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Investment Commentary

July 2019

Recent economic developments

■ On the economic front, there has been no real improvement over the past month with a broad range of reports pointing to a slowdown in the pace of global economic activity. In the US, while first quarter GDP growth rate was confirmed at 3.1%, the emerging evidence suggests that Q1 is likely to have marked the peak in growth rate for the year.

■ Looking ahead some important leading indicators of US economic activity, including the ISM and Chicago Fed's National Activity Index, have pointed to ongoing moderation in the pace of growth. Indeed, the latest update of the widely followed Atlanta Fed's GDP growth projections point to a GDP growth rate in the second quarter that is less than half that recorded in Q1. Likewise, market consensus forecasts point to subdued economic performance over the rest of 2019 as recent data have flagged ongoing modest pace of activity across retail sales, auto sales and manufacturing.

■ In the UK, the balance of evidence points to a lacklustre outlook for the economy over the next few quarters. For instance, in recent weeks, survey data from the widely followed Purchasing Managers Indices have pointed to outright contraction in the manufacturing and construction industries while the dominant services sector has stalled. This suggests that the UK economy as a whole is likely to have contracted in the second quarter of 2019.

Figure 1: Index returns for June 2019 (%)

INDEX	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	5.6	6.6	5.8	4.3	5.9
MSCI USA	6.0	7.0	6.2	4.7	7.0
MSCI Europe ex UK	6.4	7.4	6.6	5.1	4.9
MSCI United Kingdom	4.0	5.0	4.2	2.7	4.0
MSCI Japan	2.8	3.8	3.0	1.5	3.0
MSCI AC Asia ex JP	5.6	6.7	5.8	4.4	5.4
MSCI EM Latin America	5.2	6.2	5.4	3.9	3.8
MSCI EM (Emerging Markets)	5.3	6.3	5.5	4.0	4.7
Bonds					
JP Morgan GBI Global (Traded)	1.2	2.1	1.4	0.0	1.2
JP Morgan GBI United States (Traded)	0.0	0.9	0.2	-1.2	0.9
JP Morgan GBI Japan (Traded)	0.5	1.5	0.7	-0.7	0.7
JP Morgan GBI United Kingdom (Traded)	0.2	1.2	0.4	-1.0	0.2
JP Morgan EMU	3.5	4.5	3.7	2.3	2.3
Currencies					
Sterling	n/a	1.0	0.2	-1.2	n/a
US dollar	-1.0	n/a	-0.8	-2.1	n/a
Yen	-0.2	0.8	n/a	-1.4	n/a
Euro	1.2	2.2	1.4	n/a	n/a

Source: MSCI, FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management.
Past performance is not a reliable indicator of current and future results. Data as of 30 June 2019.

■ In this context, the mixed messages from the Bank of England (BOE) remain at odds with the recent changes in monetary policy settings by other major central banks. Having hitherto guided the markets to expect further hikes in interest rates Mark Carney, the BOE Governor, recently appeared to soften his views on the likely path of policy when he acknowledged the downside risks to global growth. However, that contrasted with views from two members of the Bank's Monetary Policy Committee–Michael Saunders and Ben Broadbent–who recently appeared to favour rate hikes in the near future.

■ As with the UK, emerging data on the Euro-zone economy points to sluggish growth and ongoing risk of stagnation. For instance, it was recently reported that German factory orders fell by 8.6% on the previous year (in May), marking the steepest decline since October 2009. Likewise, indicators of consumer and business confidence have continued to weaken across the Euro Area.

Financial markets & investment strategy summary

■ Following weak performance in May, equity markets staged a strong rally in June as bullish sentiment was boosted by a number of factors. First, comments by central bank officials in the US and Euro Area fuelled investors' expectations that the Fed and ECB would resume monetary policy easing in the weeks ahead. Investor sentiment was further

boosted by the apparent easing of trade tensions between the US and China following the recent G20 summit in June. While the likely outcome of talks remains unclear, the absence of further escalation was sufficient to trigger a relief rally across financial markets. Figure 1 illustrates the broad-based nature of the gains with positive returns recorded for equities, bonds and a broad range of alternative investments.

■ Multi-asset investors would have noticed that virtually all segments of their portfolios delivered strong returns in June. While strong positive returns are welcome, the sustainability of the moves is questionable. For while sovereign bond yields are being driven lower (and prices higher) by the reality of a weakening economic outlook, the gains in equities have been fuelled by the hope that the major central banks will act in both a timely manner and with sufficient zeal (cue optimistic expectations of a 50 basis-point cut in rates by the US Federal Reserve in July) to prevent the ongoing economic slowdown from turning into a downturn.

■ In the near term, the magnitude of the rally in government bonds has triggered warning signs in important technical indicators and we now expect a temporary push up in yields to unwind some of the crowded investor positioning. Consequently, we have adopted an underweight asset allocation position to the asset class. We retain a neutral allocation to risk assets including equities and alternatives. In the currency markets, sterling is likely to remain under pressure from elevated political risk and ongoing Brexit-related uncertainties.

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