Monthly Newsletter Savings and Investments

Slowing growth rate, but that does not mean that global recession is around the corner

February 2019

Market overview

January was very strong for many world's stock markets. Both developed and emerging market equities gained over 7% return. For example, in United States (US), the main stock market index (S&P 500) saw its best January since 1987, recovering most of its December decline. Few of the main drivers for the rebound were US central bank much less strict communication about monetary policy tightening and movements in US-Chinese trade negotiations. 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 and that the market is overly pessimistic on the growth outlook and too afraid of the recession risk for the US. We expect that equities should be supported over the coming months as the market starts to digest more positive outlook. We keep maintaining our slight overweighting risk assets such as equities, mostly because of more accommodating monetary policy environment and the January rebound in tactical US macro data. In line we are closely tracking what is happening in the markets and are ready to make changes.

Stock market indexes' performance (until 31 January 2018)

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

Major events and expectations

In focus. Continued Brexit deadlock. This week **British Parliament** will again **vote on** Brexit. The European Union is sticking to its decision not to postpone the United Kingdom's withdrawal deadline and not to open the way for new negotiations if no new situation arises. Such a situation might be if the UK requests time for the second referendum or snap election, but right now both these alternatives appears closed. A **reasonable guess** is that since both the **UK and EU want avoid a hard** (without agreement) **Brexit** at any price, they will find a way to **extend the deadline** if there are no other alternatives.

US economy continues to show **signs of strength but** lately we saw some **mixed economic data** and most likely it is related to trade tensions with China. The December **ISM manufacturing** survey **fell significantly** (the largest monthly decline since 2008). The survey was largely dragged down by a fall in the new orders component. However, equity markets have been buoyed by the truce between the US and China, which is set to be active until at least 1 March and US stock markets finished the month up 8.0% (S&P 500 index).

The US government entered the year partially closed. There was 35-day **government shutdown** period, which was the longest in history. **This will negatively affect US GDP** but it is expected that the loss will largely be recovered by the end of this year. The impact over the longer term might eventually be small but it has certainly affected sentiment in the US.

US labour market continues to show very strong signs. Probably January's jobs report may be affected by the government shutdown but the December jobs report was very strong. 312,000 jobs were added to the US economy and wage growth inched up to 3.3% year on year.

The **US central bank** has signalled that it is in **less of a rush to tighten monetary policy and raise interest rates this year**. There are no signs of much higher inflation in near future which means there will be less pressure on the Fed to raise rates in order to control inflation.

By the end of January, the **US corporate report season** was more than hallway over. Around **70%** of companies (of S&P 500) have reported **higher earnings** than expected and around **60% higher sales**. However we foresee **risk of continued downward revisions in earnings forecasts**.

Overall the US economy is at the front of the cyclical process, as reflected in record-low unemployment and high capacity utilisation. Due to resource shortages and potentially temporary negative effects from the US-Chinese trade conflict early in 2019, we will see a deceleration. But **we foresee no recession, "only" slower growth**.

Europe. Signs of slowdown persists in Europe. The region caught in the crossfire of the trade war and has also been hurt by the fall in demand from China. We also believe that temporary factors, such as new European Union regulations that have hampered important auto sales, amplified the slowdown. And the recent data from Europe did not improve in January. **Business surveys** (**PMIs**) continued to weaken and now are at their weakest since 2014. On the other hand, **domestic demand** in Europe has **remained fairly resilient** despite the external factors that have threatened its progression. The **lower oil price** and the continued **improvement in the labour market** should help to **support euro zone consumption**.

The **European Central Bank (ECB)** said the risks surrounding the euro area growth outlook have moved to the downside. Despite this, the central bank kept its forward guidance on rates (the probability that rates can be raised in autumn this year) as well as its bonds purchasing program (economy stimulus program) which ended in 2018 year end.

Overall, growth in Europe is being maintained by business investment needs and a good outlook for households, but various political problems are dampening the mood, while weaker global demand is hurting vital exports. We expect growth to stabilise at somewhat above today's levels, but slower than in prior years.

Emerging markets. China's economic policy shift and **deceleration are proceeding as planned**, but they have been heightened by a world trade tensions. In the face of these trade tensions, as well as uncertainty rising from the domestic slowdown, the **Chinese authorities are taking numerous steps to stimulate growth.** We believe this will be enough to make the deceleration more modest. Other emerging market (EM) countries have also seen slower growth, partly due to a downturn in commodity prices. Yet global trade remains at decent levels, while domestic demand is strong in most places. We thus expect the **EM economies to remain an important engine of the world economy**.

To **summarize** currently we are a bit more optimistic about growth than the market consensus and this in combination with the more accommodative monetary policy environment led us to the decision to **remain overweight risk for now**. However, there is still a long list of challenges for the global economy so we stress that the **overweight is a tactical decision**.

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. We assume that a**verage volatility in 2019 will probably be lower than we experienced late last year**. Investors have already assumed more cautious positions which will reduce the need for further risk reductions. Both **political leaders** and **central banks** have surely been affected by the turbulence of 2018 and may thus **make more supportive future decisions**.

Overall, we expect **global economic growth of 3.5% in 2019**. This is somewhat less than before, but still a relatively good level. We thus do not expect a recession, although the risk of one has increased somewhat. We believe there is a **20-25% probability that a recession will occur in 2019-2020**.

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".

The Institute of Supply Management (ISM) manufacturing, non-manufacturing indexes	An index based on surveys of manufacturing/non-manufacturing firms by the Institute of Supply Management in US. An index with a score over 50 indicates that the industry is expanding, and a score below 50 shows a contraction. By monitoring ISM manufacturing and non-manufacturing indexes, investors are able to better understand national economic conditions. When this index is increasing, investors can assume that the stock markets should increase because of higher corporate profits. The opposite can be thought of the bond markets, which may decrease as indexes increases because of sensitivity to potential inflation.
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.