THOMAS MILLER INVESTMENT

Investment Commentary

March 2019

Recent economic developments

■ Latest updates of key leading economic indicators continue to signal diminishing growth momentum across major economies including the US, China and the Euro-zone. On balance, the evidence suggests that this diminution in growth momentum is likely to persist for the rest this year.

■ In this context, it is worth noting the recent revisions to global growth forecasts by the OECD. In its latest Interim Economic Outlook, the organisation noted that “economic prospects are now weaker in nearly all G20 countries than previously anticipated. Vulnerabilities stemming from China and the weakening European economy, combined with a slowdown in trade and global manufacturing, high policy uncertainty and risks in financial markets, could undermine strong and sustainable medium-term growth worldwide.” The figure below presents the updated forecasts (and direction of changes to forecast) by the OECD.

■ As we have noted in the past, at this point, there is no reason to expect that the ongoing slowdown will turn into something more severe. However, that depends to a large extent on the absence of negative shocks in the year ahead. While there is no shortage of potential sources of such negative shocks, it is worth noting that recent steps taken by monetary (and in the case of China, fiscal) authorities in the US, Euro zone and China should help offset some of the weakness.

■ In the US, the Federal Reserve has halted its policy of progressive hikes in interest rates while in China authorities have announced a raft of fiscal stimulus measures in an attempt to mitigate the impact of the ongoing slowdown. Likewise, the European Central Bank has also recently struck an unexpectedly dovish tone and affirmed its willingness to adopt further stimulus measures.

Financial markets & investment strategy summary

■ Risk assets have maintained their strong start to the year, with gains in the range of 2% to 5% for most equity markets in February. Outside of that range, the best performance came from China’s Shanghai Composite which returned 13.8% in February. That added up to a local currency total return of 17.9% over the first two months of 2019. Chinese equities have benefited from improved investor sentiment on the back of the combination of looser fiscal conditions and investors’ expectations of a positive outcome to ongoing trade talks. The main laggards over the last month were stock markets elsewhere in the emerging markets. For instance, Brazil’s Bovespa returned -1.9% while Russia’s MICEX declined by -1.4% (both in local currency terms).

■ The mild increase in bond yields over the past month meant that fixed income markets recorded modest losses, with declines of -0.3%, -0.9% and -0.3% across US Treasuries, UK Gilts and German Bunds respectively. In contrast, corporate bonds benefited

Figure 1: OECD Interim Economic Outlook Projections

Year on year, %. Arrows indicate the direction of revisions since November 2018.

	2018	2019	2020		2018	2019	2020
World	3.6	3.3 ↓	3.4 ↓	G20	3.8	3.5 ↓	3.7
Australia	2.9	2.7 ↓	2.5 ↓	Argentina	-2.5	-1.5 ↑	2.3
Canada	1.8	1.5 ↓	2.0 ↑	Brazil	1.1	1.9 ↓	2.4
Euro area	1.8	1.0 ↓	1.2 ↓	China	6.6	6.2 ↓	6.0
Germany	1.4	0.7 ↓	1.1 ↓	India[1]	7.0	7.2 ↓	7.3 ↓
France	1.5	1.3 ↓	1.3 ↓	Indonesia	5.2	5.2	5.1
Italy	0.8	-0.2 ↓	0.5 ↓	Mexico	2.1	2.0 ↓	2.3 ↓
Japan	0.7	0.8 ↓	0.7	Russia	2.3	1.4 ↓	1.5 ↓
Korea	2.7	2.6 ↓	2.6 ↓	Saudi Arabia	2.0	2.1 ↓	2.0 ↓
United Kingdom	1.4	0.8 ↓	0.9 ↓	South Africa	0.8	1.7 ↑	2.0 ↑
United States	2.9	2.6 ↓	2.2 ↑	Turkey	2.9	-1.8 ↓	3.2 ↑

Source: Interim Economic Outlook, OECD. March 2019.

from the broad improvement in risk appetite which resulted in further tightening in credit spreads. In a further demonstration of positive investor sentiment, the best performance in the fixed income space was recorded by high yield credit. US, UK and Euro high yield saw recorded gains of 1.6%, 1.3% and 1.8% respectively, in local currency terms.

■ The positive tone continued in currency markets (at least as far as sterling is concerned) as investors revised lower the probability of a 'no-deal' outcome to the ongoing Brexit negotiations. As a result, sterling continued its rally against both the US Dollar and Euro. So far this year, sterling has gained about 4% against the USD and almost 5% against the Euro. Figure 2 illustrates the gains in selected assets over the first two months of the year.

■ The rally in risk assets over the first couple of months in 2019 has been impressive given the backdrop of elevated policy, economic and geo-political uncertainty. Of these primary sources of uncertainty at the turn of the year, only one has seen a positive turn. On the monetary policy front, investors have been buoyed by a broad dovish turn by major central banks including the US Fed and the ECB. That has helped to loosen financial conditions and revive demand for risk assets.

■ While the combination of relatively cheap starting valuations and central bank (Fed) support provided justification for the rally from the trough in late December 2018, investors now appear to have largely priced away the other important risk factors. The combination of slowing growth and prevalence of events with significant downside risks (specifically, ongoing Brexit and US/China trade negotiations) suggest that periodic bouts of market volatility will be more frequent than usual in the year ahead. On balance, these factors call for some caution in asset allocation decisions, particularly for investors with low tolerance for sharp losses.

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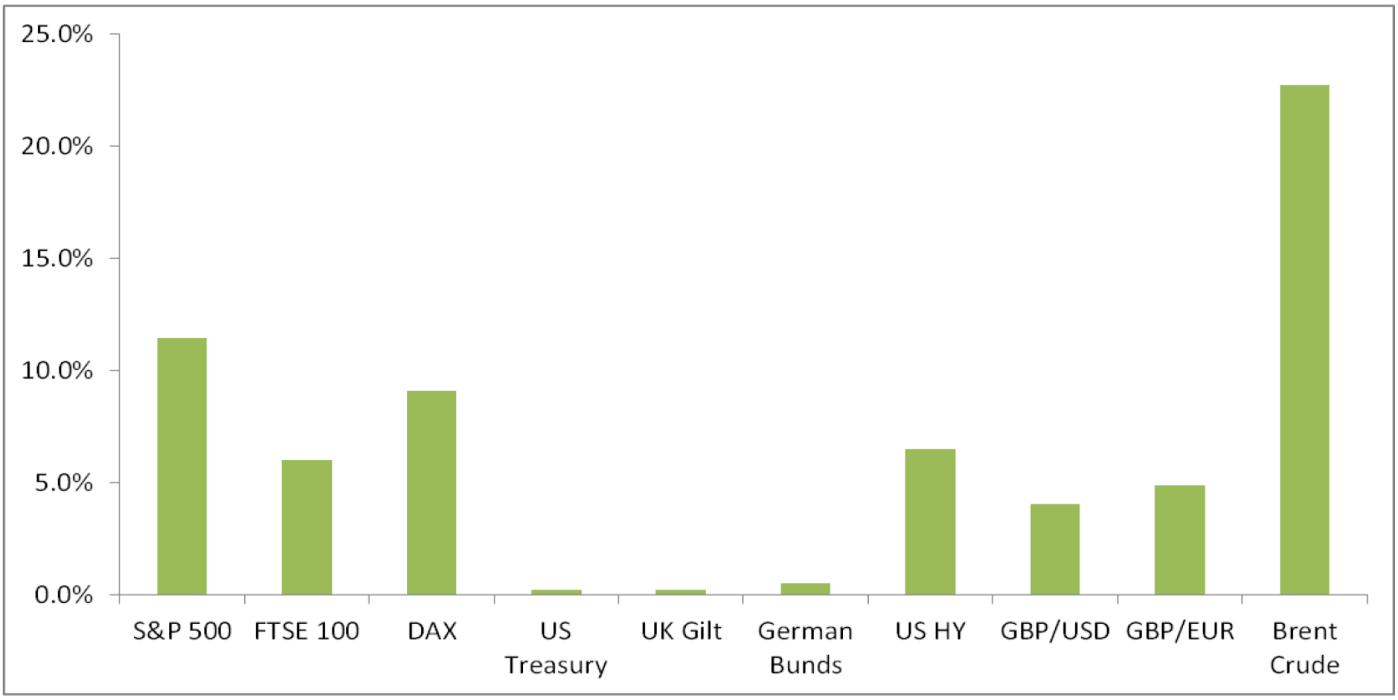
Figure 2: Total Return Performance of Major Financial Assets, 2019 YTD

(Local Currency)



Source: data from Deutsche Bank

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