Monthly Newsletter Savings and Investments

Relatively stable fundamentals are providing fuel to stock markets, but uncertainty may increase the risk of volatile stock prices

March 2019

Market overview

Positive sentiment in equity markets continued in February – stock prices climbed across regions for the second consecutive month. Optimism among investors was maintained by a combination of reasons – constructive US-China trade talks, a considerably more dovish stance from the US Federal Reserve and the implementation of Chinese stimulus measures. Also recent economic data releases in US showed continuing economy strength. On the other hand, economic data releases outside of the US, were not so exciting. The downturn in capital expenditure is slowing industrial activity. As yet, consumer spending is looking more robust thanks to strong labour markets. Our general market view is that growth is going to slow in 2019, compared to 2017 and 2018, but we think that it is going to be a gradual decline. We keep maintaining our slight overweighting risk assets such as equities. In line we are closely tracking what is happening in the markets and are ready to make changes.

Stock market indexes' performance (until 28 February 2018)

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

Major events and expectations

In focus. US-China trade talks and Brexit. At the end of February US President D. Trump announced that **US is postponing the tariff hike on Chinese goods scheduled for March 1**. He also said there has been major progress in trade talks with China and if this trend continues, he will meet with China's President Xi Jinping to **sign a trade agreement**. The summit is scheduled for late March in Florida and investors anticipate a "positive" solution, but there is still a risk of reversals. **Brexit** – Prime Minister Theresa May has promised Parliament that no later than **March 12 it can vote** (again) **on exit agreement with European Union**. Parliament **will probably reject it again**. If so, they will vote by next day on whether to let the United Kingdom leave the EU with no deal, which they will probably reject. This should lead to **postponement of EU withdrawal**.

US. Stronger US GDP growth than expected. GDP grew by a pace of **2.6%** (annualised) in the fourth quarter of 2018, above our 2.3% forecast and the 2.2% consensus market prediction. **Capital spending recovered** after weak Q3. This is encouraging, since the trade conflict with China and higher US interest rates have caused concerns about business investments. Though better than expected, growth was slower than the previous quarter's 3.4%. We believe this **trend of slower growth will continue in 2019**.

The partial **government shutdown ended** at the end of January. The shutdown had served to depress both **household and corporate sentiment** in January, but there were signs of a bounce back in February. The latest US composite purchasing managers' index (PMI) improved to 55.8, which points to an ongoing robust rate of growth in the US economy of around 2%.

The report of the January **US Central Bank** (Fed) meeting confirmed the dovish shift in thinking about raising **interest rates**, with "patience" remaining the operative word. Also it was mentioned about the Fed's decision to maintain a larger balance sheet and there-fore to end the process of **quantitative tightening** by the end of the year.

In US there are **several other political events** which could have an **impact on the market and** will shift investors' focus. Two of those are: 1. **US debt ceiling negotiations** (brinkmanship on raising the ceiling could hurt equity prices and put upward pressure on bond yields); 2. **Tariffs on US auto imports** (US president is indicating tariffs on all imports of autos and auto parts, but the timing of such an announcement is uncertain; this would hurt European and Japanese equities, particularly equities related to the auto industry).

Europe. Signs of weakening momentum persisted in Europe. The second estimate of euro zone's **2018 Q4 GDP** growth remained at **0.2%**. Looking at the biggest economies – growth in France was better than expected, but the German economy's growth was 0%. The flash euro zone composite **PMI improved** to 51.4, but the **manufacturing index fell** below 50, indicating an outright contraction in manufacturing activity. **Consumer confidence increased** for the second month in a row and there are signs of a significant improvement in car registrations, which suggests the auto industry is beginning to adjust to the new auto emissions regime. The **European political landscape** continues to keep **higher tension** among investors (Brexit, political decisions in Spain and Italy, European Parliament elections in May, etc.).

European Central Bank (ECB) after latest meeting (March 7th) communicated a decision to change the forward guidance to signal unchanged rates "through the end of 2019", instead of "through summer of 2019". This means that **interest rates will probably not be increased this year**. Also ECB surprised markets by **announcing about new liquidity instruments** to assist the banks-through the use of targeted longer-term refinancing obligations (TLTROs). Markets reacted accordingly, with the euro weakening and bond yields falling.

Mario ECB's chairman M. Draghi explained the ECB decision to add policy accommodation (only two months after ending quantitative easing), as an attempt to proactively manage "pervasive uncertainties", increase economic resilience and safeguard inflation convergence. Since the earliest interest rate increase date was pushed back until 2020 Q1 we see risk for the ECB to miss its window of opportunity to recover any policy leeway before the next economic downturn.

Emerging markets. Challenges for emerging markets persist. Activity is still weak, if not contracting, in many countries according to the composite PMI reports. However, a **more dovish Fed** and the resulting prospects for a weaker dollar, combined with the **Chinese stimulus measures**, is **increasing investor appetite** for the asset class. Chinese policymakers are implementing a mix of fiscal and monetary measures to support growth. **Outside of China** there are still a number of emerging markets that are feeling the effects of former currency depreciation, which is lifting inflation. This may constrain the ability of emerging market central banks to stimulate economies by lowering interest rates.

To **summarize** most of the 2018 Q4 downturn in stock markets has now been recovered. Meanwhile the **growth picture has become less favorable**. The risk of reversals has probably increased.

We **expect 2019 to be stormy** as well, 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. The US Central Bank also clearly signaled that it will slow the pace of rate hikes and keep a close eye on the strength of economic growth and the performance of financial markets, a message that led to large downturn in yields and yield forecasts, which will help to support the stock market.

The outcome of the **2018 Q4 reporting season** can best be described as **better than feared**. We foresee risks that earnings forecasts may be lowered a bit more in the coming months, but we believe these forecasts will remain positive.

Relatively **stable fundamentals** are **providing fuel to stock markets**, but **uncertainty may increase the risk of volatile stock prices**. We thus keep maintaining our slight overweighting risk assets such as equities, but in line we are closely tracking what is happening in the markets and are ready to make changes.

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.