Politics slows broad market rally

eastspring investments

A member of Prudential plc (UK)

September 2019

The World in six bullet points

- **Equity markets** rallied off the lows of August as central banks around the world eased monetary policy by either cutting interest rates, cutting tax rates or re-starting quantitative easing programmes. Weak economic data from China and eurozone, and a chink in the armour of the US consumer, was enough to send central bankers to search for their red pens, initially leading bond yields and equities higher. Later, the shine was taken off the rally as political concerns both domestic (the US and UK) and international (Saudi Arabia and Iran) began to weigh on positive sentiment.
- Yemeni rebels claimed responsibility for a drone and missile **attack on Saudi Arabia's** Abqaiq crude oil processing centre and while the US was quick to point to Iran as being behind the strikes, Tehran denied any responsibility. Analysts estimated daily output from Saudi would be cut by 5.7m barrels a day and the oil price duly spiked as high as 20% at one point but fell back as the limited damage became apparent and talk of retaliation cooled.
- **Chinese ADRs** sold off sharply at the end of the month on speculation that the White House was looking to restrict US-sourced investments into China. This could mean the forced delisting of some China companies in the US but also stopping government-related pension plans from investing in Chinese stocks, or pressuring index providers from raising the weighting of China equities. Some observers dismissed the news as a negotiating tactic but others saw it as a continuation of the White House's strategy to attempt to restrict China's capital flows.
- The US House of Representatives said it would begin a formal **impeachment inquiry** into President Trump, the first step in a process that could lead to an impeachment vote by the House. The announcement followed allegations the President pressured the Ukrainian President Volodymyr Zelenskiy to investigate Hunter Biden, the son of Joe Biden and one of the front runners for the Democrat nomination for Presidency. The White House responded by calling the inquiry "presidential harassment".
- **Britain's** new Prime Minister Boris Johnson suffered another blow when the country's Supreme Court ruled his suspension of parliament unlawful. Critics of the Prime Minister said Mr. Johnson had 'prorogued' parliament in an attempt to stifle debate prior to the 31st October exit date but before the suspension began, MPs successfully passed legislation that would force Mr. Johnson to ask for a further exit extension if a new deal could not be agreed by the EU and the UK's parliament. The government also lost its majority in parliament making another general election this year almost certain.

Figure 1. US 2yr, 10yr and 3-month Bond yields

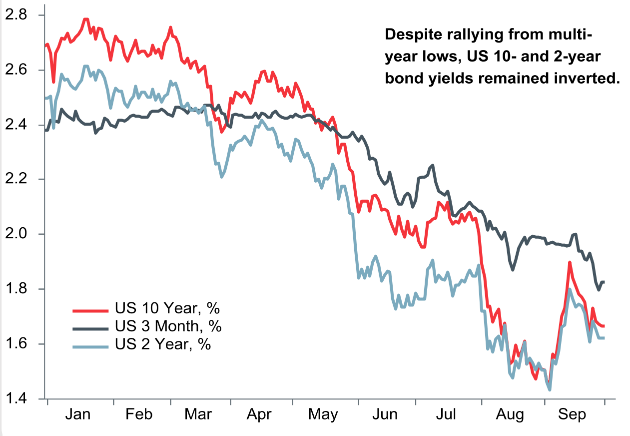
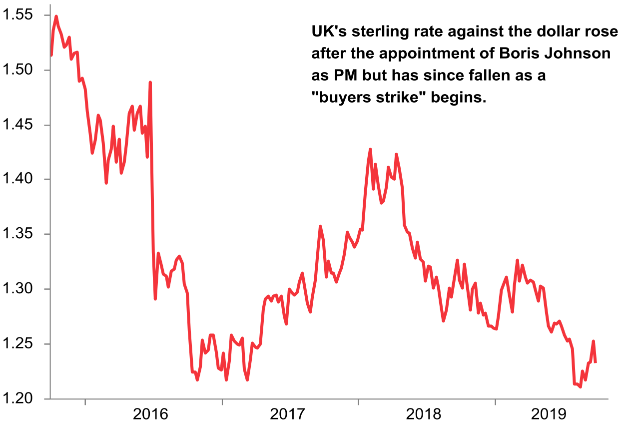


Figure 2. US dollar to UK pound



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 September 2019.

Equity Markets

- **Global** equity markets recovered some of the ground lost in August's sell off but it was a volatile month with equities surging at the beginning of the month and falling into the close as geopolitical worries began to outweigh encouraging economic data. Trade-sensitive markets such as Korea and Taiwan outperformed while Japan was the best performing major market with a 4.2% gain made on news of a trade agreement with the US as well as hints the US-Sino trade dispute could be close to an end.
- **Europe** gained 2.7% to outperform the **US**, which was up just 1.8%, the first time since May that Europe has bettered the US. Emerging Markets added 1.9% with **Latin America** outperforming with a 2.6% gain helped by Chile and Mexico that added 4.3% and 2.6% respectively while Brazil was also in line with the regional market. The **EMEA** region rose 1.0% although individual market performances here were more mixed with Turkey surging 12% and Russia 3.3%, the latter on higher oil prices.
- In **Asia**, hints the US and China could be reaching a deal on trade boosted stocks in **Korea** which also gained from higher chip prices and from local pension funds investing heavily into the local markets. But China's stocks failed to rally and flatlined as a cautious Beijing cut rates by just 5 bps and a still restless **Hong Kong** weighed on stocks there. **Taiwan** returned 4.3% as chip prices recovered and was the region's best performing market in Q3 by some distance with a 5.9% positive return against a 3.9% fall in the **Asia Pacific ex Japan** index.
- Elsewhere in the region, south east Asia was mixed as **Indonesia** saw its heavy-weight tobacco stocks weigh post an unexpectedly steep price hike on cigarettes. The **Philippines** fell 2.0% on higher oil prices, and **Thailand** also fell into the red despite dovish comments from the central bank. **Singapore** outperformed to gained 1.2% despite very weak export data and **India** outperformed to add 3.1% after the government announced a corporate tax cut.
- For the **quarter**, equities fell with most markets failing to recover from the losses they saw in August when concerns over economic growth and negative trade dispute rhetoric sent stocks sharply lower. The US continued to outperform other regions with a 1.6% positive return while Europe fell 1.8%, weighed by weak economic figures from Germany and uncertainty on Britain's exit from the EU. Emerging Markets also fell, losing 4.1%, with Brazil weighing after its currency fell sharply after Argentina saw a near collapse in its currency and equity market. Asia was better but with Hong Kong seeing a 12% drop amid the large-scale street protests (see page 7 for data).

Figure 3. Regional Equity Indices

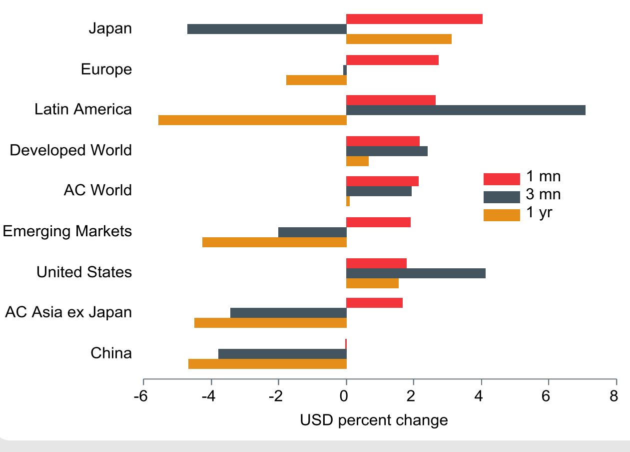
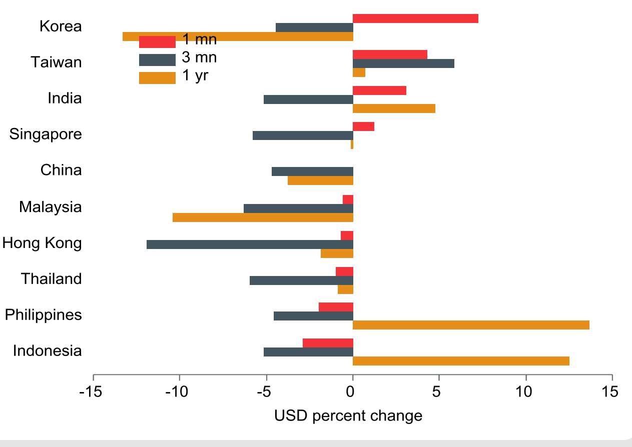


Figure 4. Asia Equity Indices



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 September 2019. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Fixed Income

- **Global bond yields** were mixed in September. In the US, a resumption in China-US trade talks and concessions made by both sides ahead of their planned October meeting bolstered risk appetite and contributed to rising bond yields. The impact on market sentiment from the Federal Reserve's interest rate cut was relatively muted, given that the move had been widely expected amid still-benign inflation data.
- Towards the month end, the **US Treasury** (UST) curve steepened on news that the US administration was considering potential curbs on US portfolio investments into China. As stocks sold off, yields on shorter-duration notes fell while those at the longer end of the curve rose. Sentiment stabilised somewhat after officials discredited the news. The two-year yield ended up 12bps at 1.62% and ten-year yield up 17bps at 1.66%.
- Meanwhile, **German bund yields** also rose despite the start of the European Central Bank's (ECB) massive easing programme and ECB president Mario Draghi's call on EU governments to loosen fiscal spending.
- In **Asia,** Indonesian government bond yields fell and outperformed regional peers. Bank Indonesia cut interest rates for a third straight month. Conversely, Philippine bond yields rose despite easier monetary policy. In India, plans by the government to cut the corporate tax rate and concerns over potential fiscal slippage lifted bond yields.
- In **Latin America,** rate cuts continued apace in Brazil and Mexico where domestic bond yields ended lower.
- **Emerging-market USD-denominated credits** posted negative returns overall, mainly because of higher US risk-free rates that pushed total returns lower. Credit spreads tightened, however, given the positive developments in trade talks in the early part of the month. In Asia, high-yield credits posted positive returns and outperformed investment-grade bonds.

Figure 5. Bond Indices Performance in USD

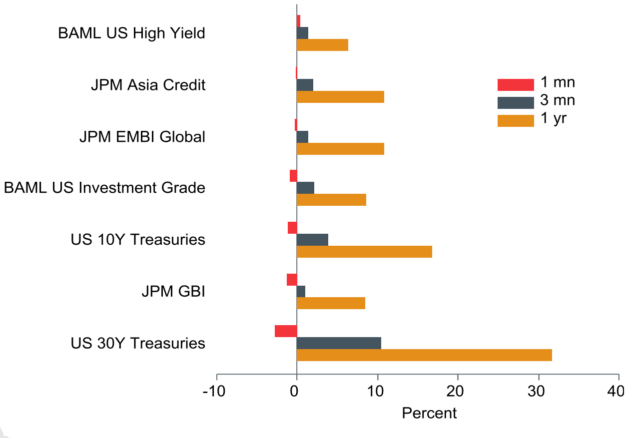
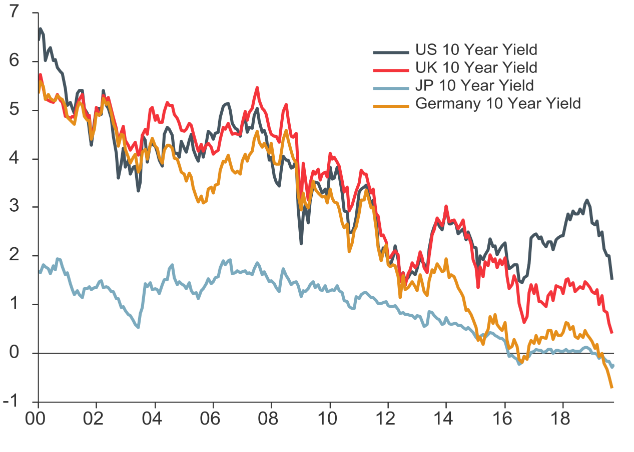


Figure 6. Key Bond Yields (%)



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 September 2019. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Currencies

- **The US dollar Index (DXY)** continued its march higher and is now rapidly closing in on its mid-2017 highs. But despite the overall performance of the DXY, against the G10 currencies, the dollar was more mixed during the month. The UK pound was the best performer gaining nearly 1.1% as fears over a no-deal Brexit eased although the gains were offset somewhat by comments from the Bank of England that hinted at rate cuts if the UK did leave the EU at the end of October. The Japanese yen meanwhile declined more than 1.5%.
- The **euro** traded below USD1:1.10, considered by many to be a key level for the currency as the ECB restarted its bond purchase programme. Other G10 currencies continued to trade within a tight range as markets lacked any clear direction. Oil-related currencies such as the Canadian dollar and Norwegian krone gained about 0.5% against the USD following the spike in crude prices after oil facilities in Saudi Arabia came under missile and drone attack and despite the disruption only likely to last a short time. But it was enough to spook the markets.
- **Emerging markets' currencies** managed to make a comeback after a difficult August. The Argentine peso gained nearly 13% against the USD. While there was no new news on Argentina per se, the recent capital controls on currency markets have been supportive for the peso. The Russian ruble was up nearly 3.5% after the oil prices spiked while the Turkish lira which has been one of the more embattled currencies in the last year also gained more than 4% as monetary policy was eased and a "New Economic Programme" was announced.
- In Asia, the **Chinese yuan** climbed to an 11- year high of 7.18, but settled around the 7.10 mark by the end of the month despite a less-than-expected interest rate cut by Beijing. Economic data in September was weak but the lack of progress on a trade deal with the US continues to weigh on the markets. The headlines this month have been supportive of talks however a trade deal looks far from imminent.
- Meanwhile, with the improvement in risk appetite, other **Asian currencies** all gained against the USD. The Indian rupee was up just over 1% and the Indian markets have turned more bullish in general following a surprise corporate tax cut by Prime Minister Modi. This should continue to attract equity inflows supporting the rupee. The Korean won also found some reprieve on improved risk sentiment as rhetoric around the Sino-US trade dispute cooled.

Figure 7. Currencies Performance vs USD

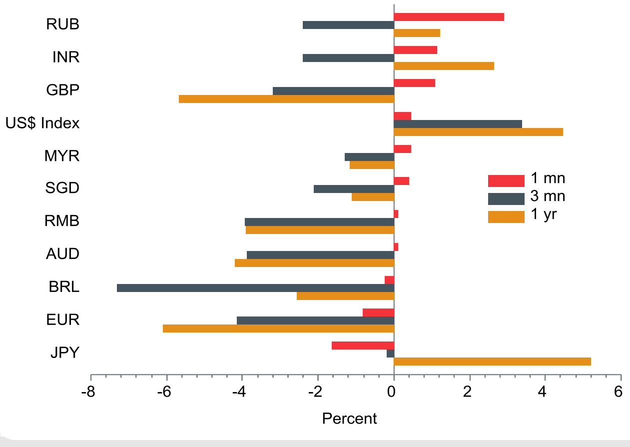
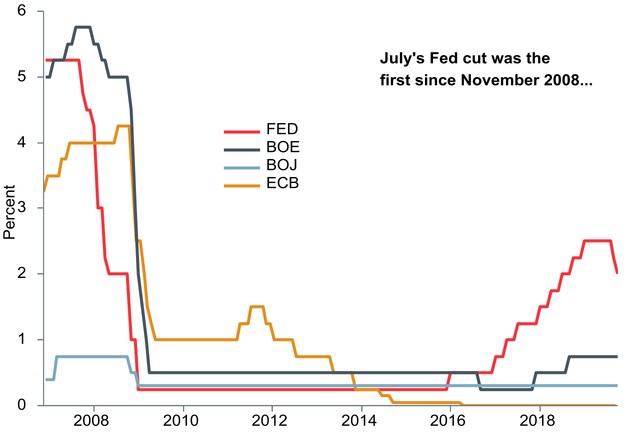


Figure 8. Central Banks Interest Rates



Source: Eastspring Investments. Chart data from Thomson Reuters Data stream as of 31 July 2019. For representative indices and acronym details please refer to notes in the appendix. For representative indices and acronym details please refer to notes in the appendix.

Commodities

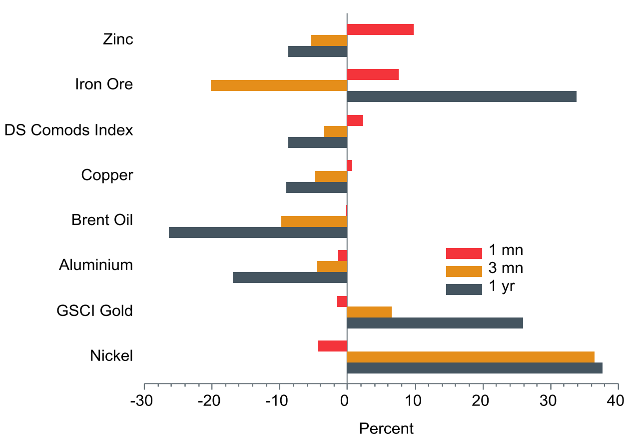
- **Oil** prices continued their year-long slide for most of the month as investors worried about weak economic data. But the attack on a Saudi oil facility caused extreme volatility mid-month as prices spiked sharply in the immediate aftermath of the attack before settling back as many short trades were covered. The Saudis were able to re-establish shipments within days and full production was restored by month end but Saudi Aramco did have to purchase oil from neighbouring countries to fulfil some orders.
- **Copper** prices initially fell to fresh two-year lows on weak US economic data but bounced mid month as the US-Sino trade dispute eased and the US dollar topped out. But once again, fears of weakness in the global economy sent prices lower into the month end.
- **Gold** prices fell over the month to touch two-month lows as the US dollar gained ground. Prices fell especially sharply in the second half after the attack on the Saudi oil facility and on worries over global growth.
- **Nickel** prices surged early in the month to reach record highs after Indonesia said it would restrict ore exports from next year. **Palladium** hit a new record peak before falling back with other metals after weak economic data from China but **Iron Ore** reversed its slide to end higher.

Economics

- The **US** Federal Reserve cut rates by 25 bps as expected but hinted that an expected cut in Q4 was not guaranteed. The Fed also intervened four times in the repo market after its target rate was breached – the last time it did that was prior to the GFC – but this time the reason was likely connected to corporates hoarding cash to pay tax bills.
- Among the **US data** points, August housing starts and existing home sales rose higher than expected; Industrial Production grew 0.6% yoy. August retail sales were better than expected as was the Univ. of Michigan consumer sentiment index, but the Conference Board US consumer confidence index showed a second monthly decline.
- The **Bank of Japan** held rates steady as expected but did signal that additional easing was a growing possibility. The **UK** also held rates steady despite the increased Brexit uncertainty but the **ECB** cut its deposit rate by 10bps to -0.5% and brought back its asset purchase programme; it also lowered its GDP and inflation forecasts.
- **Norway** raised rates by another 25bps, its fourth such increase in a year and one of the few countries to hike rates this year. The **Philippines** and **Mexico** cut interest rates by 25bps to 4% and 7.75% respectively. **China** cut its rates by just 5bps despite some gloomy industrial output data.

Figure 9: Commodity Prices, year to date

Figure 10. Commodities Performance in USD



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 September 2019.

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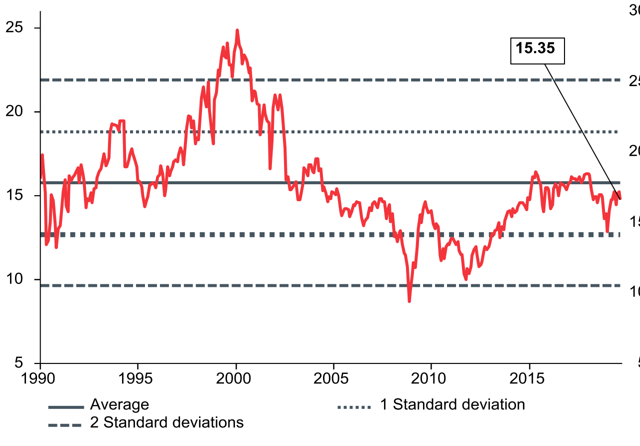
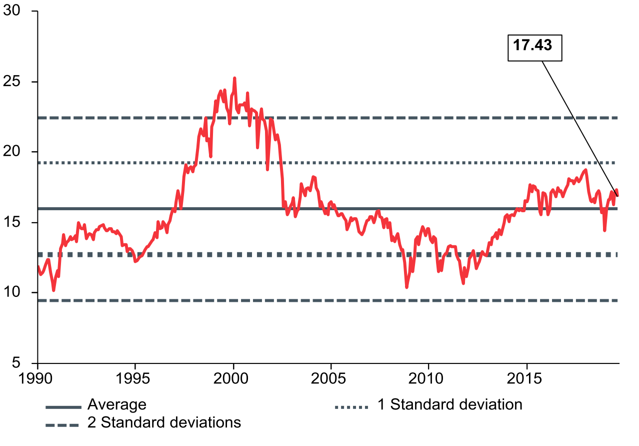
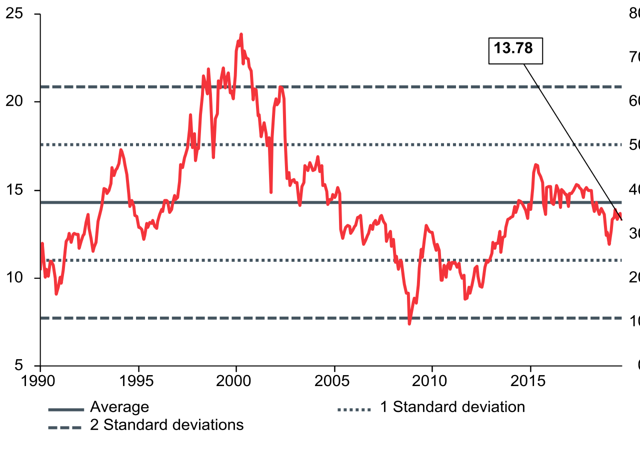
MSCI AC World 12M Forward PE



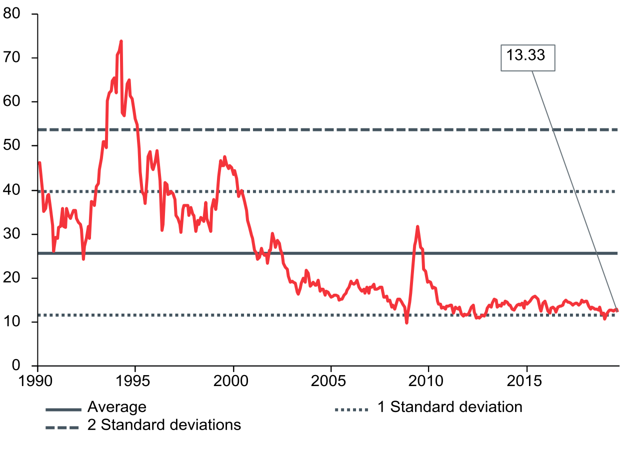
MSCI USA 12M Forward PE



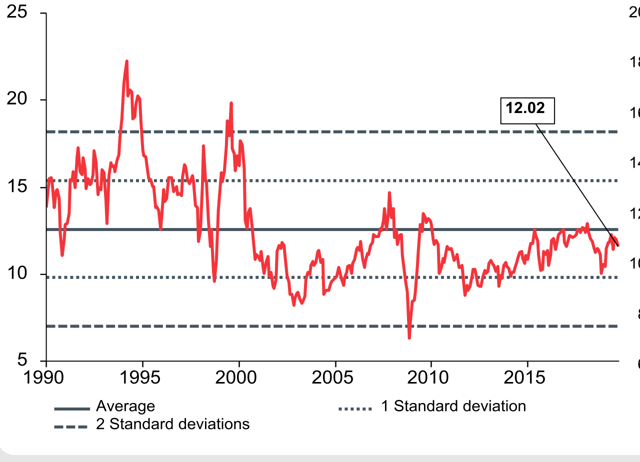
MSCI Europe 12M Forward PE



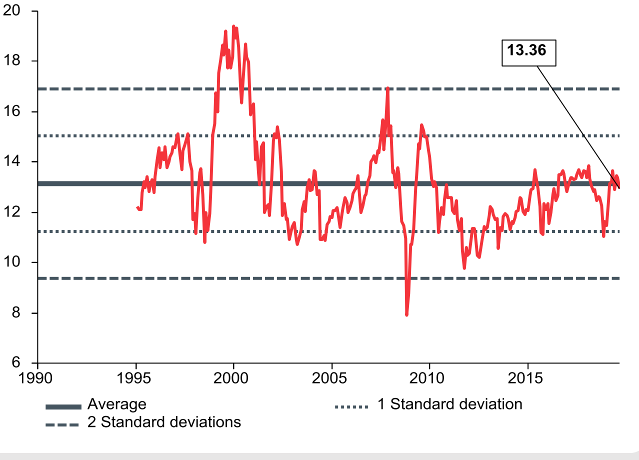
MSCI Japan 12m Forward PE



MSCI Emerging Markets 12M Forward PE



MSCI Asia Pac ex Japan 12M Forward PE



Source: Eastspring Investments. Chart data using IBES estimates from Refinitiv Datastream as of 30 September 2019.

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MSCI monthly, quarterly and year-to-date data

	Sep-19	Aug-19	Jul-19	Q3 19	Q2 19	Q1 19	YTD	2018
World	2.2	-2.3	0.3	0.1	3.8	12.3	16.7	-8.9
Developed World	2.2	-2.0	0.5	0.7	4.2	12.6	18.1	-8.2
United States	1.8	-1.7	1.5	1.6	4.3	13.9	20.6	-4.5
Europe	2.7	-2.5	-1.9	-1.8	4.9	11.0	14.4	-14.3
Japan	4.2	-1.0	0.1	3.3	1.0	6.8	11.5	-12.6
Emerging Markets	1.9	-4.8	-1.1	-4.1	0.7	10.0	6.2	-14.2
Asia Pac Ex Japan	1.8	-4.4	-1.3	-3.9	0.8	11.5	8.0	-13.7
Asia Ex Japan	1.7	-4.4	-1.7	-4.4	-0.6	11.4	6.0	-14.1
Latin America	2.6	-8.1	0.1	-5.6	4.6	7.9	6.6	-6.2
Brazil	2.5	-9.2	2.6	-4.5	7.2	8.2	10.8	-0.2
EMEA	1.0	-7.3	-0.5	-6.8	7.4	5.6	5.7	-15.5

	Sep-19	Aug-19	Jul-19	Q3 19	Q2 19	Q1 19	YTD	2018
Australia	2.4	-4.3	0.6	-1.4	7.4	11.4	18.0	-11.8
New Zealand	0.3	-6.8	4.0	-2.8	4.0	16.9	18.1	-3.5
Hong Kong	-0.7	-8.3	-3.3	-11.9	1.0	15.6	2.8	-7.8
China	-0.0	-4.2	-0.5	-4.7	-3.9	17.7	7.8	-18.7
Korea	7.2	-5.0	-6.2	-4.5	-0.9	5.0	-0.6	-20.5
Taiwan	4.3	-2.1	3.7	5.9	1.1	9.0	16.7	-8.2
Thailand	-1.0	-2.5	-2.6	-5.9	9.4	7.5	10.7	-5.3
Malaysia	-0.6	-3.7	-2.1	-6.3	1.2	0.3	-4.9	-6.0
Singapore	1.2	-6.0	-0.9	-5.8	7.0	6.2	7.1	-9.4
Indonesia	-2.9	-3.7	1.4	-5.2	3.7	4.3	2.5	-8.7
India	3.1	-2.9	-5.2	-5.2	0.5	7.2	2.1	-7.3
Philippines	-2.0	-3.3	0.6	-4.6	4.6	8.0	7.8	-16.1

	Sep-19	Aug-19	Jul-19	Q3 19	Q2 19	Q1 19	YTD	2018
Mexico	2.6	-0.4	-3.8	-1.6	1.3	5.6	5.1	-15.3
Chile	4.3	-6.4	-5.0	-7.3	-4.9	4.4	-8.0	-18.9
Hungary	0.9	-4.9	0.2	-3.9	-4.1	6.0	-2.3	-6.1
Poland	1.0	-8.7	-4.2	-11.7	3.6	-0.6	-9.0	-12.5
Czech Republic	-2.7	-5.3	-1.7	-9.5	3.9	3.8	-2.4	-2.2
Russia	3.3	-4.7	0.7	-0.9	17.3	12.2	30.4	0.5
Turkey	12.3	-10.7	11.3	11.7	3.1	-3.0	11.7	-41.1
South Africa	-1.2	-8.9	-2.8	-12.4	6.8	4.6	-2.2	-24.3
Qatar	0.7	-2.0	1.0	-0.2	0.6	-3.5	-3.1	29.8
Saudi Arabia	0.4	-8.8	-1.0	-9.3	1.4	14.9	5.6	19.2
United Kingdom	4.2	-4.7	-1.8	-2.5	0.9	11.9	10.2	-14.1
Germany	2.5	-3.0	-3.5	-4.0	7.8	7.0	10.7	-21.6
France	2.5	-1.7	-2.4	-1.6	7.3	10.8	16.9	-11.9
Netherlands	2.6	-1.0	0.9	2.5	6.1	13.6	23.5	-12.8
Austria	2.4	-3.6	-1.7	-3.0	3.1	8.6	8.6	-23.2
Italy	2.9	-1.4	-1.3	0.1	3.6	14.7	19.0	-17.0
Spain	4.1	-3.5	-4.2	-3.8	2.9	7.1	6.1	-15.7
Greece	2.1	-5.3	0.4	-3.0	16.4	12.8	27.4	-36.7
Portugal	4.1	-1.7	-0.5	1.8	2.6	10.2	15.2	-10.1
Switzerland	0.7	0.3	-0.7	0.3	9.0	13.5	24.1	-8.2

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 September 2019. Data and commentary prepared by Peter Bennett.

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