

Who ate all the pies?

Weekly Digest

19 March 2018

– Alex Harvey (CFA)

Last week the folk at the Office for National Statistics (ONS) released the details of their annual review of the UK inflation basket. “Pork pies out, leggings in” read the headlines as the winners and losers were announced. In all, over 700 individual items comprise this hypothetical shopping basket and once a year the statisticians review and recompile the basket in an effort to keep it representative of spending in the UK, sourcing prices from some 140 different locations around the UK. Those lamenting the quintessentially British pork pie’s departure should spare a thought for that wartime favourite corned beef which was cast aside in 2005 after 58 years in the basket! It brings new meaning to the words ‘spam filter’.

The ONS’s lead measure of inflation today - the CPIH - includes a component called Owner Occupied Housing (OOH) which incorporates costs relating to owning and maintaining one’s own home and council tax. Whilst this alters the headline division weights in the basket, all other CPI line items remain the same.* When OOH is factored in to the inflation basket then the housing, water, electricity, gas and other fuels component jumps to 30% of the overall index, of which OOH specifically accounts for nearly 17%. 0.3 percentage points separated these two measures in January with the year-on-year CPI data coming in marginally higher at 3%, both unchanged on the month. Tomorrow the February data is released with both measures expected to fall back marginally. Whilst month-on-month these data do fluctuate with a degree of noise, gilt traders will be watching closely with the Monetary

Policy Committee (MPC) meeting on Thursday. Whilst consensus is probably that near term inflation has peaked, rates markets are pricing a rate hike in May at about a 60% probability today, down from nearly 80% a little over a week ago, but up from 50/50 in early February following the hawkish tone of the Bank of England Inflation Report.

The reality though is that there is no ‘one size fits all’ measure of inflation. We are individuals and families with unique and dynamic spending patterns. I don’t know anyone with 30% housing costs who also spends 5.9% on their clothing and footwear and 2.1% on their health (and I doubt they’d know it if they did), but in aggregate, across the country and across different age groups, that’s what we spend our money on. So how should we think about inflation when planning for the future? Well in the same way that it may be unrealistic and misleading to classify gilt funds generically as ‘low risk’ (it has to depend on who the buyer is and what outcome they are seeking), so it is that inflation linked gilts are not the panacea for inflation. They may be suitable for some, but are less so for others, and their deeply negative yield today guarantee a negative real return over time. Unlike the government, we aren’t in the business of shrinking our clients’ wealth and as such we offer a range of multi asset solutions constructed with the aim of outperforming inflation by a margin over time. By focusing on specific outcomes and giving the portfolios time to perform, we can increase the likelihood of you and your clients achieving your desired goals.

The Marketplace

- Brent crude rose 0.8% last week to \$65.9 a barrel
- Gold fell by 0.6% to 1313.9 an ounce
- Global equity indices struggle for direction
- US tariffs draw ire from China as Germany seeks to thwart a trade war

Market Focus

US

- The Dow Jones fell 1.5% finishing the week at 24946.5.
- US Blocks Broadcom's hostile takeover bid of Qualcomm – it would have been the largest tech acquisition in history.
- Factory output increased 1.2% in February, total industrial production rose 1.1%.
- The US dollar weakens and markets reacted with caution on the back of constant White House personnel changes and potential scandals.
- The yield on 10-year Treasuries fell one basis point to 2.82 percent, the lowest in more than two weeks.
- The S&P index fell 1.2% to 2752 - it declined every day in the last week.

UK

- Theresa May accuses the Kremlin over the poisoning of former spy Sergei Skripal and his daughter- the UK government garnered support from the US, Germany and France.

- The UK expels 23 Russian diplomats; Russia responds by expelling an equal number of British diplomats.
- The EU publishes their latest version of the draft text of the Brexit withdrawal agreement. Broad agreement with the UK has been reached on the terms of the two year transition period.
 - The FTSE fell 0.8% to 7164.
 - UK Labour costs rose 3.7% in the last quarter when compared to a year earlier.

Europe

- Unilever to move their HQ to Rotterdam from the UK.
- Putin set for another six years in office as he wins over 70% of the vote in Russia's election.
- The Euro Stoxx 50 index rose 0.5% to 3437.4.

Asia

- Xi Jinping cements his place as Chinese leader in perpetuity. He announced sweeping restructure of government agencies and increases the strength of the central bank by merging regulatory commissions into the People's Bank of China.
- The Hang Seng rose 1.6% to 31501.9.
- The Nikkei 225 rose 0.9% to 21676.5.

Asset Class/Region	Currency	Currency returns			
		Week ending 16 March 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-1.2%	1.5%	3.2%	17.2%
United Kingdom	GBP	-0.9%	-0.8%	-6.1%	-0.1%
Continental Europe	EUR	0.0%	-0.4%	-1.6%	3.9%
Japan	JPY	1.2%	-1.8%	-4.4%	12.7%
Asia Pacific (ex Japan)	USD	1.1%	1.7%	3.4%	26.0%
Australia	AUD	-0.2%	-0.6%	-0.7%	7.4%
Global	USD	-0.7%	0.9%	1.8%	16.6%
Emerging markets equities					
Emerging Europe	USD	-2.7%	-3.2%	3.8%	23.3%
Emerging Asia	USD	1.8%	2.7%	5.0%	32.6%
Emerging Latin America	USD	-2.9%	-0.9%	8.1%	18.8%
BRICs	USD	0.8%	1.5%	7.1%	35.0%
MENA countries	USD	2.3%	2.9%	6.2%	6.9%
South Africa	USD	-4.3%	-1.6%	0.9%	22.2%
India	USD	-0.4%	-2.6%	-4.8%	13.4%
Global emerging markets	USD	0.5%	1.6%	5.0%	28.8%
Bonds					
US Treasuries	USD	0.3%	0.3%	-1.9%	0.6%
US Treasuries (inflation protected)	USD	0.2%	0.3%	-1.7%	1.1%
US Corporate (investment grade)	USD	0.2%	-0.2%	-2.8%	3.1%
US High Yield	USD	-0.2%	-0.3%	-0.6%	4.8%
UK Gilts	GBP	1.3%	1.1%	-0.8%	0.8%
UK Corporate (investment grade)	GBP	0.4%	0.3%	-1.7%	1.9%
Euro Government Bonds	EUR	0.5%	0.7%	0.5%	3.2%
Euro Corporate (investment grade)	EUR	0.0%	-0.1%	-0.4%	2.2%
Euro High Yield	EUR	-0.1%	0.1%	-0.2%	5.0%
Japanese Government	JPY	0.1%	0.2%	0.4%	1.1%
Australian Government	AUD	0.6%	0.8%	0.6%	3.8%
Global Government Bonds	USD	0.5%	0.8%	1.5%	7.9%
Global Bonds	USD	0.3%	0.6%	0.6%	7.5%
Global Convertible Bonds	USD	0.1%	1.1%	3.5%	9.8%
Emerging Market Bonds	USD	0.0%	0.2%	-2.5%	2.6%

Asset Class/Region	Currency	Currency returns			
		Week ending 16 March 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	1.3%	4.3%	-7.9%	-3.8%
Australian Property Securities	AUD	0.3%	1.8%	-5.6%	-1.9%
Asia Property Securities	USD	2.2%	1.9%	2.1%	17.6%
Global Property Securities	USD	1.1%	2.8%	-2.9%	9.2%
Currencies					
Euro	USD	-0.2%	0.7%	2.2%	14.7%
UK Pound Sterling	USD	0.6%	1.1%	3.1%	12.8%
Japanese Yen	USD	0.7%	0.6%	6.1%	6.8%
Australian Dollar	USD	-1.6%	-0.9%	-1.2%	0.7%
South African Rand	USD	-1.2%	-1.4%	3.6%	6.5%
Swiss Franc	USD	-0.3%	-0.9%	2.2%	4.7%
Chinese Yuan	USD	0.0%	0.0%	2.8%	8.9%
Commodities & Alternatives					
Commodities	USD	-0.4%	-0.3%	1.3%	9.2%
Agricultural Commodities	USD	-1.0%	-1.2%	4.3%	-2.2%
Oil	USD	1.1%	0.7%	-1.0%	28.0%
Gold	USD	0.4%	0.6%	1.6%	8.2%
Hedge funds	USD	-0.4%	0.1%	0.1%	4.3%

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