Monthly Newsletter Savings and Investments

Strong 2019 Q1 for stock markets, what to expect for the rest of the year?

April 2019

Market overview

The Q1 of 2019 is now behind us and we can clearly state that it has brought a new wave of optimism, with equities rallying strongly across the world. The sell-off in equities in the final quarter of last year was caused majorly by concerns about the potential for an escalation in the trade war between the US and China, fears that higher interest rates could hurt the US economy, and broader worries about a slowdown in global growth. In many ways, the weakness in Q4 set the stage for the recovery in equity markets in 2019 Q1. Much of the rally this year has been built on market expectations that central banks and especially the Fed will be more patient and not hurry to tighten monetary policy, also negotiations between the US and China has improved and it is expected that the agreement can be reached during the next couple of months. Recently we also saw some recovery in macroeconomic data. For the recovery in markets to continue, the weakness in global growth will have to recede, extending what has already been a very long economic expansion by historical standards. On this front, the data in the 2019 Q1 was more mixed. Our general market view is that growth is going to slow this year 2019. On tactical horizon, we chose to move from overweighting risk assets such as equities to decreasing it to neutral level. In line, we are closely tracking what is happening in the markets and are ready to make changes.

Stock market indexes' performance (until 31 March 2019)

Region	Index	Currency	Performance							
			2019 Mar	2018 YTD	12 Months	2014	2015	2016	2017	2018
USA	S&P 500	USD	1,8%	13,1%	7,3%	11,4%	-0,7%	9,5%	19,4%	-6,2%
Europe	MSCI EURO	EUR	1,3%	11,4%	-1,5%	2,3%	6,1%	1,7%	8,7%	-14,2%
Eastern Europe	MSCI EM Eastern Europe	USD	0,2%	8,4%	-4,3%	-40,0%	-8,1%	33,0%	12,9%	-8,3%
Asia	MSCI EM Asia	USD	1,7%	10,9%	-8,8%	2,5%	-11,8%	3,8%	40,1%	-17,3%
Latin America	MSCI EM Latin America	USD	-2,7%	7,0%	-9,5%	-14,8%	-32,9%	27,9%	20,8%	-9,3%

Major events and expectations

In focus. Brexit and US-China trade talks. On April 10th EU leaders concluded with the prime minister Theresa May being offered a longer extension than she had sought. **UK will remain as a member state of the EU until 31 October**, with the option to leave earlier if can secure support in British Parliament for the Brexit deal. The EU will also hold June summit to review the UK's behaviour as a member state of EU. After this decision, **tension among investors eased**, however it means that the uncertainty about Brexit will continue for longer time. **Trade talks**. During last several weeks bigger **optimism was noticeable about US-China trade negotiations** from both sides and it have contributed to continued stock market upturn. According to President Donald trump, a trade agreement can be reached by early May. On the other hand, there is still not clearly certain as to how the negotiations will evolve.

US. Despite some mixed data US economy continues to show strength. The last estimate of **2018 Q4** GDP showed that **US economy grew by 2.2%** (annualised), a bit less than the previous estimate of 2.6%. Now investors will focus on 2019 Q1 growth and it is increasingly likely that GDP growth will turn out to have been below the average quarterly growth rate of 2.3%t registered since the recession ended in 2009. But it is in line with our forecast that **slower growth will continue in 2019**.

Consumption is the key to the economy's performance, and the outlook for the consumer has not fundamentally changed. As long as job growth holds up, wages rise and the stock market remains on a satisfactory path, consumers will have the confidence to safely spend. Consumer spending typically accounts for approximately two-thirds of GDP, so it has an outsized effect on economic activity. Labor market is still strong and moving in the right direction, with unemployment rate at 3.8%. Consumers can also lift the manufacturing sector and business investment intentions out of their softer patch during recent months.

The Fed maintained the target range for the **federal funds rate at 2.25 to 2.50%** at the meeting that concluded March 20. The Fed's own rate path shifted to indicate zero rather than two rate hikes in 2019. **We expect the Fed** to leave the fed funds **target range unchanged throughout 2019** and probably 2020 although risks are on the downside. The Fed also presented a plan for reducing the balance sheet starting from May and ending at the end of September.

Earnings reporting season is starting. Companies are starting to report 2019 Q1 earnings and investors will pay attention to it. However, **we do not expect the earnings season to be a significant driver for equities over the coming months**. Focus is on economic outlook (which requires stronger macroeconomic data) and not on what earnings have been in Q1. With that being said downward revisions to earnings per share (EPS) estimates have been massive and we do expect to see on aggregate positive surprises. But it will not drive equities significantly higher.

Europe. Macroeconomic data from Europe continues to look week. The divergence between US and European macroeconomic momentum continues to be quite large. We see weak growth in the biggest European economies. In Germany, the biggest economy, business surveys shows that Manufacturing PMI fell to 44.1, which is well below 50 and shows contraction. However, despite weakness which is seen in business surveys, we saw some improvements in macroeconomic data. Industrial productions seems to be bottoming out. We still maintain the view that German growth will through over the coming months as the auto sector recovers from the 2018

slowdown. Also consumer confidence, which is very important factor for economic growth, increased for the third month in a row. **Political uncertainty in Europe** remains high and adds additional risk.

The European Central Bank (ECB) during the last meeting on April 10th **did not make any policy changes**. ECB's chairman M. Draghi tried to assure markets that **ECB is both able and willing to act to counter possible worsening outlook**. A month ago ECB said that it would not raise rates until at least next year, having previously said it wouldn't hike until at least the summer. The ECB also announced a new round of cheap financing for the banking sector (LTRO) and discussed measures to reduce the drag that negative rates have had on bank profits.

Emerging markets. Emerging Markets is increasingly looking like the region which is showing the strongest improvements in growth. Although the growth levels are yet by no means impressive compared to those of for example 2017 we note that we now for the second consecutive month are looking at improvements in leading indicators which shows quite good trends for the rest of this year. The Chinese authorities are now stimulating domestic demand with a package of tax cuts, infrastructure investment and measures designed to support bank credit growth. We now see that the falling Chinese credit growth have started to bottom out. We expect this trend to continue over the coming months and help stabilizing Chinese growth. Although we are still looking at negative growth rates in exports for some of the major EM countries we are taking note that leading indicators hereof is starting to improve. We expect this trend to be become even stronger in case of a trade deal between US and China, which we still see as our base case scenario.

To **summarize** at present, before the Q1 2019 reporting season begins, and given mixed macroeconomic figures, we are in a bit of vacuum in terms of signals about future direction in stock markets. This suggests trendless performance during the coming weeks. On **tactical horizon, we chose to move from overweighting risk assets such as equities to decreasing it to neutral level**. In line we are closely tracking what is happening in the markets and are ready to make changes. For us to go higher in risk tolerance we do require macroeconomic data to accelerate uniformly across regions and sectors. We are seeing more and more signs that China is starting to benefit from the fiscal and monetary stimulus launched over 2018 and 2019. We are seeing signs of stabilization for the US. But as long as Europe remains as weak as it is, and as long as the picture of a global growth reacceleration is not clearer, we will probably will not hurry to increase risk tolerance.

Overall, talking about this year we **expect it to be quite volatile** in markets, since we are still in the late phase of the economic cycle. This means that **global growth will gradually slow down** and that the earnings-generating ability of the corporate sector will be challenged. In this phase, more short-term sources of disruption such as political turmoil often have a greater impact as well. But we also foresee some positive counterforces that may diminish volatility during the year ahead, for example more attractive valuations of financial assets. Investors have already assumed more cautious positions, which will reduce the need for further risk reductions.

Glossary

Terms used	Explanation
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicate a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicate a relatively higher risk of default than investment grade bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Two main credit rating agencies Standard & Poor's (S&P) and Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. S&P designations of 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as high yield or "junk bonds".
LTRO (long-term refinancing operations), TLTRO (targeted longer-term refinancing operations)	This is a cheap loan scheme (lending money at a very low interest rate) for European banks that was announced by the European Central Bank (ECB) towards the end of 2011 to help ease the euro zone crisis. The injection of cheap money means that banks can use it to buy higher-yielding assets and make profits, or to lend more money to businesses and consumers – which could help the real economy return to growth. In summer of 2014 the ECB decided to conduct a series of targeted longer-term refinancing operations (TLTROs) aimed at improving bank lending to the euro area non-financial private sector, excluding loans to households for house purchase, over a window of two years.
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.
Purchasing managers' indexes (PMIs)	An indicator of the economic health of the manufacturing sector. The PMI indexes are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI of more than 50 represents expansion of the manufacturing sector, compared to the previous month. A reading under 50 represents a contraction, while a reading at 50 indicates no change.
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.