

Investment News

Monthly Bulletin from the Insurance & Investment Team

January 2019

Last Month in Brief

The FTSE 100 finished 2018 weakly, posting its worst annual decline in a decade. Brexit uncertainty, apprehension about the pace of US interest rate increases and trade concerns led the FTSE 100 to hit a two-and-a-half year low of 6,536.63 on 27 December.

The Dow Jones and the S&P 500 recorded their worst December performance since 1931 and their biggest monthly loss since February 2009 among concern over the ongoing trade negotiations between the US and China, and fears around the monetary policy of the Federal Reserve. The Dow Jones was extremely volatile, and on 26 December it experienced its largest ever one-day point gain by jumping more than 1,000 points. The index was up or down more than 1 percent nine times in December alone, compared to just 8 times in the whole of 2017. Over December the S&P 500 fell more than 9 percent, the worst December performance seen since the Great Depression. Yields on US Treasuries fell, continuing the trend over the past two months.

The Purchasing Managing Index (PMI) is a survey which is an indicator of the economic health for the manufacturing and service sectors. Over the previous month, the job creation rate dropped to a two-year low, and both manufacturing and services PMIs fell. The IHS Markit Eurozone PMI composite fell from 52.7 to 51.1 in the previous month. This was below market expectations and was at its weakest level for over four years.

Chart 1: Equity Indices
Equity markets fell over the month.

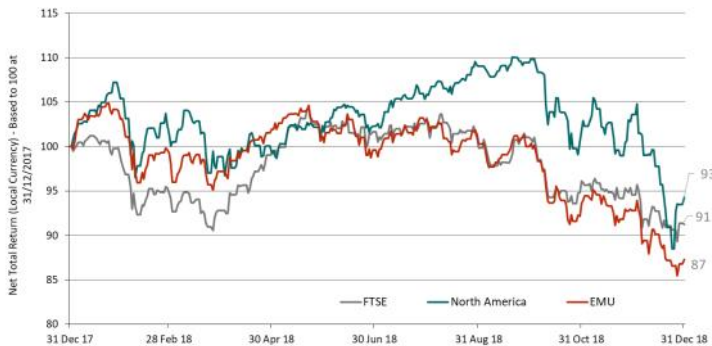


Chart 2: Sterling Credit Spreads
Credit spreads increased over the month.

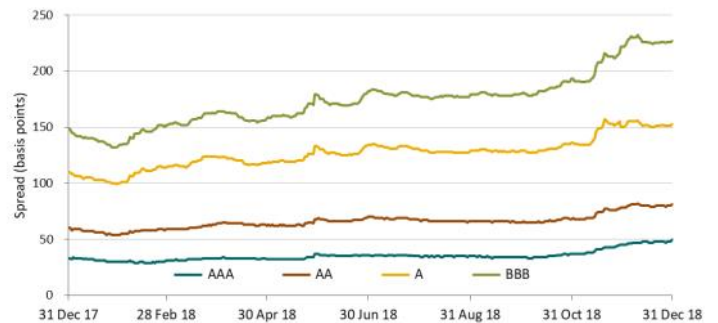


Chart 3: Gilt Yields
Real and nominal gilt yields fell slightly over the month.

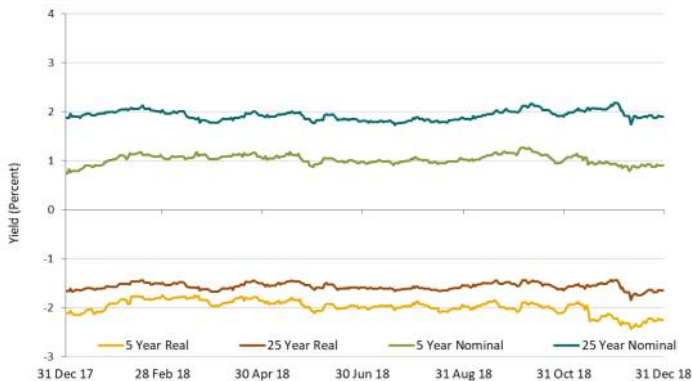
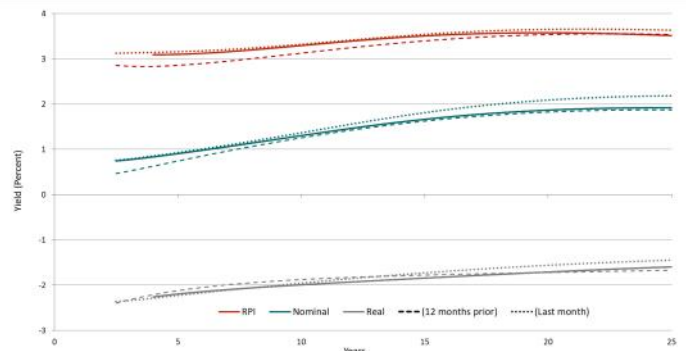


Chart 4: Gilt Spot Curves
Nominal and real yields fell over the month, particularly at longer durations.



Source: Financial Times, MSCI, Merrill Lynch Bank of America, & Bank of England

	Latest	Previous		Latest	Previous
CPI increase (annual change)	+2.2%	+2.2%	Base rate	0.75%	0.75%
PPF 7800 funding ratio*	100.9%	95.9%	\$/£ exchange rate	1.28	1.28
Halifax house prices (monthly change)	2.2%	-1.2%	VIX (volatility) index	25.42	18.07

*PPF have recently changed their methodology for calculating the above figures so the figures may not be consistent with previous updates.

For monthly published indices "Latest" and "Previous" refers to the two most recently published statistics, otherwise numbers are quoted as at the month end.

A look back on 2018

2018 was a difficult year for investors, with most asset classes falling in value. Although generally markets made a modest start to the year, since the summer all major equity markets have fallen significantly.

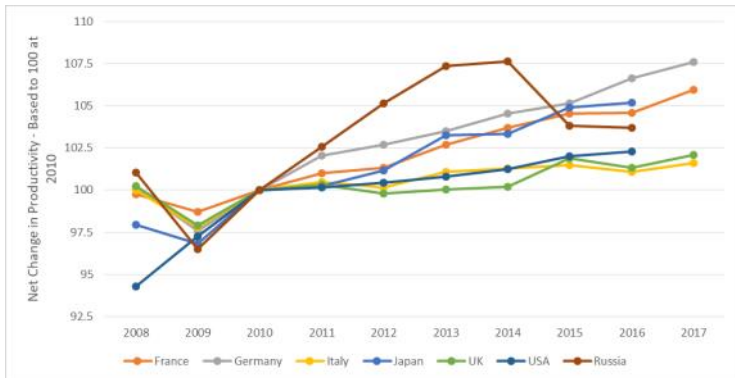
Throughout 2018, there was a lot of political and economic uncertainty surrounding Brexit negotiations. Following increased fears of a hard-Brexit or no-deal Brexit, Sterling weakened against the US Dollar and the Euro. The strength of Sterling against the Euro and the US Dollar continues to act as a measure of the perceived outcome of Brexit negotiations.

There has been further uncertainty due to US president Donald Trump's position on market issues. US Corporation tax was cut from 35% to 21% and whilst the cuts roughly doubled the growth rate in corporate profits early in the year, this did not translate to sustained equity growth as equities remained volatile (particularly in the latter stages of 2018). The S&P ended the year down by 4.5% and indicators show that corporations affected are spending at roughly the same pace as before the tax cuts. The ongoing trade war between the US and China has also contributed to the ongoing uncertainty and has been cited as one of the reasons for poor market performance over 2018.

2018 saw the second increase in the interest rate by the Bank of England in ten years, from 0.5% to 0.75%. The Governor of the Bank of England explained this increase was a response to a rebound in economic growth and that they were confident that the weak patch at the start of the year was temporary. The rate rise came with the guidance that there would be gradual and limited rate increases in the future.

Productivity

GDP (2010=100) per hour worked in six G8 countries



Source: OECD Compendium of Productivity Indicators 2018

Productivity rates slightly improved over the year in all countries, following a slowdown in productivity growth the previous year. The average productivity growth in the UK over the last 5 years has been 0.5% p.a.

Exchange rates

Sterling exchange rates against the Euro and Dollar



Source: Bank of England

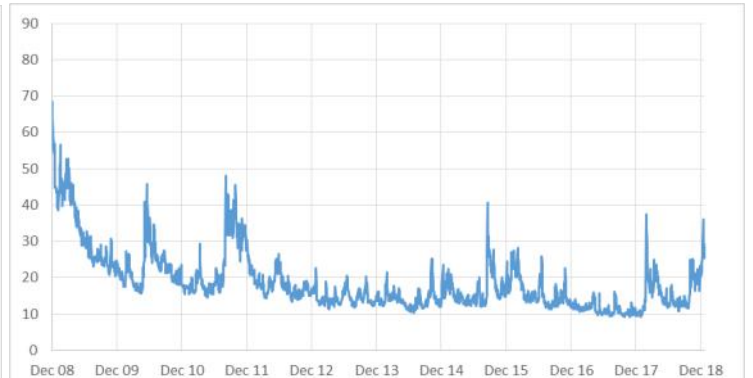
USD has exhibited strength over the year, strengthening by 8% on a trade weighted basis.

Sterling became increasingly involved in Brexit uncertainty, prompting a decline in the GBP/USD exchange rate of about 6% over the course of the year. GBP to Euro exchange rates have remained constrained in a c.5% range throughout 2018 but with dramatic intraday price swings within this range.

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Market volatility

VIX index of US (S&P 500) equity market uncertainty



Source: Yahoo Finance

The VIX is a measure of the stock market's future expectation of volatility. It provides a measure of market risk and investors' beliefs, and is known as the "fear index" as it tends to increase during periods of uncertainty. 2018 has been a year of increased volatility which is reflected above. The Dow has swung 1,000 points in a single session only eight times in its history, and five of those took place in 2018.

Forecasts

Headline economic forecasts for the UK

	2018	2019
GDP growth	1.3%	1.5%
CPI	2.3%	2.0%
RPI	3.2%	2.9%
LFS Unemployment Rate	4.1%	4.1%
Current account	£-70.8 bn	£-68.0 bn
PSNB	£30.3 bn	£32.4 bn

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury December 2018

UK GDP growth forecasts are projected to be slightly higher than over 2018 after two consecutive years of slower growth. However, forecasters still expect investment to be held back by Brexit-related uncertainties. CPI and RPI forecasts have been revised lower, which could be attributed to the 0.25% interest rate increase that occurred in August.

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