The Investor
Summer 2018

2018 Investment Outlook – Ireland & the World

The global economy has continued to perform strongly since the beginning of the year but challenges such as Brexit, Donald Trump's trade wars and geopolitical tensions may stall future growth.

Strong US economic growth in 2018 has been undermined by an increasing number of geopolitical risk factors. Political tensions in North Korea, a slide into trade wars, and difficult to predict elections in pivotal countries (Brazil, Mexico and the US) are all risks. The ugly and factional politics of immigration, income inequity and pension reform have left major questions hanging over government policies in many advanced economies.

Rising interest rates in the US and the stronger dollar are casting shadows over Emerging Market economies. Emerging Markets are also facing complications from politics, ranging from the re-election of Turkey's autocratic President Erdogan to public frustration with the political establishment in Brazil and Mexico. In addition, Argentina and Barbados have already been forced to go to the International Monetary Fund for help.

US equities have outperformed their European and Chinese counterparts in the year to date, but global markets are likely to remain sensitive to the geopolitical menu in the weeks ahead for a number of reasons:

- *The negative tone and substance of China-US relations has a substantial impact on the global economy.*
- *The questionable survival of the Merkel government in Germany is integral to the EU's overall coherence on policy matters.*
- *The ongoing slide into real trade wars is beginning to have an impact on how business leaders are approaching upcoming expenditures.*

The challenge for investors is to distinguish between rhetoric and reality, a task which is becoming more difficult as deadlines for trade actions are reached. Considering the uncertain outcomes on trade, the variance of how much trade accounts for different states' economies and the damage that can be done to the global economy, markets will have no option but to become increasingly more focused on this issue.

Eurozone growth, while decent, has slowed remarkably, posing a challenge to the European Central Bank's plans to soon stop buying bonds. Growth in Britain, where the government is grappling with the rather complicated task of leaving its biggest trading partner the EU, has stalled, forcing the Bank of England to abandon plans to raise interest rates. China, the powerhouse behind global growth rates in recent years and now locked in a trade spat with the US, looks to be slowing, and may even be in need of stimulus later this year.

World GDP Forecasts

	2017 (estimated)	2018 (forecast)	2019 (forecast)
World	3.3%	3.8%	3.4%
Ireland	7.8%	5.5%	4.0%
United Kingdom	1.7%	1.4%	1.3%
Eurozone	2.4%	2.1%	1.8%
United States	2.3%	2.9%	2.3%
Japan	1.8%	1.0%	0.9%
China	6.8%	6.5%	6.3%

Source: Merrion 30.06.18

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Ireland

The most recent figures from the Central Statistics Office showed that GDP was up 3.2% in the quarter and 8.4% in the year in real terms in the final quarter of last year. Preliminary National Accounts results for 2017 as a whole showed an increase of 7.8% in GDP and a rise of 6.6% in GNP in real terms compared with 2016. In current prices, there was a GDP rise of 7.5%, with the debt/GDP ratio for last year estimated at about 71%. Apart from a small contraction in the financial and insurance sector, all other sectors of the economy experienced growth last year:

- *Industry grew by 8.9% in volume terms.*
- *Information & communication and construction showed growth of 16.8%.*
- *Distribution, transport, hotels and restaurants grew by 1.6%.*

From an expenditure perspective, personal consumption of goods and services (an important measure of domestic economic activity and accounting for almost a third of the economy in 2017) rose by 1.9% last year. Within the capital, construction was up 16.7%, with new dwellings up 32.6%. Exports of goods and services grew by 6.9% in 2017.

Observing the total picture, the latest GDP numbers were very positive, especially when one allows for the distortions of intellectual property on the economy. Looking ahead to this year, GDP figures will continue to be impacted by intellectual property products and indeed aircraft leasing. Lower overall GDP growth is expected in 2018 but should still reach a very healthy 5-6%. The labour market continues to strengthen and the unemployment rate is set to drop to 5% before year end.

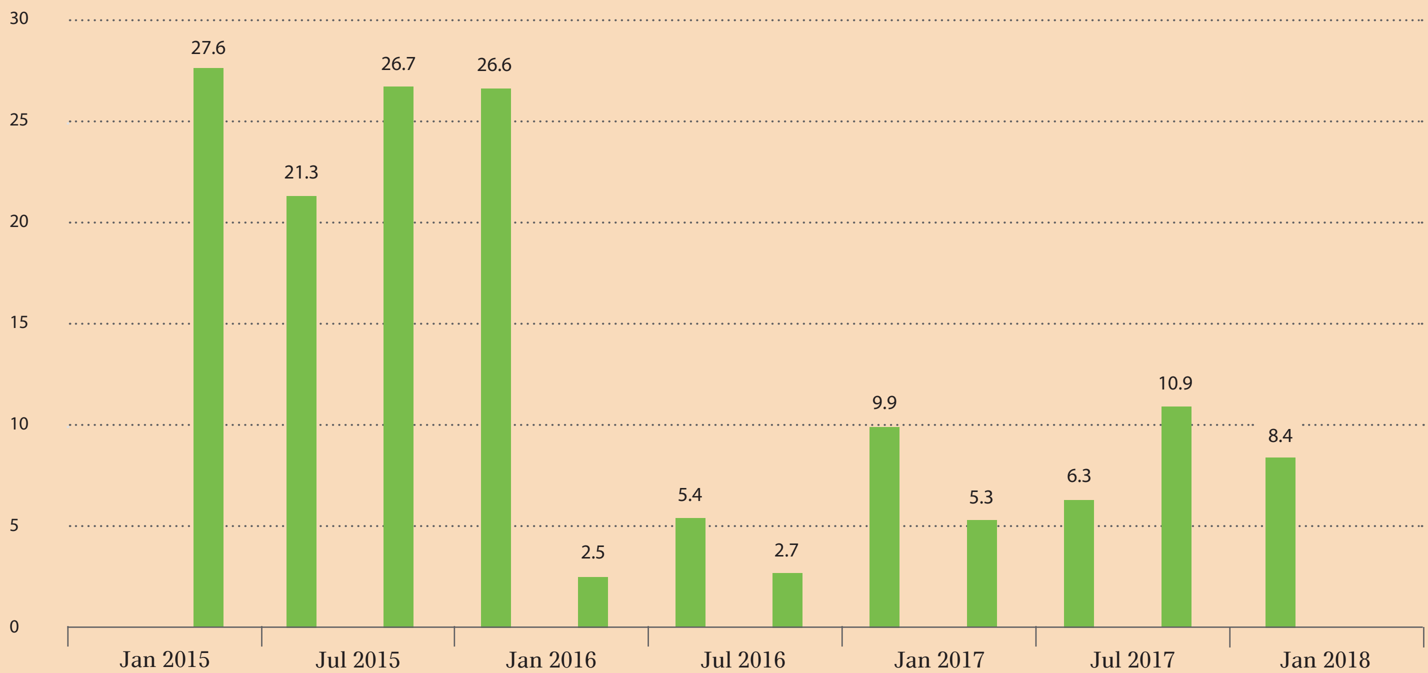
Europe

Comprehensive data confirmed that the Eurozone economy lost steam in the first quarter of the year, growing at the weakest pace since the second quarter of 2016. The wider global economy was primarily behind the slowdown, with a strong euro and slowing global recovery fuelling a decline in overseas sales. Data for the second quarter suggest that momentum has regained some lost ground, although growth will likely be below last year's highs.

The unemployment rate hit a new multi-year low in April, and strong services sector growth pushed the composite Purchasing Managers Index (PMI) up in June. That said, data for the manufacturing sector have been weak, with industrial production contracting in May and the manufacturing PMI falling to an 18 month low in June.

Moreover, the outlook for the sector has turned gloomier in recent weeks. On 22 June, US President Donald Trump threatened to slap a 20% tariff on all EU manufactured automobiles if retaliatory tariffs on US goods enacted by the EU were not lifted. While the US initial tariffs on steel and aluminium are expected to have a relatively small economic effect, the automobile industry is a much larger sector and tariffs could dampen manufacturing activity.

Ireland GDP Annual Growth Rate



Source: tradingeconomics.com | Central Statistics Office Ireland

2018 Investment Outlook – Ireland & the World

United States

Economic growth appears on track to record a stellar performance in the second quarter, fuelled by strong business investment, tax cuts and an ever-tightening labour market increasing consumer spending. In May, the unemployment rate hit a new low, and growth in retail sales accelerated as consumer confidence remained near a historic high. Furthermore, housing starts picked up in the same month, helped by rising wages and lower taxes boosting household incomes. Recent survey data indicate the private sector has so far been unfazed by current tensions with trade partners.

However, the US economy is likely to lose momentum after a strong performance in the second quarter, with the threat of a global trade war increasing the chances of a recession in the next two years, according to a recent Reuters poll. US GDP growth is forecast to average 2.9% for 2018 in a poll of over 110 economists taken in June, an upgrade from the previous month and the highest since polling began in May 2016. For the third quarter, the economy is forecast to grow at an annualised pace of 3.7%, up sharply from the 3% forecast in the previous poll. If realised, that will be the highest growth rate since the second quarter of 2015.

The median probability of a recession in the next two years edged up to 35% in the latest poll, compared to a touch below a one in three chance in the previous poll. Forecasts ranged from 15% to 75%. That rise was driven in part by growing concerns about the blowback to US industry and the wider economy from President Trump's trade battles, now overshadowing optimism about the boost from aggressive tax cuts passed late last year.

Market Performance 01.01.18 to 30.06.18

Market	Index	Local Currency	Euro
World	FTSE World (€)	2.8%	2.8%
Ireland	ISEQ	-0.8%	-0.8%
UK	FTSE 100	-0.7%	-0.2%
Europe	FT/S&P Europe Ex. UK	-3.7%	-3.7%
US	S&P 500	1.7%	4.7%
Japan	Topix	-4.8%	-0.4%
Hong Kong	Hang Seng	-3.2%	-0.8%
Bonds	Merrill Lynch Euro over 5 years	1.1%	1.1%

Source: Bloomberg: 01.01.18 – 30.06.18

China

Economic growth moderated sharply in May, mostly due to tighter financial conditions as authorities continue to crack down on shadow banking and support financial deleveraging. Infrastructure investment, which is highly sensitive to new credit, led the fall in fixed asset investment growth. While manufacturing output slowed in May, activities related to the new economy (mainly high tech) continued to post solid growth. After showing resilience for most of this year, consumption has now become a concern as retail sales growth fell to a multi-year low in May. While a drop in car sales represented the bulk of the deceleration, a further deterioration in retail sales could seriously hit growth in the second half of 2018.

The escalation in the trade war between China and the US continued in June, with both countries targeting $50bn in import tariffs. While the impact is expected to be rather limited, it represents another step towards a full-blown trade conflict. Although recent data suggest the economy is losing steam, China will still record enviable growth this year, mainly due to resilient domestic demand. The main risks to the economic outlook are rising trade tensions, fears of abrupt financial deleveraging and a cooling housing market, however, authorities will likely step in if growth slows sharply. Growth of 6.5% is forecast for 2018 and 6.3% for 2019.

Japan

Although the economy appears to be recovering from the 'soft patch' in the first quarter, recent data suggest that the rebound will be weaker than expected. Moreover, consumer confidence remains constrained by disappointing income growth. Export growth remained relatively robust in the first two months of the second quarter. However, rising trade protectionism in the US, which enacted tariffs on aluminium and steel imports from Japan, along with evidence that the global tech cycle likely peaked in the first quarter, pose downside risks to Japan's external sector.

Meanwhile, in June the Japanese cabinet approved a new midterm fiscal plan that pushes back from 2020 to 2025 the goal of achieving a primary budget balance and removes an important spending cap. While the plan was widely expected, it delays efforts to reduce the country's massive public imbalances. Japan will continue to benefit from the Bank of Japan's ultra-loose monetary policy and a tightening labour market. Moreover, investment should remain robust in the wake of works related to the 2020 Tokyo Olympics.

Managing Risk with Multi-Asset Funds

Diversified Opportunities Funds invest in a range of assets, countries and market sectors, diversifying your investment across many different asset classes.

Recognising that clients require investment solutions that match their needs, Invesco developed the Diversified Opportunities multi-asset funds. These funds aim to generate long term capital growth and target specific levels of volatility with returns appropriate to a client's calculated risk profile. Each of our three Diversified Opportunities Funds includes equities, bonds (fixed interest), property, cash and alternatives.

Risk targeted solutions

Invesco's Diversified Opportunities Funds are designed and managed to defined risk targets which match a predetermined volatility scale. The funds give the investor access to a blend of international active and passive fund managers across a range of sectors, asset classes and geographic areas.

With multi-asset funds, different asset classes behave at least partly independently of one another, so that a drop in one asset class will not put your entire investment in danger. For example, should equities drop in price, this may be offset by a rise in prices of alternative assets. All of the managing and monitoring can be left to the fund manager, who will adjust the asset allocation of the fund depending on the markets.

Funds which specialise or concentrate their investment in specific regions, sectors (such as emerging markets or smaller companies) or in a smaller number of shares can result in greater fluctuations in value. Funds that invest in a wide range of sectors or shares generally carry less risk.

Risk Control Measures

- **Investment Committee**
  Establishing a house view on investment markets, due diligence for each fund manager, monitoring asset allocation and performance.
- **Selection Criteria**
  Independent rating of each fund by Morningstar OBSR and in-depth statistical analysis by Irish Life Investment Managers of fund manager investment strategy and credentials.
- **Rebalancing**
  Quarterly rebalancing of funds to keep them in line with the agreed risk profile.
- **Asset Allocation**
  Annual formal reviews of our investment strategy with independent oversight. Asset allocation is carefully controlled and operates within a robust risk structure which defines the optimum ranges for the different asset classes.

Asset Class	Diversified Opportunities Fund 3 Low/Medium	Diversified Opportunities Fund 4 Medium	Diversified Opportunities Fund 5 Medium/High
Equities	31%	46%	69%
Property	14%	14%	14%
Alternatives	24%	20%	12%
Fixed Interest	26%	16%	5%
Cash	5%	4%	-
Total	**100%**	**100%**	**100%**

Asset splits are for guidance purposes only and are subject to change.

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