Corporate Client Update

January 2018

Market Review Q4 2017

#Euroboom
2017 saw Eurozone equity investments turn in one of their better years since the single currency was born in 1999. In a year that threatened the very existence of the European Union with the rise of populism characterised by Brexit, anti-Euro election victories in Germany and Italy and the fall-out from the Catalonian referendum results, most of the major benchmark indices posted double digit returns. The brighter outlook and dramatic swing in fortunes also allowed the European Central Bank to take their first steps on the path to monetary policy normalisation by halving their bond purchasing program to €30bn per month. As the recovery began gaining momentum, it even gained its own Twitter hashtag #Euroboom.

Stock markets hit ALL-TIME highs! SO GREAT!
The US stock market also roared in 2017 cheered on by its number one fan from the social media side-line, Donald Trump. Trump tweeted 58 times about the stock market over the year as the major US benchmark indices climbed to new peaks. The Dow Jones finished the year up +28.11%, closing at all-time highs 71 times in 2017, more than in any other year in history and doing so with a maximum drawdown during the year of -3.4%, the second lowest of any year in history. Not to be outdone, the S&P 500 finished the year up +21.83%, in turn recording positive gains in every month of a calendar year for the first time in 30 years.

Yields are proving stubborn
Despite all the positive economic data emanating from Europe in 2017, including Germany posting its highest ever manufacturing PMI and the fastest EU jobs growth in nearly a decade, yield increases in Eurozone government bonds were subdued and in some cases non-existent. The German 10-year Bund yield rose 22bps in 2017 to 0.46% but much of the movement happened late in December on the news that the German government plan to issue more debt than expected in the next year.

The US Treasury yield also experienced a December spike as Donald Trump's controversial Tax Bill was approved marking his first major legislative win since taking office. The 10 Year US treasury yield finished the year at 2.33%, more or less where it started the year.

It has been an interesting year for the UK. Despite progress in Brexit talks late in the year, UK GDP slowed to 1.7% while inflation rose to 3.1%, materially higher than the BOE's 2% target. The effects of Brexit were also seen as net migration to the UK from the EU fell by 40% in the 12 months following the referendum. This all added to a 5bps decrease in the yield on 10-year gilts over the year to 1.37% and further devaluation of GBP vs the Euro.

Where has the volatility gone?
2017 will go down as one of the most peaceful years in history. The DJIA had an intraday range of <1% on 95% of all trading days in the year. The headline volatility stats however come from the VIX Index which finished the year at 11.04. Out of the top 10 lowest monthly closing values for the index in history, 5 of them were in 2017 including the lowest ever monthly closing value in September of 9.51. The lack of volatility has confounded investors and led to a number of asset managers altering their investment strategies to sell options on the VIX and benefit from the premiums received. Is this the calm before the storm?

Active Managed Fund Highlights

Average Return for Q4	2.8%
Best Performer for Q4 *Davy Asset Management*	3.9%
Average Return 1 Year	7.0%
Best Performer 1 Year *Aberdeen Standard Investments*	9.3%
Best over 3 years *Setanta Asset Management*	9.0% p.a.
Best over 5 years *Setanta Asset Management*	12.5% p.a.
Best over 10 years *Setanta Asset Management*	7.0% p.a.

Key Market Indices – Summary of Returns to 31st December 2017 (in Euro terms)

Asset Class	Q4 %	YTD %	1 Yr %	3 Yrs % p.a.	5 Yrs % p.a.
Cash: 3 Month Euro Bank Deposit	-0.1	-0.4	-0.4	-0.3	-0.1
Government Bonds: ML EMU Gov't > 5 Year Bond Index	1.0	0.3	0.3	2.4	5.8
LT Government Bonds: ML EMU Gov't > 10 Year Bond Index	1.4	-0.4	-0.4	2.9	7.4
Euro Corp Bonds: ML EMU Corporate Large Cap Bond Index	0.6	2.5	2.5	2.2	3.4
Global Equity: FTSE World Index	4.2	9.0	9.0	10.3	13.8
Emerging Mkt Equity: MSCI Emerging Markets Index	5.8	21.0	21.0	9.8	6.7
Commodities: 50% GSCI + 50% GSCI Non-Energy Index	4.5	-7.3	-7.3	-5.7	-7.5

Summary of Managed Fund Returns

Active Managed Funds – Summary of Returns to 31st December 2017

Manager	Q4 %	Rank	YTD %	Rank	1 Year %	Rank	3 yrs % p.a.	Rank	5 yrs % p.a.	Rank	10 yrs % p.a.	Rank
Friends First	3.4	2	8.2	2	8.2	2	6.9	6	10.6	4=	4.3	7
Merrion Investment Managers	1.3	7	4.4	7	4.4	7	5.6	7	9.8	7	5.0	4
New Ireland	3.3	3	7.6	3	7.6	3	7.9	2	10.1	6	4.9	5
Davy Asset Management	3.9	1	6.4	5	6.4	5	7.7	3	10.9	3	4.4	6
Setanta Asset Management	2.9	4	6.8	4	6.8	4	9.0	1	12.5	1	7.0	1
Aberdeen Standard Investments	2.6	5	9.3	1	9.3	1	7.0	5	11.0	2	6.2	2
Zurich Life	2.2	6	6.1	6	6.1	6	7.5	4	10.6	4=	5.6	3
Average	2.8		7.0		7.0		7.4		10.8		5.3	

Active Managed Funds – Percentage Asset Allocation as at 31st December 2017

	Equities											
Manager	Ireland %	UK %	Europe ex ROI & UK %	North America %	Japan %	Other %	Total %	Fixed Interest %	Property %	Cash %	Alternative Assets %	Total %
Friends First	1.5	2.2	14.2	38.0	6.5	10.4	72.8	25.8	0.0	1.5	0.0	100.0
Merrion Investment Managers	1.7	3.5	23.4	23.9	9.4	4.4	66.1	7.5	2.8	9.2	14.4	100.0
New Ireland	1.8	3.6	26.0	33.8	6.4	8.0	79.6	11.5	4.3	4.6	0.0	100.0
Davy Asset Management	0.0	5.1	16.0	40.8	6.4	2.1	70.4	10.3	11.6	7.8	0.0	100.0
Setanta Asset Management	7.4	9.5	11.0	37.4	1.2	2.4	68.8	11.7	9.7	8.7	1.1	100.0
Aberdeen Standard Investments	1.3	2.8	19.9	34.5	6.4	9.0	73.9	11.7	7.3	7.0	0.0	100.0
Zurich Life	4.0	4.0	14.0	34.0	7.0	6.0	69.0	30.0	0.0	1.0	0.0	100.0
Average	2.5	4.4	17.8	34.6	6.2	6.0	71.5	15.5	5.1	5.7	2.2	100.0

Warning: Past performance may not be a reliable guide to future performance. While every care has been taken in collecting this data from investment managers, it has not been audited or verified for accuracy.

Active Managed Funds – Yearly Performance Figures

2017		2016		2015		2014		2013	
Aberdeen Standard	9.3%	Setanta	12.2%	Merrion	13.6%	Setanta	17.8%	Aberdeen Standard	19.6%
Friends First	8.2%	New Ireland	9.6%	Aberdeen Standard	10.7%	Merrion	16.7%	Setanta	18.5%
New Ireland	7.6%	Zurich Life	6.6%	Davy	10.4%	Davy	16.2%	Merrion	16.3%
Setanta	6.8%	Davy	6.3%	Zurich Life	9.8%	Aviva	16.2%	Friends First/F&C	16.0%
Davy	6.4%	Friends First/F&C	5.2%	Setanta	7.9%	Friends First/F&C	15.1%	Zurich Life	15.9%
Zurich Life	6.1%	Aberdeen Standard	1.1%	Friends First/F&C	7.4%	Aberdeen Standard	15.1%	Davy	15.8%
Merrion	4.4%	Merrion	-0.7%	New Ireland	6.6%	Zurich Life	15.1%	Aviva	15.7%
				Kleinwort Benson	6.4%	Kleinwort Benson	14.5%	New Ireland	15.6%
				Aviva	6.3%	New Ireland	11.9%	Kleinwort Benson	14.7%
Average	7.0%	Average	5.8%	Average	8.8%	Average	15.4%	Average	16.5%

Consensus Funds – Summary of Returns to 31st December 2017

Fund Name	Q4 %	YTD %	1 Year %	3 Yrs % p.a.	5 Yrs % p.a.	10 Yrs % p.a.
Friends First/F&C	3.9	10.1	10.1	8.2	11.2	5.6
Irish Life Investment Managers	2.7	7.0	7.0	7.9	11.0	5.2
Average	3.3	8.6	8.6	8.1	11.1	5.4

Representative Fund Performance

Summary of Returns to 31st December 2017

Fund Name	Type of Fund	Q4 %	YTD %	1 Yr %	3 Yrs % p.a.	5 Yrs % p.a.	10 Yrs % p.a.
Davy Global Equity	Global Equity	5.0	9.2	9.2	8.5	12.0	3.9
Friends First/F&C International Equity	Global Equity	5.0	11.5	11.5	9.0	12.9	6.2
ILIM Dynamic Global Value	Global Equity (Traditional Value Style)	3.8	8.0	8.0	10.4	14.6	-
KBI GI Dividend Plus Global Equity	High Yield Global Equity	4.9	6.2	6.2	8.6	13.4	7.8
KBI GI Innovator	Alternative Investment Themes/Trends	4.3	9.9	9.9	4.7	4.9	0.0
Merrion Global Equity	Global Equity	2.6	4.7	4.7	6.7	11.2	5.4
Merrion High Alpha	Concentrated Absolute Return Fund	-1.5	-2.4	-2.4	0.7	4.6	-
New Ireland Consensus IRIS 2022+	Target Date Lifestyle Fund	2.1	5.7	5.7	4.8	7.7	3.4
Setanta Dividend Fund	High Yield Equity	2.8	6.3	6.3	10.1	12.8	7.3
Setanta Global Focus Fund	Concentrated Global Equity	3.5	9.7	9.7	9.6	13.4	9.5
Aberdeen Standard Investment GARS	Absolute Return Fund	1.8	1.9	1.9	0.6	2.8	4.8
Aberdeen Standard Global Equities	Global Equity	2.2	6.9	6.9	6.3	11.5	6.2
Zurich Life 5*5 Global Equity	Concentrated Global Equity	5.2	11.4	11.4	9.6	11.8	4.8
Zurich Life International Equity	Global Equity (Rotational Style)	3.9	9.2	9.2	9.8	13.4	6.7

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Market Outlook

"The global economy is doing well. We're in a synchronised expansion. It's the first time in many years that we have seen this"

In her final press conference as Federal Reserve Chair, Janet Yellen provided a bullish assessment of the world economy. Although her legacy may be debated for years to come, there can be no doubting that the global economy is in a better place today than when she took office 4 years ago. According to the IMF, Global GDP rose to 3.6% in 2017, which is on par with the average of the 2 decades leading up to the global financial crisis in 2007, and up from 3.2% growth in 2016. Allayed to this unemployment rates in advanced economies are at multi-year lows and global stock markets continue to march higher. Perhaps Yellen's greatest feat however has been to begin to taper the central bank's stimulus programme without disturbing financial markets. Optimism abounds going into 2018 but despite supportive macroeconomic indicators, there are still major risks on the horizon.

The Inflation Conundrum

The greatest mystery of 2017 has been the absence of inflation. While this is nothing new, the persistence of low inflation over the last 12 months has been particularly confusing for economists and policy makers alike, with the traditional textbook connection between inflation and unemployment appearing to have broken down.

In the US, core inflation once again undershot its 2% target for the year despite the US jobless rate coming in at 4.1%, its lowest reading since 2001. These unusual conditions present an interesting dilemma for Central Banks. The Fed has predicted 3 more rate hikes for 2018 and while most board members don't completely understand why inflation is remaining low, they are confident it will rise as the economy continues to grow and employers are forced to offer higher wages. Of course, raising interest rates would usually dampen inflation so if it doesn't respond the way they anticipate – this move could end up holding back the economy. Persistently low inflation could then force the Fed to cease rate rising activities and could leave them with little room to manoeuvre should another recession hit.

The story is similar in Europe with inflation generally subdued across the continent despite strengthening labour market conditions. The signs are more promising however with Eurozone inflation coming in 1.5% in November up from 0.6% 12 months earlier but crucially, still below its 2% target. Strong economic data is beginning to ignite inflation across the continent with the manufacturing PMI, for example, hitting its highest level since surveys began in 1997. The ECB's stance on rate hikes has been one underpinned by patience but as inflation ticks up they will come under pressure to take action. As it stands it looks like Mario Draghi will see out his whole 8-year term without ever having raised interest rates.

The Trump Threat

While monetary policy has so far been unable to solve the inflation puzzle in the US, there is growing belief that fiscal policy may be the catalyst in 2018. With the passing of the Tax Cuts and Jobs Act of 2017 in December, Donald Trump recorded his first major legislative win since taking office. Despite falling way short of promises made during his campaign, the Bill is the most significant overhaul to tax legislation in the US in over a decade and will see corporations and most individual tax payers pay less.

The reduction in headline corporate tax rate from 35% to 21% could have far reaching consequences with large multinationals potentially being tempted to move their operations back to the United States. The possibility of a race to the bottom would be even more detrimental to Ireland if other developed countries begin to consider matching or even undercutting the US. Of course, a headline rate of 12.5% still makes Ireland very attractive. That said, recent disputes between Ireland and the EU over supposed taxation revenues owed to the state by Apple only serves to shine an unnecessary media spotlight on Ireland, a spotlight typically reserved for showcasing our "Céad Míle Fáilte" welcome for foreign direct investment and tourism.

European Drivers

2017 was a hectic year for European politics. In Europe, France elected a new president, German government coalition talks hit an impasse following a disastrous September election while EU integration was put to the test with the unruly events following the Catalonian referendum. Brexit negotiations rumbled on with every breakthrough followed by another deadlock. "Sufficient progress" were the two words uttered by UK Prime Minister Theresa May alongside her EU counterpart Jean-Claude Juncker in December. That allowed Brexit talks to move to phase 2 after nearly 7 months of negotiations. Talks will restart in late January with the focus on developing a transition agreement for the 2 years following the UK's exit in March 2019. Once this agreement has been reached, the small issue of a trade agreement will only then be discussed.

Despite this, the Eurozone is undoubtedly in a healthy position. The latest annualised growth numbers show GDP of 2.6% compared to the US's 2.3%, while unemployment has fallen to its lowest level since 2009 alongside manufacturing sector growth which is at its highest level since surveys began in 1997. This economic strength helped to push the Euro to $1.20, a rise of just under 14% for the year. It is important that this rebound does not lull the bloc into a false sense of security with many of the member states still needing to significantly reduce their government debt while structural reform on a high level is required. Eurozone leaders have been advised to "fix the roof while the sun is shining" by IMF counterparts.

For further information please contact:

Bronagh Traynor (btraynor@invesco.ie)
Finian O'Driscoll (fodriscoll@invesco.ie)

Dublin 2 Sandyford Business Centre, Burtonhall Road, Sandyford, Dublin 18, Ireland
tel +353 1 294 7600 fax +353 1 294 7633

Cork No. 6 Lapp's Quay, Cork, Ireland
tel +353 21 480 8041 fax +353 21 431 0530

web www.invesco.ie email info@invesco.ie

invesco