Our theme is *holidays* – a tradition now firmly embedded within British culture where we take time away from our usual routine often travelling to another location to assist our ‘recuperation’. The tradition of the summer holiday has its roots in what was known as the Grand Tour in the 18th century – a sophisticated gap year exclusively for young upper-class British men. Since 1968, Club 18-30 has provided holidays to party destinations for the younger generation. Thomas Cook could be looking to offload the brand, claiming that millennials are looking for ‘ego travel’ (i.e. destinations and hotels more aesthetically pleasing to their social media followers). It seems that millennials now prefer avocado to alcohol, perhaps a return to the sophisticated travel of the 18th century.

In recent years the ‘staycation’ – holidaying close to home – has become increasingly popular. The main catalyst for this trend was austerity following the credit crisis, exacerbated by the weakening of sterling following the EU referendum in the summer of 2016, which had the consequence of increasing the expense of travelling abroad (and eating etc.). The introduction of pension freedoms in April 2015 saw a marked increase in the purchase of caravans and camper vans as individuals were able to take a greater portion of their pensions as cash (albeit anything above 25% is taxed).

Despite the uncertainty hanging over the UK economy as we continue to plough through negotiations with the EU, the outlook for consumer spending is a little brighter, though it is marginal. Export-led inflation is falling and a modest boost to annual wage growth, which is now running at 2.9%, means that real wages are finally rising in the UK. Petrol prices, though, due to (a) the oil price and (b) sterling’s recent weakness against the US dollar, are a fly in the Ambre Solaire.

The overall picture of the UK economy is far from idyllic. Following GDP growth of just 0.1% in the first quarter, house prices saw the biggest monthly price drop in eight years. Weaker growth, mixed economic data and a pervasive cloud that is the Brexit negotiations prompted the Bank of England to put plans for a UK rate rise on hold (it had been expected during its May meeting). Only two members of the Monetary Policy Committee (MPC) voted for a rate rise, whilst seven members voted for no change.

Another potential negative is the rise of protectionism across the globe, led as previously highlighted, by President Trump. East versus west has been a bit of a theme for a while – it could be focused on eastern China and west coast USA as the tech (social media, retail and search engine) giants slug it out.
Closer to home, the debate continues to rage – should the UK endeavour to stay in some sort of customs union with the EU after March next year? Theresa May’s preferred option appears to be that of the customs partnership, which is a hybrid model and would see the EU recognising UK customs checks as equivalent to their own. This, however, rests on EU acceptance and has faced significant backlash from within the government. Many MPs appear to prefer ‘maximum facilitation’, which would mean a border between the UK and the EU.

They argue that the UK could follow the blueprint from Canada and the USA and would see the UK and the EU agree to minimise all checks with the help of smart technology. The reality is, the technology is not there to deal with the likes of the Irish border, so this seems something of a pipe dream. Undoubtedly there is more to come …

Economic growth remains constrained by uncertainties, mostly Brexit-led, with many businesses delaying investment decisions until there is further clarity on trade deals. We retain our cautious stance with asset allocations – we now have our lowest historic weighting towards UK equities within discretionary portfolios.

**Term or word(s) to watch:** BRINO or BRENDA – Brexit In Name Only or Brexit–No Deal. With a big day tabled in Parliament on 12 June, and being less than 10 months away from the Government’s stated exit date, there remain two possibilities. BRINO essentially leaves a customs deal and the likelihood of continued budget contributions. BRENDA is the scenario where no formal agreement is reached between the UK and the EU (although other deals will undoubtedly be done) and the UK walks away from any further budget contributions.

Some MPs are pushing for the UK to pursue a BRENDA exit should the EU continue to drag its heels over discussions of future trade deals. No formal agreement on trade means that the UK must operate within the EU under World Trade Organization rules (though having imposed tariffs it seems President Trump is not too worried about those same rules). Lengthy border checks for travellers may accompany economic and trade-related cross-border pain, putting a real dampener on those exciting summer breaks/weekend city trips that we have become so partial to in recent decades.
Investors seem to be trying to work out whether the protection afforded to them by the Federal Reserve since the financial crisis is still in existence. Can the central bank be expected to change the course of its policy if the stock market is adversely affected?

The new Chairman, Jerome Powell, certainly seems to be suggesting that things are going to change under his watch. He has made numerous comments intimating that a fall in equity prices would not blow him off course and seems sceptical of the impact that a stronger dollar will have on the global financial system. So, investors have certainly received adequate warning that they should be on guard.

Some of these concerns have started to make investors look at the fixed interest market – at least at lower duration bonds that are less affected by rising interest rates. There is also plenty happening elsewhere in markets – not least a potentially significant crisis emerging in Italy – which is creating a demand for US Treasuries. For years now there really has been ‘no alternative to equities’ – it even spawned the acronym ‘TINA’ – but this has changed with the recent movement in bonds, which makes the dividend yield offered on the S&P 500 relatively less attractive.

In the summer of ’69 (that is, 1869), a young preacher from Boston named William H.H. Murray published one of the first guidebooks to a wilderness area. This description of the expanse of lakes, forests and rivers in upstate New York, known as the Adirondack Mountains, was amongst the first on record to promote wilderness landscapes as a source of enjoyment rather than a formidable outback to be conquered. He presented hiking, canoeing and fishing in a natural landscape as the ultimate health tonic for city dwellers struggling with the demands of civilised life. Thus, the American city slicker tradition of the vacation was born.

Aside from the obvious longer-term dynamism of the US economy, we struggle to see the attractions of the wider US stock market given the high valuations that persist. Central bank indifference does not suggest we should be doing otherwise.

There always seems to be an election going on somewhere in Europe. In Slovenia the anti-immigrant Slovenian Democratic Party (SDP) has emerged as the largest party. The SDP took 25% of the vote but may find it difficult to find allies to build a coalition. The result reflects a rise in anti-immigration parties in European elections, following results from Hungary in April and Austria last year where the far-right Freedom Party formed part of the governing coalition.
This leads us to Italy where the Northern League, who campaigned on anti-immigration, has entered a coalition with the anti-establishment Five Star. This was formed after their initial attempts were blocked by the Italian President as he vetoed their choice of a Eurosceptic economist as Finance Minister and it had looked as if we may see new elections. This led to a selloff in Italian assets with the gap in yield between Italian and German bonds reaching 2.6% on the 10-year bonds.

Portuguese debt also saw weakness with other eurozone peripheral debt seeing a selloff. Whilst these fears have now receded, the conversation around Italy’s future in the euro is a major risk given the significance of the Italian bond market.

Spain also saw a change of leader with socialist Pedro Sanchez forcing a no-confidence vote in former Prime Minister Mariano Rajoy, and replacing him in the role. Had Rajoy resigned, it would have forced new elections. Spain is less of a concern than Italy, with the change not seeing a movement to anti-European parties and the Iberian state being in far better health than Italy after having undertaken reforms since the eurozone debt crisis.

If you believe certain media outlets, everything will be more expensive after Brexit! Holidays are a prime candidate for price increases, particularly for those visiting Europe. Brexit could lead to restrictions over duty free purchases, increased air travel costs, loss of free health care and less protection in the event of delayed flights. Perhaps a holiday from Brexit-related news would be nice?

True, the problems of European sovereigns do not necessarily equate to problems for European corporates and stocks, but the developments in Italy were a reminder of political risk. Given this, we continue to prefer other regions over Europe at present.

Whether the ‘official’ definition of a recession as two successive quarters of negative growth is a sensible one is debatable, but if it has any validity, perhaps Japan could be the first developed nation to slip back into one. Japanese Q1 GDP contracted at an annualised rate of 0.6% as its best growth run for several decades came to an end. Another contraction next month would mean that a recession would be officially declared by commentators.

The Japanese economy and investors in it are accustomed to experiencing setbacks, but this would be a major disappointment. Set against this news was a decent set of retail sales data and stable consumer prices suggesting the economy is staying on top of its fight against deflation.
**MONTHLY MARKET COMMENTARY**

**JUNE 2018**

| JAPAN  
<table>
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<tr>
<td>Clearly a deterioration in economic growth is far from desirable; the longer-term Japanese equity story is not completely dependent on the growth rate being maintained. There are so many excellent opportunities available at the stock level in exciting sectors such as technology, that a decent Japanese exposure is still advisable.</td>
</tr>
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*Karoshi is a Japanese term referring to death from overworking, something that became prevalent during the 1980s when a number of young men (some in their 20s) died from heart attacks and strokes induced by work-related stress. The minimum number of holiday days for Japanese employees has since increased to 10, half that of EU member states.*

We have written in previous commentaries about how some of the gloss has undeniably come off the Japanese growth story, but as with other regions, select and focused exposure should continue to be rewarding.

<table>
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<th>ASIA PACIFIC</th>
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<td>Starting with <strong>Australia</strong> this month, where a public inquiry into the behaviour of its ‘Big Four’ banks continues. Whilst often thought of as a commodities dependent country, financials make up just under 40% of the Australian market. Commonwealth Bank of Australia (CBA), Westpac Banking, ANZ Banking Group and National Australia Bank are four of the five largest companies by market cap. All four of the banks have faced misconduct allegations and have paid over A$1bn (£550m) in penalties and compensation since the 2008 crisis. Despite this, they have remained amongst the most profitable in the world.</td>
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The most recent development has seen CBA fined A$700m (£400m) for breaching anti-money laundering laws, with 53,000 suspect transactions that the bank did not report. With the landmark inquiry into the sector ongoing, it seems likely we will see further fines. Australia is often a high allocation in global equity income funds, because of these banks and the higher starting yield on its index than across the region. Further fines may see the ability to pay dividends reduce and equity income investors potentially looking elsewhere. |

In other areas of Asia, **India** snatched back the title of ‘world’s fastest growing economy’ with the last quarter’s GDP figures showing a 7.7% rate of expansion (up from 7.2% in the previous period). The country saw strong performance in services and manufacturing. A balanced policy environment and stable external position continues to foster India’s gradual recovery although it has faced headwinds from higher oil prices. India is the third largest importer of oil in the world, and elevated prices may cause inflationary pressure in the short term, with gasoline prices in Delhi having hit their highest in four years.
ASIA PACIFIC (cont’d)

Dhanteras is considered to be the most auspicious day of the year for Hindus to buy gold, as it is the first day that marks Diwali. The festival is an official holiday in 11 countries, and many Hindus in India use the holiday as a time to purchase the precious metal along with big ticket items, such as cars. This year it falls on 5 November.

Where we allocate to Asian Equity Income, we prefer funds with lower exposure to Australia, viewing the income and growth story elsewhere more attractive over the medium term than a higher starting yield available today. We continue to favour India longer term more generally in portfolios, although note short-term concerns.

EMERGING MARKETS

Worries about emerging markets continue to gather pace, and it is difficult to avoid negative headlines about the asset class. Some of investors’ waning of interest has been quite focused – Turkey and Argentina are the most concerning countries at the moment (even more so than Italy!) – but the whole asset class is being subject to examination. Countries across the space (excluding Turkey, who are having to take the opposite approach – see ‘Currency’ section) have been aggressively cutting rates, which has helped economic growth, but the rising US dollar is now placing pressure on currencies and forcing investors to reassess. The period of rate reductions could now go into reverse as currencies suddenly have to be defended, which puts the brakes on the growth rates that can be achieved.

The global growth narrative seems to have weakened significantly over the last quarter, and there will inevitably be an element of all emerging market countries getting caught up in the fallout from this. This only strengthens the case for adopting a nuanced approach (readers know of our preference for China and India), and perhaps even the search for interesting frontier markets less dependent on foreign capital for achieving domestic growth becomes more important/interesting. This latter area could, with several caveats over liquidity and the size of the investable universe, be a fertile ground for finding performance differentiators, and we are carrying out more work here.

Every year, tourists flock to Thailand’s stunning beaches with the goal of attending a Full Moon Party. The Full Moon Party is an all-night affair on the eve of, the night of or after, every full moon. The celebration originated in Haad Rin on the island of Ko Pha Ngan in 1988 as locals gave thanks to about 20–30 travellers.

Markets are giving off plenty of warning signals at the moment, and emerging markets are inevitably being impacted, but there are always opportunities presented by such inflection points.
### Alternatives

One might expect that the return of volatility to stock markets in February would have created a consequent increase in demand for alternative strategies. Since the financial crisis, uncorrelated strategies have attracted significant interest as investors sought the protection and diversification that might be afforded by these investments. Recently, some of the appetite appears to have diminished.

Some of this has been due to consolidation. Many of the strategies such as market neutral, long/short equity and credit can only manage certain amounts of assets before the strategy is compromised, and several large funds have closed to new investment.

Still, large institutions seem to be committed to the strategies (though some US pension funds appear to have reduced exposures) and, given the outlook for equity and fixed-income markets, this seems sensible.

We continue to hold a healthy allocation to ‘alternatives’ in portfolios – with absolute return, managed futures and structured product strategies providing a diverse response to the challenges in investment markets.

### Fixed Income

Political unrest within Italy, the eurozone’s third largest economy, provoked headlines reminiscent of the eurozone debt crisis of 2010–12 as bond prices were sent tumbling. As the news broke that a government would not be formed, short-term Italian bond yields, which move inversely to price, had their biggest one-day jump since 1992. Credit ratings agency Moody’s has stated that Italy’s credit rating could be downgraded if the next government does not make some progress towards managing the country’s huge debt pile.

Several unhelpful comments from EU commissioners and the European Central Bank exacerbated investor anxiety as fears mounted that Italy might effectively vote to leave the euro. The question is not whether this crisis has been on the cards for some time (it has), but have investors become complacent, lulled into a false sense of security by the effects of quantitative easing?

Though eclipsed by political unrest in Spain and Italy, it is important to remember that Greece is still carrying its own sizeable burden in the shape of the €248bn it owes to the International Monetary Fund (IMF) and the eurozone. Previously, the IMF had made an agreement to provide Greece with a small credit line of €1.6bn, but is now calling for eurozone governments to provide more clarity on debt relief before further financial commitments are made.
IMF officials have cautioned a deal must be agreed at the forthcoming G7 finance ministers’ meeting in early June, otherwise the fund will not have enough time to activate and review its Greek programme.

The burgeoning crises in Europe as well as our own stagnating growth picture in the UK versus an overheating economy in the US points to future monetary policy divergence. Whilst minutes from the early May Federal Open Market Committee took an unexpectedly dovish tone (noting policymaker comfort with a modest inflation overshoot), the path looks clear for at least three further US rate rises this year.

It is clear that it is now more important than ever to be selective with our fixed income exposure. Though our exposure is light in comparison to historic averages, we continue to invest in actively managed funds that our research team consider the ‘best of breed’ in their sector.

Our fixed income exposure is highly diversified with exposure to investment grade credit, high yield as well as a healthy weighting in emerging market debt. We currently have no exposure to European debt.

Whilst there is generally one major price quoted for gold, there are numerous ones for oil, with the most significant two global benchmarks being West Texas Intermediate (WTI) and Brent Crude.

These two prices are for light and sweet (referring to low sulphur content) so are ideal for refining into petrol, with the key difference in where they are sourced. WTI is sourced from US oil fields primarily in Louisiana, Texas and North Dakota, whereas Brent Crude comes from fields in the North Sea. Brent is generally seen as the global benchmark these days given it is a measure of the larger European, African and South Asian markets, with WTI the preferred measure in the USA.

Historically, WTI used to be the more expensive benchmark, owing to it being produced in landlocked areas so incurring higher transport costs than Brent, which is produced at sea. However, in recent years, the shale revolution has seen this reverse, with technological innovation in fracking and drilling making it easier to get oil out of the ground and improved pipeline infrastructure. At the end of May, Brent Crude had moved to an $11 premium to WTI.
It should perhaps be mentioned that WTI had tended to be more insulated against geopolitical risks, with it being US based. As the USA exports more, we would expect the price to become more sensitive.

Abolition of export curbs in 2015 has seen production of US oil increase. It is estimated by the International Energy Agency that export capacity will go from 1.9 million barrels a day (b/d) last year to 4.9 million b/d by 2023. These shipments will challenge OPEC and Russia’s market share of global oil. It also represents part of the solution for the trade imbalance between the US and China, with China being the world’s largest energy importer including its need for light-natural gas.

Oil prices are an important signal for global markets and can be a key factor in inflation. We do not hold any direct exposure to the oil price in portfolios at present, seeing prices as elevated given geopolitical tensions and preferring other opportunities elsewhere.

The Investment Property Databank (IPD) UK All Property Monthly Index tracks retail, commercial, residential and industrial property values. Over the past three years industrial assets have led the way, with performance head and shoulders above that of office and retail. In fact, retail has been the weakest sub-sector over the period, and it isn’t hard to see why, given the number of vacant properties on the average UK high street. There appears to be no letting up in the trend, with PwC reporting that the number of store openings is at a seven-year low.

However, outside of the high street and on the edge of town, retail warehouse assets have performed well. Part of this is down to their role in last mile delivery. This allows businesses to deliver goods to out of town stores, where they can be sorted and then sent by van to the individual customers.

Retailers are increasingly seeing their out of town retail outlets as showrooms. So, whilst you might not purchase the item on the day, you may go home and order online. The ease of access and cheaper rents make retail warehouses a logical choice for those with scale or those who sell bulky items.

Operators of these retail parks are also becoming more efficient in the way they are managing assets. One example of this is the inclusion of ‘pods’ in carparks. These are generally small buildings that are leased to fast food or coffee outlets. In doing this, retail park operators are increasing profitability by making use of excess car parking spaces and improving the overall shopping experience.
**PROPERTY (cont’d)**

Though retail parks often appear busy, the closure of stores such as Maplin and Toys R Us reaffirms the point that they too are not immune from the troubles facing the wider retail sector. The bigger lot sizes means that property managers need to rely on strong links with prospective tenants and understanding of their requirements in order to fill voids.

*Holiday homes can be rewarding investments, providing a regular retreat and source of income. Research by one holiday cottage provider found that properties* *with hot tubs were able to increase revenue by 44% and allowing guests to bring dogs increased revenue by 35%. Allowing dogs into the hot tub may not be such a great idea!*

*We have some exposure to retail warehouse properties in our portfolios but maintain that selecting funds that operate with strict due diligence and have a high quality tenant list is crucial.*

<table>
<thead>
<tr>
<th>CURRENCY</th>
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| Those *holidaying* in Turkey this year will have benefitted from a fall in the value of the lira. Most of this has been driven by the announcement that President Erdogan plans to increase his involvement in the setting of monetary policy. His unwillingness to shore up the currency by raising interest rates, despite spiralling inflation, has been unsuccessful, and last month he relented, raising rates by 3% to 16%.

The domestic picture looks bleak, and it is difficult to see confidence in the currency increasing. In Q1 Turkish demand for gold was up 34% as people looked to protect their wealth against a weakening currency and rising inflation. The currency could be in for further falls should the people of Turkey turn their back on the lira in favour of more stable currencies.

<table>
<thead>
<tr>
<th>UK INTEREST RATES</th>
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| The MPC of the Bank of England decided to hold interest rates at 0.5% during May. GDP data released towards the end of April was weak, showing a mere 0.1% growth in the first quarter of 2018. The Chancellor, Philip Hammond, claimed the weather was partly to blame as the ‘beast from the east’ led to widespread disruption. Overall, their caution was probably right.

Seven of the nine members voted to maintain current interest rates. However, minutes from the meeting suggest that rate rises are still planned in order to keep inflation close to the government’s 2% target. The MPC’s 2018 growth forecast has been cut from 1.8% to 1.4%. Perhaps the chaos endured by commuters using National Rail services will give the Chancellor another excuse, should we see poor data when the next quarter’s figures are released. A summer of discontent?

NUMBERS OF THE MONTH

Our monthly look at numbers that may or may not have grabbed the headlines.

44% The increase in Ocado’s share price following news of a deal signed with US grocer, Kroger.

388 The yield spread of Italian government bonds over German bunds (in basis points) – 3.88%.

£500m The expected boost to the British economy as a result of May’s Royal Wedding.

MARKET DATA

<table>
<thead>
<tr>
<th>Index</th>
<th>31.05.18</th>
<th>1 month</th>
<th>1 year</th>
<th>3 years</th>
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</thead>
<tbody>
<tr>
<td>Bovespa (Brazil)</td>
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<td>−11.21%</td>
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<td>Hang Seng</td>
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<td>Dow Jones Industrials</td>
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<td>RTS (Russia)</td>
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<td>M-DAX (Germany)</td>
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<td>Shanghai A (China)</td>
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<td>IBOXX UK Sterling Gilts All Mat.</td>
<td>124.89</td>
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</tr>
</tbody>
</table>

*Figures delayed by one month

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