the ADVISER

Brought to you by KRD Financial Advisers Ltd

Welcome to the latest edition of our newsletter, our update on developments in the world of financial services. In this issue we take a look at UK Interest Rate, International Markets & Emerging Markets.

UK base rate falls to record low in August

UK equity markets delivered a relatively muted performance during August as investors' attention continued to focus on monetary policy – both domestic and overseas – and on ongoing fluctuations in the price of oil.

The Bank of England (BoE) cut UK interest rates to 0.25% during the month, and also introduced further stimulus measures. The reduction – which had been widely expected – took rates to their lowest-ever level, and BoE policymakers remain poised to take additional action if necessary. Meanwhile, the price of a barrel of Brent Crude oil rose above US$50 per barrel during the month, but subsequently fell back following news of higher-than-expected US crude oil inventories. Medium-sized companies performed better than their larger counterparts during August. While the blue-chip FTSE 100 Index rose by 0.8% over the month, the FTSE 250 Index climbed by 2.6%.

The effect of the UK's decision to exit the European Union (EU) continued to manifest itself during the month. Although the Government has, as yet, announced no official plans to invoke Article 50 of the Lisbon Treaty – which sets out the process by which a member state can leave the EU – Brexit remained a major focus for many investors in August. According to Markit, UK companies found that the Brexit result had dampened new business activity during July. In the UK services sector, confidence has fallen to its lowest level since February 2009, and Markit warned that the drop in activity had "undoubtedly increased the chances of the UK sliding into at least a mild recession". At individual company level, builders' merchant Travis Perkins reported a dip in demand ahead of, and "immediately following" the Brexit referendum.

The National Institute of Economic & Social Research (NIESR) warned that the UK was likely to undergo a "marked economic slowdown" over 2016 and 2017. The NIESR believes that there is an even chance of the UK falling into a "technical" recession, which is defined as two consecutive quarters of negative GDP growth.

Brexit also proved to have a substantial impact on fund flows in June, according to the Investment Association (IA). Equity funds experienced outflows totalling £2.8 billion during June as investors reacted to the unexpected outcome of the Brexit vote and this included £1 billion-worth of withdrawals from UK equity funds. A further £1.4 billion-worth of property funds was sold during the month.

The value of the investment can go down as well as up and you may not get back as much as you put in

In This Issue:

Need Advice? Get in touch today

KRD Financial Advisers Ltd
74 Worcester Road
Hagley
Stourbridge
West Midlands
DY9 0NJ

T. 01562 888440
E. dave@krdfa.com

US rate rise appears all but inevitable

Investors appear to have accepted another increase in US interest rates this year as all but inevitable. Robust employment data for July helped to fuel expectations of a rate rise, and Federal Reserve (Fed) Chair Janet Yellen believes that the case for higher interest rates "has strengthened in recent months".

Nevertheless, the timing of any monetary tightening remains in question: the Federal Open Market Committee (FOMC) meets three more times during 2016: in September, November and December. Given that the Presidential election will take place in November, shortly after the FOMC's meeting, any increase in rates is widely expected to take place in either September or December. Looking ahead, as the FOMC's September meeting approaches, investors are likely to scrutinise economic data releases closely for any possible guidance over the timing of the Fed's next move.

The yield on the ten-year US Treasury bond rose during August from 1.48% to 1.58%. Meanwhile, despite recent volatility, the credit rating profile of US high yield bonds has risen since the beginning of last year, according to Markit, and most of this improvement has taken place since the beginning of the second quarter of 2016.

Elsewhere, many companies are taking advantage of Europe's backdrop of exceptionally low interest rates to raise cash through bond issuance. For example, US drinks manufacturer Coca-Cola issued new 20-year senior unsecured euro notes during August. Rising expectations of another increase in US interest rates before the end of the year may provide companies with additional incentive to refinance before borrowing costs escalate.

During August, credit ratings agency Fitch warned that "unconventional" monetary policy in Japan, Europe and the US, combined with a sharp increase in demand for perceived "safe-haven" assets, has driven down sovereign bond yields to new lows during 2016. In turn, this has fuelled the risk that any sudden interest rate increase could result in steep losses for fixed-income investors.

Demand for fixed-income funds was strong in July, notching up net retail sales of £1.1 billion during the month. According to the Investment Association (IA), £ Corporate Bond was the second-best-selling IA sector during July, behind Targeted Absolute Return. £ Strategic Bond and Global Bonds were ranked fourth and fifth. Demand for funds in the Global Emerging Markets Bond, £ High Yield, UK Index-Linked Gilts and UK Gilts sectors also proved relatively robust.

The value of the investments, and the income from them, can go down as well as up and you may not get back as much as you put in.

Yen's fluctuations continue to affect markets

Medium-sized Japanese companies outperformed their larger counterparts during August as exporters remained hostage to the yen's strength.

The Nikkei 225 Index and the Topix Index rose by 1.9% and 0.5% respectively over the month; in comparison, the TSE Second Section Index climbed by 2.8%.

Better-than-expected US employment data fuelled expectations of further monetary tightening in the US Federal Funds rate. As a result, the US dollar appreciated against the yen, providing some support for the share prices of Japanese exporters in early August. Later in the month, however, the effects of longer-term strength in the yen were demonstrated by disappointing trade data, which showed that ongoing yen strength had resulted in a 14% annualised decline in exports during July. Imports fell by 24.7% over the same period. The data led to a sharp drop in share prices in the middle of August.

A package of economic stimulus measures worth 28 trillion yen was approved by Japan's cabinet early in the month and will make up part of a supplementary Budget in September. The measures are intended to support Japan's struggling economy, but received only a lukewarm reception from investors.

Japan's economy expanded at a lacklustre annualised rate of 0.2% during the second quarter. Inflation continued to cast a shadow as the consumer price index registered another decline, falling at an annualised rate of 0.5% during July. Nevertheless, as August drew to a close, investors drew encouragement from some positive economic data: Japan's rate of unemployment fell from 3.1% to 3%; meanwhile, household spending held up better than expected, falling by a smaller-than-anticipated 0.5%.

The Reserve Bank of Australia (RBA) cut its key interest rate from 1.75% to 1.5% – its lowest-ever level – during August. Inflation remains subdued in Australia, suppressed by muted growth in domestic labour costs and low cost pressures overseas, and RBA policymakers agreed that further monetary easing would support economic growth and inflation in the longer term. The ASX All Ordinaries Index fell by 2% during August. The RBA expects the country's economy to grow by between 2.5% and 3.5% during 2016, after which it is forecast to pick up to reach 3%-4% by 2018. However, policymakers are concerned about headwinds to growth, including the outlooks for Australia's labour market and for China's economy, which remains a potential hindrance to global growth and demand for commodities.

Emerging markets outperform in August

Emerging equity markets generally performed better than their developed counterparts during August, led by a strong contribution from China. The Shanghai Composite Index rose by 3.6%. During the month, a plan to connect the Hong Kong and Shenzhen stock exchanges was finally approved in principle.

The International Monetary Fund (IMF) expects China's economy to expand by 6.6% this year. In comparison, China's National People's Congress issued an official growth forecast for 6.5% to 7% earlier this year. However, the IMF suggests that China's strategy of setting annual growth targets, instead of projections, could create an "undesirable focus on short-term, low-quality stimulus measures". By 2021, the IMF expects China's economic growth to moderate to 5.8%.

Elsewhere, investors were disappointed by soft trade data for July. China's exports fell at an annualised rate of 4.4% in US dollar terms during the month, while imports fell by 12.5%. Data from the industrial and retail sectors also proved weak: retail sales rose at an annualised rate of 10.2% in July, compared with growth of 10.6% in June; meanwhile, industrial output posted annualised growth of 6%.

India's economic growth lost momentum during the second quarter of 2016. The country's economy grew at an annualised rate of 7.1% during the period, compared with a rate of 7.9% during the first quarter. Growth was dampened by subdued growth in the agriculture, forestry & fishing sector and by negative growth in the mining sector.

The next Governor of India's central bank was announced during August. Urjit Patel is a current Deputy Governor of the Reserve Bank of India (RBI) and will replace incumbent Governor Raghuram Rajan in September. India's parliament passed new tax reforms designed to simplify the current complicated system. Over August as a whole, the benchmark CNX Nifty Index rose by 1.7%.

Brazil's economic decline appeared to have slowed during the second quarter. The country's economy shrank at an annualised rate of 3.8% during the period, compared with a first-quarter contraction of 5.4%. The rate of investment rose into positive territory, rising by 0.4% quarter on quarter. However, Brazil's rate of unemployment climbed during the three months to July, rising from 11.3% in June to 11.6%. At the end of August, Brazil's President Dilma Rousseff – who was suspended in May – was formally impeached by the country's Senate. The Bovespa Index rose by 1% during August.

European markets deliver mixed performance in August

Although the overall performance of European equity markets was relatively muted during August, returns at individual country level were rather more mixed. Ireland generated a strong performance during the month, and the benchmark ISEQ 20 Index rose by 4.7%. Research from Bank of Ireland suggests that confidence amongst Irish businesses and consumers has improved since the UK's Brexit vote in June. Sentiment amongst industrial and retailing firms rebounded particularly strongly during August; in comparison, optimism within the services sector showed a slight deterioration.

At the other end of the performance spectrum, Denmark's OMX Copenhagen 20 Index fell by 5.4% during August and Denmark's government downgraded its predictions for domestic economic growth to 0.9% in 2016 and 1.5% in 2017. Whilst warning that the backdrop for growth in Denmark's economy has "turned bleaker", the government continues to expect "modest" economic growth and "solid" employment growth. Denmark's economy expanded at a quarterly rate of 0.5% during the second quarter, compared with growth of 0.7% in the first three months of the year.

The eurozone's economy expanded at a quarterly rate of 0.3% and an annualised rate of 1.6% during the second quarter. Italy's economy stagnated during the second quarter, having posted growth of 0.3% during the first three months on the year. A devastating earthquake in central Italy undermined sentiment towards the end of the month. The FTSE MIB Index endured a relatively volatile month, but ended August in positive territory, rising by 0.6%. The International Monetary Fund (IMF) expects Italy's economy to expand by 0.9% during 2016; meanwhile, the eurozone is predicted to post growth of 1.6%.

Having fallen sharply in May, industrial production in the eurozone rebounded during June, rising at a monthly rate of 0.6%. Elsewhere, the rate of unemployment in the euro area remained unchanged at 10.1% and the annualised rate of inflation stayed at 0.2% during August. The news fuelled hopes that European Central Bank (ECB) policymakers might consider implementing additional stimulus measures.

Confidence amongst German firms deteriorated sharply in August, according to Ifo's Business Climate Index and economic growth in Germany lost momentum during the second quarter. The country's economy expanded by 0.4% during the second quarter, compared with 0.7% during the first quarter. Nevertheless, the Dax Index rose by 2.5% over August as a whole; in comparison, France's CAC 40 Index ended August largely unchanged.

Demand for equity income remains robust

UK base rate reached its lowest-ever level of 0.25% in August, providing income-seeking investors with even more reason to look elsewhere for yield. During the month, the yield on the FTSE 100 Index edged slightly higher, rising from 3.72% to 3.73%, while the FTSE 250 Index's yield eased from 2.66% to 2.61%. In comparison, the ten-year UK gilt yield declined from 0.80% to 0.64%. Over August as a whole, medium-sized UK companies outperformed larger companies: the FTSE 250 Index rose by 2.6% over the month, while the FTSE 100 Index climbed by 0.8%.

Since the beginning of 2016, the best-performing industry sectors include industrial metals, technology hardware & equipment, mining, industrial engineering, and oil & gas producers. At the other end of the performance spectrum, the worst-performing sectors over the year to date include real estate investment & services, fixed-line telecoms, life insurance, and general retailers. Insurer Direct Line reported better-than-expected interim profits during August, and revealed a special dividend of ten pence per share. Meanwhile, having suspended its payout in 2015, infrastructure group Balfour Beatty announced the reinstatement of its dividend. In contrast, miner BHP Billiton revealed a US$6.4 billion annualised loss and cut its dividend payout by 76%.

Although demand for fixed-income funds was strong during July, according to the Investment Association (IA), equity funds experienced post- Brexit outflows of £2.2 billion during the month. This included a £1 billion outflow of UK equity funds that resulted primarily from a £917 million outflow in the UK All Companies sector. In comparison, the UK Equity Income sector experienced modest inflows, while the Global Equity Income sector enjoyed relatively robust demand.

Headline growth in global dividends rose by 2.3% during the second quarter of 2016, while underlying growth was 1.2%, according to Henderson's Global Dividend Index. A subdued contribution from the US meant that growth during the second quarter was slow compared with the first quarter; however, continental Europe's performance was relatively strong, as two-thirds of European dividends are paid during the second quarter. Headline dividend growth in the UK was strong at 7.7%, enhanced by substantial special dividend payouts that more than offset the effects of sterling's weakness. Nevertheless, underlying growth fell at an annualised rate of 3.3% as a decline in corporate profits led to dividend cuts from companies including Barclays and Anglo American.

The value of the investments, and the income from them, can go down as well as up and you may not get back as much as you put in.

Investors seek growth amongst emerging markets

Global equity markets generally rose during July, and the overall performance of emerging markets outstripped that of developed countries as investors sought growth opportunities. Investor sentiment in China received a boost from encouraging retail sales data: retail sales rose at an annualised rate of 10.6% in July, compared with 10% in the preceding month. Industrial production proved stronger than expected during June, rising by 6.2% year on year. The Shanghai Composite Index rose by 1.7% over July, but has fallen by 15.8% since the start of the year.

China's economy achieved better-than-expected growth during the second quarter, expanding at an annualised rate of 6.7%. Ratings agency Standard & Poor's (S&P) increased its forecasts for China's growth from 6.35% to 6.6% this year, and from 6.05% to 6.3% next year. Nevertheless, S&P emphasised that these upgrades do not signal an improvement in China's economic health; instead, they suggest that S&P had "overestimated the authorities' appetite for slower GDP growth as the price for improving medium-term financial sustainability". S&P believes the economy's current trajectory is "unsustainable" and warned that the risk of a short-term correction in China would continue to increase if China's leaders do not correct the "credit-heavy pattern of GDP growth".

Policymakers at Brazil's central bank maintained its key Selic interest rate at 14.25%. The Selic rate has remained static for the past eight meetings of the Central Bank Monetary Policy Committee (Copom) and was last raised twelve months ago. The Copom's July meeting was the first led by new Governor Ilan Goldfain. Interest rates are expected to fall over the next few months as inflationary pressures start to moderate. Brazil's rate of inflation declined to 8.84% during June and is expected to fall below its upper target limit of 6.5% during 2017. The benchmark Bovespa Index rose by 11.2% during July, and has surged by 32.2% since the beginning of 2016.

In India, the prospect of a cut in interest rates continued to recede as the country's rate of inflation continued to creep higher. Annualised consumer price inflation edged up from 5.76% in May to 5.77% in June, fuelled by rising food costs. At present, the Reserve Bank of India (RBI) has a target inflation rate of 5% by March 2017. The CNX Nifty Index climbed by 4.2% during the month and by 8.7% over the year to date.

T: 01562 888440 F: 01562 886301 E: dave@krdfa.com www.krdfa.com