DART CAPITAL

Market Commentary

May 2018

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May saw geopolitics come to the fore, with political upheaval in Italy and a number of Emerging Markets, along with the rejection of the Iran nuclear deal by the US government, serving to unsettle markets.

UK

In line with the market's expectation, the Bank of England's Monetary Policy Committee (MPC) voted in favour of keeping the base rate at 0.5% in their meeting on the 9th May, with the recent deterioration in economic data sufficient to perturb the Committee from increasing borrowing costs at this time. Despite this show of caution, it is clear that the Bank of England are keen to follow a similar path as the Federal Reserve in raising the base rate later this year should the economy recover even modestly following a very weak, albeit weather-affected, first quarter. This expectation is outlined in the minutes from the Committee's meeting, which stated that the MPC continue to "expect a limited tightening of policy will be required over the forecasting period in order to control inflation".

Notably, survey figures released over the month indicated that the economy has picked up modestly so far this quarter, whilst the most recent available data showed that nominal wage growth increased to 2.9% year-on-year in March, a sign that the labour market is still in reasonable health. Domestic inflation, as measured by the Consumer Price Index (CPI) continues to moderate, with the figures from the Office of National Statistics (ONS) showing prices increased 2.4% year-on-year in April, a modest fall from March's 2.5% reading and significantly below the most recent peak of 3% reached in November 2017. It should be noted that we expect the inflation rate to stabilise at around the current level over coming months as the impact of the recent uptick in petrol prices feeds into the data. Sterling weakened a further 3.5% against the US Dollar over the month. This was largely as a result of the US Dollar strength as opposed to sterling weakness and the Pound ended the period broadly unchanged against the Euro.

UK equities enjoyed another strong month, with the combination of the stronger US Dollar, buoyant commodity prices and the uncertainty in the Eurozone and Emerging Markets helping increase the relative attractiveness of the UK market, which remains significantly under-owned by international investors. MSCI UK All-Cap gained 2.2% over the month in capital return terms. Within the bond market, the flare-up of concerns over the Eurozone late in the month caused a safe haven rally in the Gilt market, with the yield on the 10-year Gilt ending the month 19 basis points (bps) lower at only 1.23%.

US

Data released by the US Department of Commerce showed that personal spending grew by an impressive 0.4% in April, figures which, albeit flattered somewhat by higher than normal utility spending, are indicative of household consumption growth of around 3% over the second quarter. This buoyant growth backdrop was supported by survey data from the manufacturing sector which showed activity reached its highest level since the summer of 2014, whilst the reading from the services sector also strengthened.

Having come under pressure over the first quarter of the year on the back of concerns over the growing US fiscal deficit, which is expected to exceed $1trillion this year as a result of President Trump's corporate and household tax cuts, the US Dollar has reversed course and strengthened significantly since mid-April. This turnaround in sentiment can be attributed to markets re-focusing on the comparative strength of the US economy when compared to the slowdown being experienced in the rest of the developed world and rising US interest rates – the Federal Reserve have now raised interest rates 6 times in this hiking cycle - which make the US a more attractive home for investors' capital.

Having traded as low as $1.25 against the Euro in mid-April, the Dollar has since gained over 7% against the single currency and ended the month at below $1.17. US equities, as measured by the large-cap S&P 500 index, returned 2.2% over the month, although this gain owed largely to the strong performance of the Information Technology sector, which accounts for around 25% of the index and gained 7.1% over the period on the same basis.

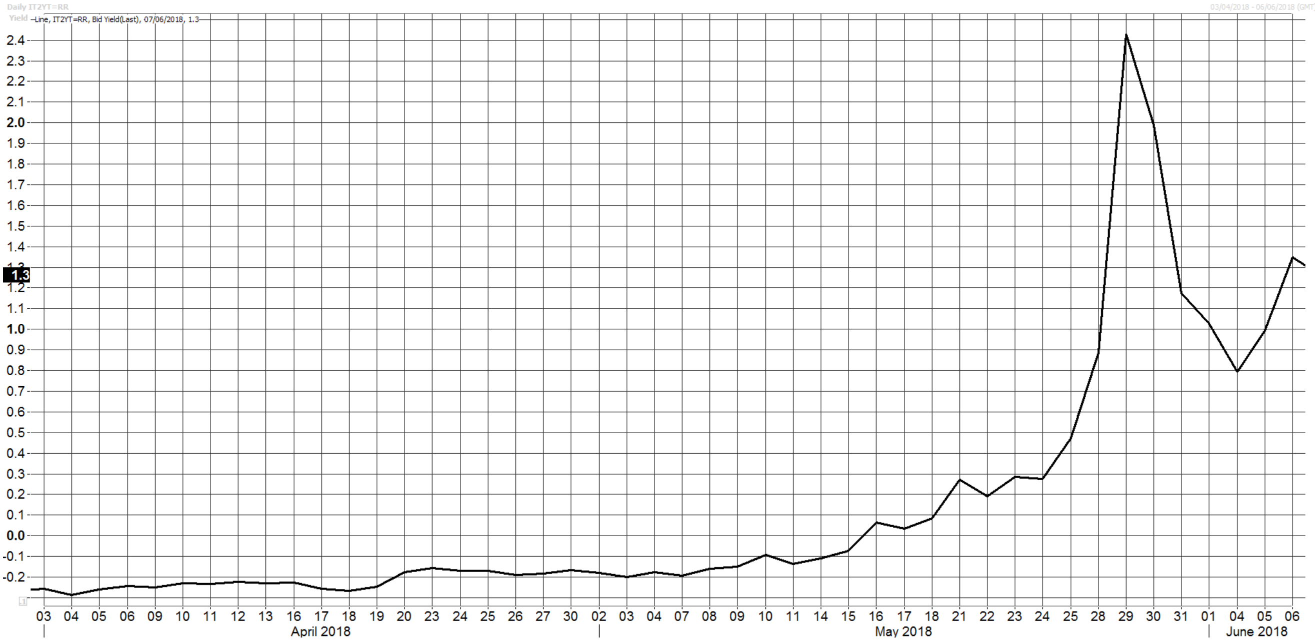
Eurozone

The initial estimate from Eurostat showed that the Eurozone economy grew 0.4% in the first quarter, a significant slowing from the 0.6% rate achieved in the final quarter of 2017. Survey data also indicates that the economy has lost some momentum since the start of the year. Although the cause of the slowdown in the Eurozone is not completely clear, concerns over a potential trade war with the US and adverse weather are likely partly to blame. Furthermore, based on demographic and productivity rates, it is unlikely that the Eurozone can grow at an annualised pace of above 1.5% over the longer-term, a rate which is well below the 2.7% delivered last year. Therefore, it should be noted that a slowdown in growth was to be expected this year. Whilst the pick-up in the oil price is set to boost inflation over coming months, core inflation (which excludes food and energy) within the currency bloc remains subdued and is currently running at only 0.7% year-on-year, well below the European Central Bank's target.

Late in the month saw the political fragility at the core of the Eurozone project come back to the fore. Investors focused on the unstable political situation in Italy, which is still without a government following March's general election. The situation escalated towards the close of the month as the proposed appointment of a Eurosceptic as Finance Minister and a power-share between two populist parties led to growing concerns that Italy could look to leave the Eurozone. This led to the yield on Italian government and corporate bonds spiking, and a sell-off in the country's equity market, as investors priced in the risks associated with a potential move back to the Lira. This uncertainty was best demonstrated by the gyrations of the yield on the 2-year Italian government bond, which increased from -0.2% at the start of the month to a peak of over 2.4% on the 29th, before retreating somewhat at the very end of the period, as shown on the graph overleaf.

With most Italians still being in favour of remaining in the Eurozone, it remains highly unlikely that Italy will leave the currency bloc in the short-term. However, the market's dramatic reaction to the Italian situation does demonstrate the fact that many years of ECB asset purchases, whereby Italian government and corporate bonds are purchased on a large scale basis by the Central Bank along with bonds issued by other Eurozone countries, have numbed investors to the risks inherent to investing in peripheral European bonds. MSCI Europe ex-UK ended the period down 2.6% in local currency terms.

The yield on the 2-year Italian Government Bond spiked towards the end of May



Source: Thomson Reuters

Asia

The Chinese economy appears to have lost steam over recent months, with business investment and retail sales data for April coming in below the market's expectations. Infrastructure spending, which was ramped up as part of the government's 2016 fiscal stimulus package, also saw slowing growth. Concerns over an all-out trade war between the US and China died down over the month, as China made concessions based around increasing imports of US goods, most notably natural gas, and treatment of the intellectual property of US businesses. MSCI China H, which represents the performance of Chinese stocks listed in Hong Kong, fell 2.7% over the month in local currency terms.

Emerging Markets

Having enjoyed a very strong 2017, Emerging Markets have suffered from a rockier time so far this year, with the pressure from rising US interest rates and a recent strengthening of the US Dollar causing some capital to flow out of Emerging Markets. Furthermore, idiosyncratic challenges faced by Turkey and Argentina have caused consternation for international investors.

The comments made mid-month by Turkey's President that he plans on taking control of monetary policy and is firmly against raising interest rates, concerned investors given that the Turkish economy is currently experiencing high inflation and a growing current account deficit. The comments led to a significant weakening of the country's currency, the Turkish Lira, which fell 10.2% against the US Dollar over the month. Having issued a 100 year US Dollar-denominated bond at a yield of less than 8% only a year ago, the economic backdrop in Argentina has deteriorated significantly over recent months with the country's Central Bank forced to raise domestic interest rates to 40% in May in an attempt to quell annual inflation which is currently running at around 25%. MSCI Emerging Markets, excluding Asia, lost 9.8% in US Dollar terms over the month.

Several Emerging Markets have come under pressure this year

Commodities

President Trump's decision to pull out of the Iran nuclear deal, along with ongoing supply disruption in Venezuela, caused the oil price, as measured by Brent Crude, to spike to over $80 per barrel mid-month before falling back slightly as investors looked ahead to the upcoming OPEC meeting where the cartel will agree the output quotas for the coming year. The oil price ended the month at $78 per barrel, an increase of 3.2% on the month. Geopolitical uncertainty has helped support the gold price over recent months, even as the US Federal Reserve continue to raise interest rates. The gold price ended the month down 1.3% in US Dollar terms.

Asset Class Performance – End May 2018 (in Sterling terms)

Asset Class	Dart Capital Position	1 Month	3 Months	12 Months	Index
Cash	↘	+0.04%	+0.13%	+0.39%	Bank Of England Base Rate in GBP
Fixed Interest	↘	+0.90%	+1.82%	-1.68%	L&G All Stocks Gilt Index Trust I Inc in GBP
Equities – UK	↗	+2.19%	+5.96%	+2.46%	MSCI UK All Cap in GBP
Equities – International	↗	+3.40%	+1.44%	+6.75%	MSCI All Country World Index ex UK in GBP
Property	↘	+0.33%	+1.61%	+6.95%	FE UK Property Proxy in GBP
Alternatives	↗	+0.04%	+0.13%	+0.39%	Bank of England Base Rate in GBP

Benchmarks are capital return which excludes income
Month to 31 May 2018
Treasury yields data supplied by Thomson Reuters
All other performance data supplied by Financial Express Analytics
Dart Capital positions based on Dart Capital mid risk strategy

↗ Overweight
→ Neutral
↘ Underweight