Corporate Client Update

October 2018

Market Review Q3 2018

Ignorance is bliss
Q3 2018 saw a continuation of some of the same themes that have been prevalent in markets this year. Global trade tensions dominated financial markets as the ongoing trade war between the United States and the rest of the world intensified. A currency crisis in Turkey threatened to destabilise the European banking system while emerging market weakness continued as South Africa plunged into recession and Argentina struggled with its enormous debt burden. Yet despite a seemingly endless list of geopolitical issues and economic warning signs, the performance of stocks betrayed little evidence of investor concern. Ignorance is bliss.

US stocks race clear
Ten years on from the collapse of Lehman Brothers, the US economy is in rude health. Unemployment is at a record low with August becoming the 3rd consecutive month where available jobs outnumbered unemployed workers. Wages are growing at their fastest rate in 9 years and GDP numbers are equally impressive. These strong economic foundations are helping to drive seemingly overpriced US stocks to new highs. The S&P 500 has returned in the region of 200% since the Lehman collapse and it added another 7.7% this quarter. The NASDAQ and DJIA also finished the quarter significantly higher as the US continue to lead the way for stock returns.

Political unrest is proving to be quite a headwind for European equities. With governments in Italy, Spain, Sweden and the UK struggling with policy, equities in the region are being left behind by their US counterparts. The French CAC 40 was the best performing major European Index over the quarter adding 3.36% as investors remain enthusiastic about President Macron's pro-business reform agenda.

Yields higher across the board
We have seen significant moves in bond yields over the quarter. The yield on the 10 Year German Bund rose 17bps to 0.47% while the yield on the equivalent UK gilt finished the quarter up 29bps at 1.57% helped by the BOE's 2nd rate hike in 10 years.

Meanwhile in the US, the 10 Year Treasury finished the quarter at 3.06%, up 21bps from the end of Q2. With the US economy chugging along, the Federal Reserve has met its dual objectives and is continuing its march towards normalisation. September marked the 8th interest rate rise in the last 3 years as the Fed Fund's target rate moved to a range of 2.00%-2.25%.

EM currency rout continues
US Dollar momentum slowed in Q3 as it remained broadly flat versus the Euro. The Greenback has been the subject of much conjecture this quarter as current US administration policies of unilateralism, trade wars and sanctions have raised the question among other global superpowers as to whether the rest of the world should diversify away from the risks of the USD, replacing the world's primary reserve currency.

The bigger moves in currency markets, as in Q2, were contained to emerging markets. The Indonesian Rupee, Argentinean Peso, South African Rand and Turkish Lira were amongst the worst hit as these nations grapple with their debt in a rising interest rate environment.

Active Managed Fund Highlights

Average Return for Q3	3.1%
Best Performer for Q3 *Davy Asset Management*	4.5%
Average Return 1 Year	7.2%
Best Performer 1 Year *Davy Asset Management*	10.6%
Best over 3 years *Setanta Asset Management*	10.1% p.a.
Best over 5 years *Setanta Asset Management*	11.0% p.a.
Best over 10 years *Setanta Asset Management*	9.7% p.a.

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

Asset Class	Q3 %	YTD %	1 Yr %	3 Yrs % p.a.	5 Yrs % p.a.
Cash: 3 Month Euro Bank Deposit	-0.1	-0.3	-0.4	-0.4	-0.2
Government Bonds: ML EMU Gov't > 5 Year Bond Index	-1.3	-0.2	0.7	1.8	5.5
LT Government Bonds: ML EMU Gov't > 10 Year Bond Index	-1.6	0.4	1.8	2.3	7.5
Euro Corp Bonds: ML EMU Corporate Large Cap Bond Index	0.0	-0.6	0.0	2.6	3.0
Global Equity: FTSE World Index	5.7	8.6	13.2	12.8	12.9
Emerging Mkt Equity: MSCI Emerging Markets Index	-0.4	-4.3	1.3	11.3	7.2
Commodities: 50% GSCI + 50% GSCI Non-Energy Index	-1.0	4.7	9.4	-0.8	-4.9

Summary of Managed Fund Returns

Active Managed Funds – Summary of Returns to 30th September 2018

Manager	Q3 %	Rank	YTD %	Rank	1 Year %	Rank	3 yrs % p.a.	Rank	5 yrs % p.a.	Rank	10 yrs % p.a.	Rank
Friends First	2.7	5	4.5	4	8.0	3	7.9	3=	9.4	4	7.9	4
Merrion Investment Managers	2.1	7	3.2	6	4.5	7	4.3	7	8.3	6	7.8	5
New Ireland	2.8	4	1.7	7	5.1	6	7.9	3=	8.2	7	7.7	6=
Davy Asset Management	4.5	1	6.5	1	10.6	1	8.7	2	10.4	2	7.7	6=
Setanta Asset Management	4.2	2	5.7	2	8.7	2	10.1	1	11.0	1	9.7	1
Aberdeen Standard Investments	2.3	6	3.4	5	6.1	5	7.2	6	9.1	5	9.3	2
Zurich Life	3.2	3	5.2	3	7.5	4	7.7	5	9.6	3	8.5	3
Average	3.1		4.3		7.2		7.7		9.4		8.4	

Active Managed Funds – Percentage Asset Allocation as at 30th September 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	12.5	42.5	6.1	9.6	74.6	23.9	0.0	1.5	0.0	100.0
Merrion Investment Managers	1.7	4.1	13.2	32.9	8.6	9.1	69.7	7.8	2.8	5.5	14.3	100.0
New Ireland	1.1	3.7	23.3	32.4	5.8	8.1	74.5	13.6	4.4	7.5	0.0	100.0
Davy Asset Management	0.0	5.8	14.6	43.5	5.9	1.6	71.3	10.1	10.9	7.7	0.0	100.0
Setanta Asset Management	7.1	11.6	10.3	36.9	1.5	2.5	69.9	14.1	9.7	5.2	1.1	100.0
Aberdeen Standard Investments	0.9	4.3	16.7	39.3	6.9	9.2	77.3	15.0	6.1	1.6	0.0	100.0
Zurich Life	0.0	3.0	10.0	40.0	7.0	9.0	69.0	26.0	0.0	5.0	0.0	100.0
Average	1.7	5.0	14.4	38.2	6.0	7.0	72.3	15.8	4.8	4.9	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 30th September 2018

Fund Name	Q3 %	YTD %	1 Year %	3 Yrs % p.a.	5 Yrs % p.a.	10 Yrs % p.a.
Friends First/F&C	2.5	2.5	6.4	8.3	9.7	8.8
Irish Life Investment Managers	3.1	4.7	7.5	8.4	9.8	8.4
Average	2.8	3.6	7.0	8.4	9.8	8.6

Representative Fund Performance

Summary of Returns to 30th September 2018

Fund Name	Type of Fund	Q3 %	YTD %	1 Yr %	3 Yrs % p.a.	5 Yrs % p.a.	10 Yrs % p.a.
Davy Global Equity	Global Equity	6.2	9.7	15.2	11.5	11.5	8.4
Friends First/F&C International Equity	Global Equity	4.4	7.4	12.7	11.2	11.8	10.3
ILIM Dynamic Global Value	Global Equity (Traditional Value Style)	5.8	7.3	11.4	12.6	12.9	-
KBI GI Dividend Plus Global Equity	High Yield Global Equity	4.6	4.8	9.9	11.2	10.9	10.5
KBI GI Innovator	Alternative Investment Themes/Trends	1.7	-0.7	3.6	8.5	4.6	2.9
Merrion Global Equity	Global Equity	3.5	5.0	7.8	5.8	9.7	9.2
Merrion High Alpha	Concentrated Absolute Return Fund	0.1	0.7	-0.8	-3.2	3.4	8.2
New Ireland Consensus IRIS 2022+	Target Date Lifestyle Fund	1.7	2.1	4.3	5.4	6.5	6.9
Setanta Dividend Fund	High Yield Equity	4.1	4.7	7.6	9.6	10.6	10.4
Setanta Global Focus Fund	Concentrated Global Equity	4.9	9.3	13.1	11.3	12.2	13.4
Aberdeen Standard Investment GARS	Absolute Return Fund	0.1	-4.8	-3.0	-1.5	1.1	5.1
Aberdeen Standard Global Equities	Global Equity	2.2	1.7	3.9	6.0	8.2	9.5
Zurich Life 5*5 Global Equity	Concentrated Global Equity	5.1	7.3	12.9	10.6	11.1	7.7
Zurich Life International Equity	Global Equity (Rotational Style)	4.9	7.3	11.5	11.6	12.2	10.0

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Market Outlook

Briefly outlined below are some key considerations with respect to the outlook for the economy for the fourth quarter of 2018 with a specific focus on the potential implications of a global trade war and concerns around the Italian debt problem. Also included is a snippet from the latest edition of the Invesco Education Series.

Trade War moves to the next level

We have alluded to the potential negative implications of a global trade war before and despite Donald Trump ratcheting up the terms in the interim – stock markets have been relatively unaffected. Trump has now levied $250 billion of tariffs on imports from China and is threatening tariffs all $500 billion of imports. China meanwhile, who import less than a quarter of the flow in the opposite direction from the US, have already imposed tariffs on all of their imported American products leaving them with little room to manoeuvre should Trump continue to attack the trade account deficit.

Who will win this trade war? It depends who you ask. One train of thought is that the United States account for roughly 25% of the worlds GDP and the health of China's economy is heavily dependant on exporting to the US so, the thinking goes, the Chinese government will capitulate to American demands. On the other hand, about 60% of China's exports to the US are produced at factories owned by non-Chinese countries so tariffs imposed by the Trump administration that are directed at China are actually hitting American and European companies. Likewise, much of what the US imports from China has value created in other locations. For example, an imported washing machine has parts sourced and manufactured in places like Korea, Japan and America itself. So once again, tariffs targeted at the Chinese are actually landing back on Trump's doorstep

One thing is clear – after almost seven decades of trade liberalisation – a global shift towards protectionism and open-ended trade disputes will have geopolitical consequences. While JP Morgan is forecasting lower growth by only 0.25% as a result, they acknowledge their model cannot capture the potential of the larger drag if business sentiment declines. A more realistic guess may be from the BOE who estimate that a full-blown trade war will hit global GDP by 2.5% over 3 years.

Italian Concerns

On the other side of the world, Italy's new populist leaders are causing headaches for the rest of the European Union. Intent on following through on the promises that brought them into power, the coalition of the 5 Star Movement and League parties announced their 2019 budget plans in September and it did not make for popular reading for the rest of the EU. Despite possessing a debt to GDP ratio of 130%, the second highest in the Euro area after only crisis-stricken Greece, the plans announced would push the Italian budget deficit to 2.4% of GDP or 3 times the size of the spending gap under the previous administration. Although that remains within the EU's 3% limit, it violates the further requirement that highly indebted nations make a genuine effort to shrink their debt burden, which in Italy's case would require a deficit significantly smaller than 2%.

Although it may not seem like much of a difference, it could have big consequences for Europe. If investors lose confidence in Europe and Italy's ability to control this debt, European leaders may be looking at the next Greek debt crisis except this time it will be an altogether more serious issue as Italy are Europe's third biggest economy. Initial investor reaction to the budget has been a cause of concern as yields on Italian government debt spiked and Italian stocks sold off.

Exchange Traded Funds - ETFs

The pension & investment landscape is constantly evolving. New technologies combined with changing market structures and regulatory shifts are driving a dynamic investment environment which is ripe with new investment opportunities. There has been a noticeable shift in attitude amongst investors over the last 20 years who are no longer willing to pay the same price for simple index tracking funds or indeed the much higher fees for active managers. Taking advantage of this trend of fee compression, ETFs have seen rapid growth since their inception in 1993. While ETF's are now fairly common for private investors, allocating funds through their local broker or investment advisor, we have not seen them penetrate the institutional pension market in Ireland to the same degree.

Invesco undertook a project over Q3 2018 to gather more information on ETF's and the potential benefits and drawbacks of their use within the Irish pension's industry. We looked at commonly cited cost advantages as well as access to niche asset classes and compared these to traditional pooled fund options. If you would like to learn more about some of the conclusions we came too - please contact your Investment Consultant. We would be happy to forward on the recently completed paper on the topic as part of the Invesco Education Series.

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