkei 25 delivered -1.2%. Among larger emerging markets in US$, the strongest performer for the month was the MSCI Russia at 0.6%, while other markets lost ground. The weakest markets included Brazil’s Bovespa (-8.1%), South Korea’s KOSPI (-6.3%) and the MSCI China (-5.2%). The Bloomberg Barclays Global Aggregate Bond Index (US$) returned -0.4%, while the EPRA/NAREIT Global Property Index (US$) produced 2.5%.

Apart from oil, commodity prices were weaker across the board, impacted by the deterioration in global growth prospects. Brent crude oil gained 2.4%, ending June at over US$77 per barrel: price weakness caused by the trade dispute and an agreement to gradually lift supply was outweighed by supply disruptions and looming sanctions on both Venezuela and Iran. Gold lost 3.5%, while platinum was down 5.9% and palladium fell 3.3%. For industrial metals, aluminium lost 5.9%, copper fell 3.2%, lead was down 1.7% and nickel declined 2.2%.

In South Africa, global “risk-off” sentiment weighed on local markets as investors continued to sell their SA assets, as did disappointing local conditions. Although May CPI fell to 4.4% y/y from 4.5% in April, better than the 4.6% expected, Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% growth expected, with agricultural, mining and manufacturing production all shrinking. A much weaker rand and rising petrol price also raised concerns over higher inflation to come, denting business confidence. Other concerns stemmed from uncertainty over the government's proposals for National Health Insurance (NHI) and a strike at Eskom causing electricity outages. The optimism over Cyril Ramaphosa's election seen earlier in the year appeared to dissipate somewhat in the face of the daunting economic challenges the government faces.

Local bonds moved weaker on these factors in volatile trade, with the yield on the 10-year SA government bond rising from 8.6% to reach a new 2018 high at 9.2%, before rallying to end the month at 8.9%. The BEASSA All Bond Index consequently delivered -1.2% for the month. Inflation-linked bonds (Composite ILB Index) produced -2.0%, and cash as measured by the STeFI Composite Index returned 0.6%. The rand depreciated sharply in June, losing 8.2% against both the US dollar and the euro, and 7.4% against the pound sterling.

SA equities continued to reflect the more volatile global market conditions, as well as the weakness in the local economy: the FTSE/JSE All Share Index (ALSI) posted a 2.8% monthly total return, boosted by a strong performance of 6.4% from Resource stocks (Resources 10 Index), which have now returned 18.5% for the year to date. Industrial stocks were also in the black with a 4.2% return for the month, helped by the large global companies with offshore earnings, but the more SA-focused Financial shares produced -2.9%. Listed Property delivered -3.5% and has now lost 21.4% for 2018. Valuations on SA equities cheapened marginally: the ALSI's 12-month forward price-to-earnings (P/E) ratio fell from 13.9 times to 13.7 times at the end of June,a level we still see as being around fair value to slightly cheap.

According to Morningstar data, the average ASISA SA general equity fund returned 1.3% for the month. The average multi-asset high equity (balanced) fund delivered 2.0%, while multi-asset low equity funds averaged 1.4%, and multi-asset income funds returned 0.4% on average.

To find out more about **Prudential funds** contact our Client Services Team on 0860 105 775 or at **query@prudential.co.za**.

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