Monthly Newsletter Savings and Investments

Record share prices until year-end?

December 2019

Market overview

Signs of stabilization in macroeconomic statistics have provided continued support to stock markets. Overall, sentiment in markets has shifted from pessimistic to optimistic in the course of a few months. Hopes that trade conflicts moves towards resolution also contributed to that. Dovish signals from central banks are providing support, although after its October rate cut the US Federal Reserve (Fed) is now signaling that it will await coming economic developments. Long-term bond yields have rebounded after this year's sharp downturn, but they remain at extremely low levels. Lack of investment alternatives is one more reason stock markets keep climbing. Global economic growth is slowing, but we expect a soft landing, the likelihood of recession in 2020 has decreased. In light of this, we increase a bit our risk tolerance and allocation towards equities (from being slightly negative to neutral). However, a better economy has largely been priced in, and challenging valuations and muted corporate earnings growth may limit stock market potential. It suggests that some caution is advisable and this is the reason why we do not increase our risk tolerance even more.

Stock market indexes' performance (until 30 November 2019)

Region	Index	Currency	Performance							
			2019 Nov	2019 YTD	12 Months	2014	2015	2016	2017	2018
USA	S&P 500	USD	3,4%	25,3%	14,7%	11,4%	-0,7%	9,5%	19,4%	-6,2%
Europe	MSCI EURO	EUR	2,5%	20,7%	13,5%	2,3%	6,1%	1,7%	8,7%	-14,2%
Eastern Europe	MSCI EM Eastern Europe	USD	-1,3%	19,0%	14,4%	-40,0%	-8,1%	33,0%	12,9%	-8,3%
Asia	MSCI EM Asia	USD	0,5%	9,1%	5,6%	2,5%	-11,8%	3,8%	40,1%	-17,3%
Latin America	MSCI EM Latin America	USD	-4,3%	3,5%	1,0%	-14,8%	-32,9%	27,9%	20,8%	-9,3%

Major events and expectations

Trade negotiations. US and China have agreed on a phase-1 deal. According to Bloomberg, the agreement was signed by president D. Trump on December 12th. The deal is expected to include US suspending tariffs going into effect on December 15th and also lowering existing tariffs on USD 350 billion Chinese imports by 50%. In return, China is buying large amount of US agricultural goods and improves the protection of intellectual property. Market participants positively welcomed this news. Trade policy successes or setbacks may determine whether stock markets will remain at record-high levels until the end of 2019.

US – more stable macroeconomic data. There have been tentative signs of improvement in business sentiment. The November US purchasing managers' index (PMI) pointed to a pickup in activity across both manufacturing and services. More optimism around a trade deal, combined with improving activity, resulted positive equity market returns in the US. The latest estimate of Q3 GDP rose, so the pace of growth actually picked up slightly, despite expectations for a continued slowdown. Housing data has improved markedly, with new housing permits reaching their highest level since 2007, while mortgage delinquency rates reached their lowest level since 1995. Latest US labor market data was much better than expected and reflected a surge of strength that continued through recession fears that flared over the summer. The growth in newly created jobs was surprisingly high in November. Meanwhile job growth data for recent months were revised upward, and wage growth remained at moderate levels. The US economy added an average of 205,000 jobs per month from September through November, a very healthy clip. Unemployment fell to 3.5%, a new 50-year low.

The labor market and stock market have emerged as two of the biggest engines in the economy during D. Trump's third year in office, and they are both at or near record levels. Consumer sentiment is also picking up. However, economic growth has shown signs of slowing, pulled back by weak business investment. Many executives and economists believe that is because of the uncertainty caused by the prolonged trade standoff between the US and China, which remains unresolved.

The Fed is signaling no interest rates changes in 2020. As expected, in December's meeting the Fed left rates unchanged in a range of 1.50%-1.75% and signaled that they will remain at current levels for a long period to continue to support the expansion the labour market and an upturn in inflation. The message from the Fed does not change our view that the market should price a substantial likelihood for a Fed rate cut in 2020, but we acknowledge that our call for a cut already in March is challenged by both the Fed's intention to await more evidence on the effects of the earlier cuts and recent strong jobs data.

Activity in Europe was mostly better than in previous months, with the perceived easing in trade tensions perhaps playing a role. The latest Eurozone's consumer confidence data improved, while PMI business surveys rebounded. In particular, there was better news across the manufacturing sector, as all of the major components of the Eurozone manufacturing PMI rose compared to the previous month's level. The improvement in the German manufacturing PMI from a low level is encouraging, while the Q3 GDP reading confirmed that Germany narrowly avoided a technical recession. Although some rebound in manufacturing surveys appears to be underway, overall business sentiment is still somewhat mixed. The Eurozone's unemployment rate was 7.5% in October 2019, down from 7.6% in September 2019 and from 8.0% in October 2018. This is the lowest rate recorded in the euro area since July 2008.

The European Central Bank (ECB) welcomed its new president, Christine Lagarde; no ECB action now but door for easing not shut. Yesterday, ECB held their first monetary policy meeting with Christine Lagarde as new president. As expected, the statement gave little new guidance and reiterated was that the base interest rate is expected to remain at its present or lower levels until inflation outlook robustly converges to a level sufficiently close to, but below, 2%. While we expect fiscal policy to have a larger role in supporting demand and inflation in the euro area, the door for further monetary policy easing in 2020 is not shut and we maintain our forecast of a 0,1% deposit rate cut in March next year.

In UK, **British parliamentary election was held on December 12th**. The Conservatives and Prime Minister Boris Johnson won the election with a strongest win in 30 years. The Conservatives have secured a comfortable majority in the parliament (361 of 650 total seats). With this outcome, B. Johnson has secured the mandate he needs to leave the EU by the January 31st next year based on the withdrawal deal he negotiated with the EU. The UK will then enter the transition period and negotiations on a trade deal for the future relationship with EU will begin immediately. This removes much of the uncertainty what will happen in coming months as well as near-term risk of a no-deal withdrawal. However, we see the risk if upcoming negotiations in 2020 turn out to be difficult. The reason is that the new withdrawal deal no longer prevents a hard Brexit if negotiations with EU would fail.

In China, recently investors witnessed some weaker manufacturing and consumer data. Industrial production and retail sales both disappointed compared to expectations. Industrial production grew by 4.7% year on year compared to the previous month's reading of 5.8%, while retail sales grew 7.2% year on year, compared with a pace closer to 8.5% in the first half of 2019.

The ongoing protests in Hong Kong will continue to hinder the region's economy, along with the slowdown in Chinese growth and the ongoing trade uncertainty. What would be more concerning for global investors is if the situation in Hong Kong disrupts the US-China trade negotiations.

To summarize, growth is decelerating and corporate earnings forecasts are being lowered, but stock markets are climbing to new record highs. This is not entirely easy to understand. All else being equal, it suggests that caution is advisable. However, we expect recession to be avoided in 2020, due to a soft landing in growth. Meanwhile interest rates and yields will remain low for a long time. Slower growth will of course mean lower earnings increases, but a still fairly bright background situation for the stock market. The lack of investment alternatives (due to extremely low interest rates and bond yields) and decreased risks related to both growth and trade problems may provide continued support to stock markets going into 2020 as long as no negative catalyst appears. Looking at the very near term, trade policy successes or setbacks may determine whether stock markets will remain at record-high levels until the end of 2019. The news flow over the start of 2020 should be positive in terms of macroeconomics and politics.

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.
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.

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