LGT Vestra Monthly Market Commentary in association with PIA Wealth Management

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While Brexit dominates domestic headlines and political discussions, Federal Reserve (Fed) policy, US-China trade negotiations and fears of slowing economic growth have had a greater impact over the last two months.

Brexit is important for the UK economy, but the UK stock market is dominated by international companies for whom the health of the economies outside the UK are more important. Where it has impacted UK stocks has been through the currency. Over the last year, the pound has swung relative to the US dollar, but this can be seen as more of a dollar move than a shift in the pound. Against the euro, the pound has traded in a far narrower range. Despite this, many UK and overseas investors have shunned the UK market because of Brexit uncertainty. For those fearing a hard Brexit, this may be a mistake, since a fall in the pound would boost foreign earnings of London-listed international companies. It would also cause inflation to rise and cash sitting in the bank would have a negative real return. If there is a softer Brexit and sterling rallies, international investors may return to the market and this could bring support despite the fall in value of overseas earnings. It remains impossible to say exactly how things will turn out. Even if Mrs May's deal is passed, the debate over our final trading relationship will continue during the transition period. It would appear that a no-deal Brexit is less likely following the recent votes in parliament but the route to an alternative still looks fraught with difficulties.

The fear last year was that the Fed was tightening too fast and could tip the US into recession. It can take two years for the economy to feel the full impact of interest rate rises. The Fed has been raising rates since December 2015 and has been withdrawing liquidity from the market through a reversal of its quantitative easing. This had seen bond yields rise and credit spreads move wider, increasing the cost of funding for companies. The Trump tax cut may have delayed the impact, but many US economic indicators are showing signs of a slow-down in growth. The tax cuts should have seen a pick-up in corporate investment, but this has been slow to materialise. The China trade dispute and government shut down over funding the wall also contributed to the malaise.

In the last month however, there have been significant moves that have lead markets to take a more positive view. Firstly, the Fed has indicated a "patient" attitude to rate rises and expectations of multiple rate rises in 2019 have been reduced. They have also indicated that they may be prepared to reduce the extent of quantitative tightening. The US trade talks appear to be making some progress and the President has indicated that the delayed increase in tariffs may be postponed further. Chinese growth is slowing and in light of Trump's desire to get re-elected next year, there are pressures on both sides to agree a deal. Finally the government shut-down has been suspended and a compromise deal has been proposed.

In Europe, exporters have felt the impact of the trade dispute. The yellow vest protests may delay economic reforms in France. Italy has shown negative growth and while they have agreed a budget, they have just postponed their deficit problems with the EU. In Germany, Merkel is coming to the end of her time in office meanwhile in Spain there has been talk of an early election. It appears that European leadership is handicapped at a time when strong leadership is needed.

Many of the fears from last year have been eased but the trade deal has not been concluded and the damage to the global economy of trade disputes and US policy tightening may continue. Markets have recovered much of the falls in the final quarter of 2018 and we remain broadly positive on equity markets but acknowledge that the risks remain high.