# Monthly Newsletter
# Savings and Investments

More stable macroeconomic conditions

November 2019

## Market overview

October turned out to be an unexpectedly good month for risk assets such as equities, sustained by more stable macroeconomic conditions, progress in trade negotiations and better corporate earnings than had been feared. The risk of a no-deal Brexit had diminished after the European Union (EU) agreed to delay Brexit until Jan. 31, 2020. Global central banks reiterated their dovish stances and the United States (US) Federal Reserve cut interest rates for the third time this year. The slowdown in the growth of US and EU gross domestic product is decelerating. However, the stabilization, which we have seen in tactical macroeconomic data over October, is in our view not strong enough, nor uniform enough, for us to believe that a significant growth rebound is imminent. But the news flow on the margin is positive and the list of potential negative triggers has diminished. We therefore see the risk for a significant correction as falling and correspondingly we increase a bit our risk tolerance. Note that we still maintain keeping risk tolerance towards risk assets, such as equities, slightly underweighted.

## Stock market indexes' performance (until 31 October 2019)

| Region | Index | Currency | Performance | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | 2019 Oct | 2019 YTD | 12 Months | 2014 | 2015 | 2016 | 2017 | 2018 |
| USA | S&P 500 | USD | 2,0% | 21,2% | 12,0% | 11,4% | -0,7% | 9,5% | 19,4% | -6,2% |
| Europe | MSCI EURO | EUR | 0,9% | 17,8% | 10,4% | 2,3% | 6,1% | 1,7% | 8,7% | -14,2% |
| Eastern Europe | MSCI EM Eastern Europe | USD | 7,5% | 20,5% | 19,0% | -40,0% | -8,1% | 33,0% | 12,9% | -8,3% |
| Asia | MSCI EM Asia | USD | 4,4% | 8,6% | 10,3% | 2,5% | -11,8% | 3,8% | 40,1% | -17,3% |
| Latin America | MSCI EM Latin America | USD | 4,1% | 8,2% | 4,2% | -14,8% | -32,9% | 27,9% | 20,8% | -9,3% |

## Major events and expectations

**The US-China trade war headlines continues to dominate markets**. It has been swinging between escalating tensions and a more constructive outlook, and recently seems that it swung back in favor of the latter, with the announcement of what President D. Trump has called a "Phase One Deal". The deal involves China committing to significantly increase purchases of US agricultural products in exchange for a stop on the United States' scheduled October 15 tariff increase and possibly further increases mid-December.

While the announcement of the first phase of a deal between China and the US is a small breakthrough, we don't expect it to lead to a resolution of the trade war soon. And most recent D. Trump's rhetoric – D. Trump said that China want the deal "much more than I do" – confirms that. Yes, we have turned from seeing the trade war as a negative to now something which could actually be a positive, but we could well see the trade war pendulum swing back towards escalation in the coming months if D. Trump decides to ramp up anti-China rhetoric to boost support ahead of the presidential election in November of next year..

**The US economy** hadn't slowed as much as had been expected (1.6%), the real GDP annualized growth was 1.9% in Q3. Labor market data was also stronger than expected in October. More new jobs (128,000) were added than expected (95,000). The unemployment at 3.6% remains near a half-century low. However, the pace of job growth has been slowing this year – on average, 160,000 jobs have been added each month this year, compared to 220,000 per month in 2018. Also there are signs of weakness in the more trade-dependent manufacturing sector, with the Institute for Supply Management's manufacturing purchasing managers' index (PMI) indicating that the manufacturing side of the economy is contracting. The more concerning development of late, however, has been that the manufacturing weakness seems to be gradually seeping into the broader economy, with cracks beginning to appear in the US consumer. But overall consumption in US still remains strong and it is a main driver of economy.

**The Fed cut its key rate as expected and is signaling a pause.** The US Federal Reserve lowered its key interest rate for the third time this year to the 1.50-1.75% range. The Fed stuck to its message that this was a temporary downward adjustment and that a sizeable inflation upturn will be required before the central bank even considers a rate hike. This decreases the risk that rising interest rates and bond yields will put an end to the stock market rally. Our forecast is one more "insurance" rate cut in January followed by a pause.

The US **earnings season** for the Q3 of the year is almost finished, with companies doing better than expected. Earnings per share and sales are growing at 1% and 4% year on year (y/y), respectively on the S&P 500 index. However, US companies continue to give lower guidance for next year's earnings, with the trade dispute an ongoing theme.

**The eurozone economy** grew also a little more than expected in the Q3, while the unemployment rate was steady in September. The economy grew 0.2% in Q3, in line with the previous quarter and ahead of expectations of 0.1% growth. On the year, GDP rose 1.1% in the eurozone, in line with expectations and down from 1.2%. Unemployment rate for the bloc was stable in September at 7.5% and down from 8.0% in September last year. This marks the lowest rate recorded in the euro area since July 2008. The inflation rate for the eurozone fell to 0.7% in October from 0.8% in September, in line with analysts' expectations. It is far away for central bank's target rate of 2%. Our view that the euro-zone economy as a whole is slowing and will probably expand at a feeble quarterly pace of around 0.1% for the next year or so. That in turn will keep the pressure on policymakers, both in European Central Bank (ECB) and in national capitals, to do more to boost demand.

**October's ECB meeting** marked Mario Draghi's final press conference as president. Christine Lagarde, former head of the International Monetary Fund (IMF), now takes the reins. Lagarde inherits an ECB tool kit that is nearing its limits, with interest rates at -0.5% and quantitative easing of EUR 20 billion per month in place until the inflation target is close to being achieved. With a seemingly depleted monetary toolkit, the challenge will be whether or not Lagarde can convince governments to loosen the fiscal policy to stimulate the economy.

**In UK**, Prime Minister Boris Johnson was able to agree a new Brexit deal with the European Union (EU).However, members of UK parliament refused to approve rushing through the legislation process in order to leave the EU on the 31 October deadline. This meant an extension to the Brexit deadline was agreed to 31 January 2020. A general UK election will now be held on 12 December, as the prime minister seeks a new parliamentary majority to pass his deal.

**China's economy slowed a bit but keeps high pace**. The annual pace of real GDP eased to 6.0% in Q3, down from 6.2% in Q2. Weaker growth is slowing Chinese demand for external goods, with imports falling 8.5% (year on year) in September. Industrial production and retail sales data for September were more positive, rising to 5.8% and 7.8% (year on year), respectively. Overall, Chinese economy looks quite steady, which is partly a result of government's stimulative measures.

**To summarize,** favorable corporate reports and signs of stabilization in macroeconomic statistics have provided continued support to equity markets. Signals from US-Chinese trade talks are also constructive, with new tariff hikes being postponed, while the Brexit issue has been pushed lower on the risk list. Dovish signals from central banks are providing support, although after last week's rate cut the US Federal Reserve 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. The overall outcome has been that share prices rose markedly during October, with gains of 2-4% in the US and 4-8% in Europe.

Recent macro statistics point to continued global deceleration, but at a slower pace than feared. This applies especially to the US, where a continued solid labor market is helping sustain growth. In Europe, where economic expansion has slowed more sharply this year (especially in manufacturing) we are seeing signs of what may be a stabilization in growth.

So currently the news flow on the margin is positive and the list of potential negative triggers has diminished. We therefore see the risk for a significant correction as falling and correspondingly we increase a bit our risk tolerance. Note that we still maintain keeping risk tolerance towards risk assets, such as equities, slightly underweighted. Better (less bad) economic statistics and corporate reports that are better than previously feared are on the plus side, but with stock market indexes at or near new all-time highs there is an obvious risk that good news is already largely priced in.

## 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. |