# Corporate Client Update

*July 2018*

## Market Review Q2 2018

**Trade war threats**
Where Q1 2018 might have been characterised by simmering economic relationships between some of the world's biggest economies, trade tensions escalated in Q2 as tit-for-tat retaliatory tariffs threatened global economic growth. In response to Donald Trump's Q1 tariffs of $50 billion on Chinese imports to the US, China imposed a 25% tariff on a list of US products including soybeans and orange juice. As the quarter drew on, Trump took aim at Europe, threatening a 20% tariff on imported vehicles while speculation is mounting that he has planned further, more punitive measures for China, including a complete ban on Chinese investment in US Technology companies. Stock markets have generally shrugged off trade worries so far in 2018, with some exceptions, but if events continue to trend in the same directions, we are likely to see some disruption in equity markets.

**Equities**
In the US, the 3 major benchmark indices added another quarter of positive gains as strong earnings season drove returns. The tech heavy NASDAQ continues to lead the way, having added 6.61% in Q2, contributing to a 9.37% gain YTD. Having stumbled in spring, hurt by Facebook's handling of its user's personal information and worries around demand for Apple's new iPhone X, the index has rebounded and continues to outperform despite worries around inflated valuations.

The big losers from trade wars so far are in Europe and Asia. While Germany's DAX Index still added 1.73% over the quarter, it is seen as particularly sensitive to Trump's proposed tariffs given its heavy weighting to export focused car companies. The index has seen some of the heaviest selling this year, down 4.73% YTD. China's SHANGHAI Composite, meanwhile, has officially entered bear market territory. The index has declined over 20% from its January peak as a slowing economy and a deteriorating trade relationship with the US has investors worried about Chinese stocks.

**Fixed Income**
Political uncertainty in Spain & Italy sent peripheral Eurozone bond yields soaring in May as investors worried about the future of the European Union. The flight to safety to German Government drove the 10 Year Bund yield significantly lower resulting in the Bund's best week in almost 6 years. German Yields remained depressed for the remainder of the quarter, closing on the 30th of June at 0.31%, down 18 bps since the end of Q1.

Treasuries yields, in contrast, experienced some substantial upward pressure over the quarter. With inflation picking up and the US economy operating at almost full employment, the 10 Year US treasury peaked at over 3% in May. The upward momentum led to the Fed raising the Funds Target rate for the second time this year to a range of 1.75%-2.00%. Yields came back somewhat towards the end of June reflecting the increased geo-political risk but still finished the quarter up 11bps at 2.85%.

**The US Dollar rebounds**
After years of confounding economists with its unexplained weakness, the USD is finally staging a comeback. The 2nd quarter of 2018 saw the Greenback gain 4.98% against the Euro & 3.14% against the Yen respectively. A stronger US Dollar is good news for Euro investors in global equities given the heavy weighting to the US in the FTSE World.

## Active Managed Fund Highlights

| | |
|---|---|
| Average Return for Q2 | 3.9% |
| Best Performer for Q2<br>*Davy Asset Management* | 4.8% |
| Average Return 1 Year | 5.3% |
| Best Performer 1 Year<br>*Friends First* | 6.6% |
| Best over 3 years<br>*Setanta Asset Management* | 6.7% p.a. |
| Best over 5 years<br>*Setanta Asset Management* | 10.6% p.a. |
| Best over 10 years<br>*Setanta Asset Management* | 8.7% p.a. |

### Key Market Indices – Summary of Returns to 30th June 2018 (in Euro terms)

| Asset Class | Q2 % | YTD % | 1 Yr % | 3 Yrs % p.a. | 5 Yrs % p.a. |
|---|---|---|---|---|---|
| Cash: 3 Month Euro Bank Deposit | -0.1 | -0.2 | -0.4 | -0.3 | -0.2 |
| Government Bonds: ML EMU Gov't > 5 Year Bond Index | -1.1 | 1.1 | 2.9 | 3.5 | 6.0 |
| LT Government Bonds: ML EMU Gov't > 10 Year Bond Index | -1.5 | 2.0 | 4.3 | 4.7 | 7.9 |
| Euro Corp Bonds: ML EMU Corporate Large Cap Bond Index | -0.2 | -0.6 | 1.2 | 2.5 | 3.3 |
| Global Equity: FTSE World Index | 6.2 | 2.8 | 8.6 | 7.3 | 12.5 |
| Emerging Mkt Equity: MSCI Emerging Markets Index | -2.9 | -3.8 | 6.1 | 4.3 | 7.7 |
| Commodities: 50% GSCI + 50% GSCI Non-Energy Index | 8.6 | 5.8 | 9.4 | -5.7 | -4.9 |

# Summary of Managed Fund Returns

## Active Managed Funds – Summary of Returns to 30th June 2018

| Manager | Q2 % | Rank | YTD % | Rank | 1 Year % | Rank | 3 yrs % p.a. | Rank | 5 yrs % p.a. | Rank | 10 yrs % p.a. | Rank |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Friends First | 4.0 | 4= | 1.8 | 3 | 6.6 | 1 | 4.3 | 5 | 9.7 | 3= | 6.5 | 5= |
| Merrion Investment Managers | 3.6 | 6 | 1.1 | 5 | 4.5 | 6 | 1.6 | 7 | 8.8 | 6 | 6.6 | 4 |
| New Ireland | 2.5 | 7 | -1.1 | 7 | 3.4 | 7 | 4.5 | 4 | 8.6 | 7 | 6.5 | 5= |
| Davy Asset Management | 4.8 | 1 | 1.9 | 1= | 6.3 | 2 | 5.0 | 3 | 10.0 | 2 | 6.3 | 7 |
| Setanta Asset Management | 4.0 | 4= | 1.5 | 4 | 5.8 | 3 | 6.7 | 1 | 10.6 | 1 | 8.7 | 1 |
| Aberdeen Standard Investments | 4.2 | 3 | 1.0 | 6 | 5.1 | 5 | 3.6 | 6 | 9.7 | 3= | 7.9 | 2 |
| Zurich Life | 4.5 | 2 | 1.9 | 1= | 5.4 | 4 | 5.1 | 2 | 9.7 | 3= | 7.4 | 3 |
| Average | 3.9 | | 1.2 | | 5.3 | | 4.4 | | 9.6 | | 7.1 | |

## Active Managed Funds – Percentage Asset Allocation as at 30th June 2018

| | Equities | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Manager | Ireland % | UK % | Europe ex ROI & UK % | North America % | Japan % | Other % | Total % | Fixed Interest % | Property % | Cash % | Alternative Assets % | Total % |
| Friends First | 1.4 | 2.5 | 13.5 | 40.9 | 6.1 | 9.1 | 73.6 | 25.0 | 0.0 | 1.5 | 0.0 | 100.0 |
| Merrion Investment Managers | 2.5 | 4.5 | 14.4 | 28.5 | 9.7 | 7.9 | 67.4 | 8.3 | 2.8 | 6.9 | 14.6 | 100.0 |
| New Ireland | 1.3 | 3.9 | 23.9 | 32.4 | 5.9 | 7.8 | 75.2 | 12.5 | 4.2 | 8.1 | 0.0 | 100.0 |
| Davy Asset Management | 0.0 | 6.1 | 15.0 | 41.7 | 6.0 | 2.0 | 70.9 | 10.0 | 11.1 | 8.0 | 0.0 | 100.0 |
| Setanta Asset Management | 7.0 | 11.4 | 10.1 | 36.9 | 1.3 | 2.3 | 69.0 | 13.2 | 10.0 | 6.7 | 1.2 | 100.0 |
| Aberdeen Standard Investments | 1.2 | 3.4 | 18.2 | 37.7 | 7.6 | 8.9 | 77.1 | 11.4 | 5.8 | 5.8 | 0.0 | 100.0 |
| Zurich Life | 1.0 | 3.0 | 7.0 | 38.0 | 7.0 | 9.0 | 65.0 | 31.0 | 0.0 | 4.0 | 0.0 | 100.0 |
| Average | 2.1 | 5.0 | 14.6 | 36.6 | 6.3 | 6.7 | 71.2 | 15.9 | 4.8 | 5.8 | 2.3 | 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 30th June 2018

| Fund Name | Q2<br>% | YTD<br>% | 1 Year<br>% | 3 Yrs<br>% p.a. | 5 Yrs<br>% p.a. | 10 Yrs<br>% p.a. |
|---|---|---|---|---|---|---|
| Friends First/F&C | 2.5 | 0.0 | 6.4 | 5.4 | 9.9 | 7.4 |
| Irish Life Investment Managers | 3.9 | 1.6 | 5.7 | 5.3 | 10.1 | 7.1 |
| Average | 3.2 | 0.8 | 6.1 | 5.4 | 10.0 | 7.3 |

# Representative Fund Performance

### Summary of Returns to 30th June 2018

| Fund Name | Type of Fund | Q2<br>% | YTD<br>% | 1 Yr<br>% | 3 Yrs<br>% p.a. | 5 Yrs<br>% p.a. | 10 Yrs<br>% p.a. |
|---|---|---|---|---|---|---|---|
| Davy Global Equity | Global Equity | 6.7 | 3.3 | 9.0 | 5.9 | 11.0 | 6.3 |
| Friends First/F&C International Equity | Global Equity | 5.8 | 2.9 | 10.0 | 6.0 | 11.8 | 8.8 |
| ILIM Dynamic Global Value | Global Equity (Traditional Value Style) | 5.8 | 1.4 | 6.5 | 7.6 | 12.6 | - |
| KBI GI Dividend Plus Global Equity | High Yield Global Equity | 6.1 | 0.2 | 6.4 | 5.8 | 10.8 | 9.8 |
| KBI GI Innovator | Alternative Investment Themes/Trends | 3.0 | -2.3 | 3.7 | 1.3 | 4.6 | 1.0 |
| Merrion Global Equity | Global Equity | 5.6 | 1.5 | 6.2 | 1.2 | 9.9 | 7.5 |
| Merrion High Alpha | Concentrated Absolute Return Fund | -0.3 | 0.5 | 0.0 | -3.4 | 5.2 | - |
| New Ireland Consensus IRIS 2022+ | Target Date Lifestyle Fund | 1.8 | 0.4 | 4.1 | 4.1 | 6.8 | 5.5 |
| Setanta Dividend Fund | High Yield Equity | 3.6 | 0.5 | 4.2 | 6.0 | 10.7 | 9.4 |
| Setanta Global Focus Fund | Concentrated Global Equity | 8.1 | 4.2 | 12.4 | 7.0 | 11.0 | 12.5 |
| Aberdeen Standard Investment GARS | Absolute Return Fund | -2.5 | -4.9 | -3.9 | -2.2 | 1.3 | 4.6 |
| Aberdeen Standard Global Equities | Global Equity | 6.5 | -0.5 | 2.7 | 1.6 | 9.3 | 8.0 |
| Zurich Life 5*5 Global Equity | Concentrated Global Equity | 4.9 | 2.1 | 10.3 | 5.8 | 10.5 | 6.5 |
| Zurich Life International Equity | Global Equity (Rotational Style) | 5.9 | 2.3 | 8.0 | 6.9 | 12.0 | 9.0 |

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# Market Outlook

*Outlined briefly below are some of the key considerations with respect to the outlook for the economy for the third quarter of 2018 with a specific focus on the potential implications of a global trade war, concerns relating to emerging markets and the outlook for fixed income in a rising interest rate environment.*

**Trade Wars**

"When you're already $500bn DOWN, you can't lose." No these are not the words of a gambler but rather the President of the most powerful country in the world. Donald Trump has threatened much since he took office in January 2017 but the reality is that delivering reform has been much more difficult set against the backdrop of a Congress opposed to many of his draconian measures. However, Trump has been able to use loopholes to bypass Congress in his crusade to create a protectionist US Economic policy, supposedly designed to help US producers. By citing a number of Trade Acts designed originally to allow presidential interference on issues of national security, Trump has been able to impose 25% tariffs on steel imports and 10% on aluminium. Similarly, he appears to be primed to block Chinese ownership from buying US companies in the "industrially significant technology industry" by invoking the International Emergency Economic Powers Act of 1977 which was last used after 9/11 to cut off finances to terrorist networks .

But what are the implications of these tariffs and what risks do they pose to pension scheme members? As other countries are emboldened to retaliate, something we have seen over the quarter in Europe and China, there is a very real risk that a full scale global trade war may break out. Now despite Trump's protestations that "trade wars are good and easy to win", history has taught us that this is not the case. In a globalized world, tariffs can impart serious damage to the freely flowing exchange of goods and services. Put simply, if the price of steel is inflated due to tariffs, businesses will pay more for the steel they use to produce goods and individual consumers will pay more for products using steel. As these tariffs become more prohibitive for companies and consumers alike, stocks will suffer. In a recent example of how equity performance may be adversely affected by a trade war, Harley Davidson's stock price fell 7% after they signalled their intention to move the production of motorcycles from the US to their international base upon forecasting that retaliatory European trading bloc tariffs would cost the company $100m a year.

**Emerging Market (EM) worries**

One of the big concerns to emerge from the second quarter of 2018 centred around emerging markets. With the Fed well on the way to normalising monetary policy and the US Dollar finally beginning to respond, emerging markets have come under pressure. Taking advantage of the generous interest rates on offer in the US over the last number of years, EM companies borrowed significantly in USD denominated debt to finance the expansion of their manufacturing and export capacities and to fuel growth. The combination of rising rates and a stronger US dollar is frightening for highly leveraged EM companies as they try and service this debt. In Q2 2018, we saw massive depreciation of emerging market currencies (Argentina Peso, Turkish Lira, Brazilian Real to name a few) vs the USD and we are now seeing this weakness reflected in the performance of EM stocks. The MSCI World Emerging Markets Index lost 3% of its value in Q2 and is likely to continue to suffer over the coming few quarters.

From a long-term investment perspective, however, the fundamental reasons for owning emerging markets exposure remains as strong as ever. As these countries continue to make economic and political progress, they have larger potential for growth than their developed counterparts. With favourable demographics and a growing middle class, emerging market companies have huge scope to grow earnings. Undoubtably there will be headwinds along the way, not least in the coming years, but we still feel that emerging markets exposure is an important part of a well-diversified portfolio.

**Fixed Income**

We have discussed the implications of rising interest rates in these pages in previous quarters. As central banks continue to normalise their monetary policy we expect fixed income will continue to come under pressure. The yield on the German 10 Year Bund is currently at 0.31%. The general consensus is that as the ECB continues along their path to normalisation, this is likely to trend higher over the short to medium term resulting in disappointing returns over that period. Given a rising interest rate environment, it may be time for investors to consider how they position bonds within their portfolio.

Invesco undertook a project over Q2 2018 to explore the fixed income universe in much greater detail focusing on some of the more specific areas within the asset class that we feel might offer better opportunity to generate income in this difficult environment for fixed income investors. If you would like to learn more about some of our findings - please contact us. We would be happy to forward on a paper recently completed on the topic.

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