Market Update – February 2018

Inflation and changed expectations make it a volatile month

Volatility – unpredictable ups and downs in stock prices – returned to global markets with a vengeance in February. Stock markets experienced the first sizable correction (that is, a sharp decline towards lower share prices) since early 2016, as economic data pointed to faster growth in prices and wages. In turn, this spurred expectations that central banks would raise interest rates more quickly than currently expected. These trends were reinforced when the US Congress passed a massive tax reform programme, which helped to send long-term interest rates higher.

In the United States, the S&P 500 Index (a measure of overall US stock market performance) dropped by 10.2%[1] between its peak level on 26 January and the low point on 8 February, however, share prices recovered enough that the index ended the month down by 3.9%. Expectations of higher interest rates were probably the key trigger (although technical factors to do with automated trading of some investment products may have contributed to the speed of the selloff). The MSCI World Index, which measures the performance of global markets, underperformed against the S&P 500, dropping by 4.3% in US dollar terms (and down 1.2% in sterling terms, reflecting the pound's decline against the dollar over the month). This is the biggest monthly drop for this global equity benchmark since January 2016.

UK stock markets underperformed global peers. The FTSE 100 Index (which measures the 100 largest UK companies and has more international exposure) dropped by 4%, while the more domestically focused FTSE 250 Index was down 2%. This came despite the pound's 3.1% decline against the US dollar, which boosted the value of firms' foreign-currency revenues. A survey of fund managers by Bank of America found that UK equities were viewed as the least attractive out of 22 broad asset classes, underscoring pessimism among many investors towards UK shares on the back of perceived economic and political uncertainty, in part associated with Brexit.

Among other major equity markets, European stocks (as measured by the STOXX Europe 600 Index) fell 3% as the strengthening euro took its toll on the Eurozone's exporters amid evidence that the currency bloc's robust economic recovery may be starting to ease off. Japanese stocks outperformed peers globally, supported by the economy's ongoing resilience, with the benchmark Nikkei 225 Index strengthening 0.9%. Emerging-market equities underperformed, dropping by 1.7%. China's benchmark index declined 6.4% ahead of the key annual policy-making National People's Congress meetings in early March.

Turning to the bond markets, long-term interest rates in the US rose but UK and European rates were little changed. The yield (or income return) on the 2-year US Treasury note, which is sensitive to changes in fiscal and monetary policy, rose by 0.11%, while the 10-year yield gained 0.15%. A higher yield means the price of the underlying bond is lower, and vice versa.

In the UK, the yield on the 6-month “forward-implied” rate (investors’ calculations as to where interest rates are headed) increased 0.11bps, suggesting that the market expects interest rates to move higher in 2018. Credit spreads (the difference in yield between high-quality, government-issued bonds and lower-quality corporate bonds) generally widened over the month (for many credit classes, by the most since early 2016).

Commodity prices, denominated in US dollars, were largely driven by the currency’s 1.7% appreciation (in trade-weighted terms) over the month. As such, gold fell 2%, copper prices declined by 2.1%, and the price of a barrel of Brent crude oil slid by 2.5%.

1. All financial and economic data from Macrobond
2. All figures are for sterling investors, unless otherwise stated

Should I make any changes to my investments?

Everyone's circumstances are different and we aren't able to give you advice on what is appropriate for you. As always, if you are considering your own position, you should remember why you invested in the first place and consider the lifespan of your investments. Most importantly, you should seek financial advice before making any changes to your investments.

One way in which you can help reduce the impact of any market volatility is to spread your investments across different asset classes and regions. For more information about investing across different asset classes take a look at our An introduction to diversification in multi-asset funds guide.

Remember that before making any changes to your investments, you should seek financial advice. If you don't have a financial adviser, you can find one local to you by visiting find a financial adviser, which is responsible for promoting financial advice in the UK.

All figures quoted are in sterling terms to 28 February 2018 unless otherwise stated.

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