Market Review

1 February 2019

Review of markets over January 2019

Equity markets experienced welcome respite in January, after a torrid end to 2018. Both developed and emerging market equities gained over 7% in total return terms, boosted by signals from the US Federal Reserve (Fed) that it would be more patient with further rate rises, as well as by improving rhetoric towards China from the White House. Risk assets recovered some of the losses they made in the fourth quarter. Even so, political uncertainty remains a headwind, while recent macroeconomic data releases continue to send mixed signals about the outlook for the global economy.

Exhibit 1: Asset class and style returns in local currency

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Jan 2019
MSCI EM 33.6%	Global Agg 4.8%	MSCI EM 62.8%	REITS 27.6%	REITS 7.3%	REITS 20.1%	Small cap 35.8%	REITS 27.1%	Growth 6.5%	Value 15.1%	MSCI EM 31.0%	Global Agg -1.2%	REITs 11.4%
Cmdty 16.2%	Cmdty -35.6%	Small cap 40.8%	Small cap 24.4%	Global Agg 5.6%	Small cap 18.4%	Value 29.7%	Growth 11.5%	Small cap 2.8%	Small cap 14.5%	Growth 24.5%	REITs -4.1%	Small cap 9.6%
Growth 10.5%	REITS -37.3%	Growth 29.4%	Cmdty 16.8%	Value -4.9%	MSCI EM 17.4%	DM Equities 29.6%	DM Equities 10.4%	DM Equities 2.6%	Cmdty 11.8%	Small cap 19.1%	Growth -5.1%	Growth 7.9%
Global Agg 9.5%	Value -37.7%	REITS 27.4%	MSCI EM 14.4%	DM Equities -5.0%	Growth 16.5%	Growth 29.5%	Value 9.2%	REITS 2.3%	MSCI EM 10.1%	DM Equities 19.1%	DM Equities -6.9%	DM Equities 7.3%
DM Equities 5.2%	DM Equities -38.3%	DM Equities 26.5%	Growth 12.7%	Growth -5.1%	DM Equities 16.4%	MSCI EM 3.8%	Small cap 6.7%	Value -1.2%	DM Equities 9.6%	Value 14.1%	Value -8.7%	MSCI EM 7.2%
Value -0.0%	Growth -39.0%	Value 23.6%	DM Equities 10.6%	Small cap -8.7%	Value 16.3%	REITS 3.2%	MSCI EM 5.6%	Global Agg -3.2%	REITs 9.3%	REITs 9.3%	MSCI EM -9.7%	Value 6.6%
Small cap -3.8%	Small cap -40.4%	Cmdty 18.9%	Value 8.4%	MSCI EM -12.5%	Global Agg 4.3%	Global Agg -2.6%	Global Agg 0.6%	MSCI EM -5.4%	Growth 4.4%	Global Agg 7.4%	Cmdty -11.2%	Cmdty 5.4%
REITS -17.8%	MSCI EM -45.7%	Global Agg 6.9%	Global Agg 5.5%	Cmdty -13.3%	Cmdty -1.1%	Cmdty -9.5%	Cmdty -17.0%	Cmdty -24.7%	Global Agg 2.1%	Cmdty 1.7%	Small cap -12.2%	Global Agg 1.5%

Source: Barclays, Bloomberg, FactSet, FTSE, MSCI, J.P. Morgan Asset Management. DM Equities: MSCI World; REITs: FTSE NAREIT All REITs; Cmdty: Bloomberg UBS Commodity Index; Global Agg: Barclays Global Aggregate; Growth: MSCI World Growth; Value: MSCI World Value; Small cap: MSCI World Small Cap. All indices are total return in local currency. Data as of 31 January 2019.

US

The first signs of the US economy being hurt by the trade tensions with China were felt in January. The December ISM manufacturing survey fell significantly to 54.1—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. The S&P finished the month up 8.0%.

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The US government entered the year partially closed. A funding impasse over border security led to the 35-day government shutdown, which was the longest in history. However, the Congressional Budget Office (CBO) expects that almost all of the real GDP lost over the shutdown 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. The University of Michigan's Consumer Sentiment Index for January fell to 90.7 from 98.3 previously and the Conference Board's measure of consumer confidence fell from 126.6 to 120.2.

The January jobs report may be affected by the government shutdown but the December jobs report was quite strong. The unemployment rate picked up to 3.9% but this can largely be explained by a tick up in the participation rate. 312,000 non-farm jobs were added to the US economy and wage growth inched up to 3.3% year on year.

While the next few jobs reports will continue to be watched by the Fed for signs of higher wage growth, the US central bank has signalled that it is in less of a rush to tighten this year. Specifically, the Fed highlighted that muted inflation pressures meant that the committee could afford to be patient. The lower oil price, despite recent gains, meant that the latest headline inflation reading for December fell to 1.9% year on year. This means there will be less pressure on the Fed to raise rates in order to control inflation. The bond markets throughout January have priced in no further rate rises from the Fed over 2019.

The US equity market may be sensitive to incoming earnings reports. With around 40% of companies having reported their fourth-quarter earnings, earnings-per-share growth is 15% year on year so far.

Exhibit 2: World stock market returns in local currency

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Jan 2019
MSCI Asia ex Japan 38.0%	UK FTSE 100 -28.3%	MSCI Asia ex Japan 67.2%	MSCI Asia ex Japan 15.6%	US S&P 500 2.1%	Japan TOPIX 20.9%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE 100 19.1%	MSCI Asia ex Japan 35.9%	US S&P 500 -4.4%	US S&P 500 8.0%
MSCI EM 33.6%	US S&P 500 -37.0%	MSCI EM 62.8%	US S&P 500 15.1%	UK FTSE 100 -2.2%	MSCI Europe ex UK 20.0%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex UK 9.1%	US S&P 500 12.0%	MSCI EM 31.0%	UK FTSE 100 -8.7%	MSCI Asia ex Japan 7.2%
UK FTSE 100 7.4%	Japan TOPIX -40.6%	MSCI Europe ex UK 29.0%	MSCI EM 14.4%	MSCI Europe ex UK -12.1%	MSCI Asia ex Japan 19.7%	MSCI Europe ex UK 24.2%	MSCI Asia ex Japan 7.7%	US S&P 500 1.4%	MSCI EM 10.1%	Japan TOPIX 22.2%	MSCI EM -9.7%	MSCI EM 7.2%
MSCI Europe ex UK 6.6%	MSCI Europe ex UK -42.7%	UK FTSE 100 27.3%	UK FTSE 100 12.6%	MSCI EM -12.5%	MSCI EM 17.4%	UK FTSE 100 18.7%	MSCI Europe ex UK 7.4%	UK FTSE 100 -1.3%	MSCI Asia ex Japan 6.4%	US S&P 500 21.8%	MSCI Europe ex UK -10.6%	MSCI Europe ex UK 6.4%
US S&P 500 5.5%	MSCI EM -45.7%	US S&P 500 26.5%	MSCI Europe ex UK 5.1%	MSCI Asia ex Japan -14.6%	US S&P 500 16.0%	MSCI Asia ex Japan 6.2%	MSCI EM 5.6%	MSCI Asia ex Japan -5.3%	MSCI Europe ex UK 3.2%	MSCI Europe ex UK 14.5%	MSCI Asia ex Japan -12.0%	Japan TOPIX 4.9%
Japan TOPIX -11.1%	MSCI Asia ex Japan -47.7%	Japan TOPIX 7.6%	Japan TOPIX 1.0%	Japan TOPIX -17.0%	UK FTSE 100 10.0%	MSCI EM 3.8%	UK FTSE 100 0.7%	MSCI EM -5.4%	Japan TOPIX 0.3%	UK FTSE 100 11.9%	Japan TOPIX -16.0%	UK FTSE 100 3.6%

Source: FactSet, FTSE, MSCI, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency. Data as of 31 January 2019.

China

Concerns over a slowdown in China have not dissipated. Real GDP for the fourth quarter was announced at 6.4% year on year—dipping below the 6.5% mark for the first time. In the face of rising uncertainty emanating from the domestic slowdown, as well as the trade tensions with the US, the Chinese authorities have looked to provide stimulus to the economy. The People's Bank of China (PBoC) announced that it would cut its Reserve Requirement Ratio by 100 basis points throughout January. As estimated by the central bank, this round of cuts should inject roughly RMB 800 billion into the Chinese economy—equivalent to roughly 0.8% of Chinese nominal GDP. Further easing from the PBoC is expected throughout 2019 to help support the domestic economy. Despite the recent slowdown in GDP growth, both retail sales and industrial production beat expectations in the recent data releases. There was also further proof that infrastructure spending was continuing to pick up, which should help provide some targeted stimulus to the economy. The MSCI EM index rose by 7.2% over the month.

Exhibit 3: Fixed income sector returns in local currency

2012	2013	2014	2015	2016	2017	2018	Jan 2019
Euro HY 23.3%	Euro HY 8.8%	Euro Treas. 13.1%	Euro Treas. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Treas. 1.0%	US HY 4.6%
EM Debt 18.5%	US HY 7.4%	EM Debt 5.5%	EM Debt 1.2%	EM Debt 10.2%	Global IG 9.1%	US Treas. 0.9%	EM Debt 4.4%
US HY 15.5%	Euro Treas. 2.2%	Euro HY 5.5%	US Treas. 0.8%	Euro HY 10.1%	IL 8.7%	US HY -2.3%	Euro HY 2.3%
Global IG 11.2%	Global IG 0.3%	US Treas. 5.1%	Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Global IG 2.3%
Euro Treas. 11.0%	US Treas. -2.7%	IL 3.4%	Global IG -3.6%	IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	IL 2.2%
IL 8.5%	IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Treas. 3.2%	US Treas. 2.3%	IL -4.1%	Euro Treas. 1.1%
US Treas. 2.0%	EM Debt -6.6%	US HY 2.5%	IL -5.0%	US Treas. 1.0%	Euro Treas. 0.2%	EM Debt -4.6%	US Treas. 0.5%

Source: Barclays, BofA/Merrill Lynch, FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. IL: Barclays Global Inflation-Linked; Euro Treas: Barclays Euro Aggregate Government - Treasury; US Treas: Barclays US Aggregate Government - Treasury; Global IG: Barclays Global Aggregate - Corporates; US HY: BofA/Merrill Lynch US HY Constrained; Euro HY: BofA/Merrill Lynch Euro Non-Financial HY Constrained; EM Debt: J.P. Morgan EMBIG. All indices are total return in local currency. Data as of 31 January 2019.

Europe

Europe has been caught in the crossfire of the trade war and has also been hurt by the fall in demand from China. And the recent data from Europe did not improve in January. The manufacturing new export orders component of the Purchasing Managers' Index (PMI) for the eurozone remained below 50. In France, the flash composite PMI fell further to 47.9, despite a slowing in the momentum of the "yellow vest" protests that have caused significant violence and disruption to the country. More positively, consumer confidence in France and the eurozone as a whole picked up slightly.

Elsewhere in Europe, the Italian government's budget proposals, which was almost placed under the effective deficit procedure by the European Commission, were approved by the government and the Italian president. While the two main features of these proposals—the citizens' income and pension reform—are unlikely to be beneficial to fiscal sustainability in the longer term, the near-term risks appear to have eased. 10-year Italian government bond yields ended the month 37 basis points lower than the January high. Initial estimates of Italian GDP for the fourth quarter of 2018 showed a contraction of 0.2% over the previous quarter. This puts Italy into a technical recession. The fall in Italian government

bond yields means that their price goes up, allowing Italian bonds to have given a positive return of 1.2% over the month. As a sign of the stabilising European periphery, Spanish bonds ended the month returning 1.5%.

Despite the minor improvement in some of the political uncertainties, concerns over the persistence of slowing growth in the eurozone were still prevalent. The European Central Bank (ECB) made reference to the unexpected nature of the persistence of the factors that have contributed to the slowdown in growth. The ECB also 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 as well as its balance sheet re-investments the same. Similar to the ECB, the Bank of Japan also kept its monetary policy tools unchanged, but it did downgrade its inflation forecast for the fiscal year 2019 from 1.4% to 0.9%.

One positive for Europe was that the unemployment rate for November fell to 7.9%. 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 eurozone consumption.

Exhibit 4: Fixed income government bond returns in local currency

2012	2013	2014	2015	2016	2017	2018	Jan 2019
Italy 21.3%	Spain 11.3%	Spain 17.0%	Italy 4.9%	UK 10.7%	US 2.5%	Spain 2.6%	Spain 1.5%
Spain 6.0%	Italy 7.4%	Italy 15.7%	Spain 1.7%	Spain 4.2%	UK 1.9%	Germany 2.3%	Italy 1.2%
Germany 4.5%	Japan 2.2%	UK 14.1%	Global 1.3%	Germany 4.1%	Global 1.3%	Japan 1.1%	UK 1.1%
Global 4.1%	Global -0.4%	Germany 10.5%	Japan 1.3%	Japan 3.6%	Spain 1.1%	Global 1.0%	Germany 0.8%
UK 2.6%	Germany -2.3%	Global 8.5%	UK 1.2%	Global 2.9%	Italy 0.8%	US 0.8%	Global 0.7%
US 2.2%	US -3.4%	US 6.1%	US 0.9%	US 1.1%	Japan 0.2%	UK 0.6%	Japan 0.5%
Japan 1.8%	UK -4.2%	Japan 4.8%	Germany 0.4%	Italy 0.8%	Germany -1.4%	Italy -1.4%	US 0.5%

Source: FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. All indices are J.P. Morgan GBIs (Government Bond Indices). All indices are total return in local currency. Data as of 31 January 2019.

UK

Brexit uncertainty continued to dominate the headlines in the UK. Parliament proceeded to vote on the deal that the prime minister Theresa May had negotiated with the European Union (EU). That vote resulted in the deal failing to pass by a significant margin (432 against, 202 for). A series of votes then took place in order to establish a potential way forward for the Brexit negotiations that could command the support of a majority of members of parliament (MPs). The result of these votes showed two things. Firstly, that there is a majority in parliament against a no-deal scenario. And secondly, that there is a majority of MPs who would support May's deal if she can re-negotiate the Irish border backstop. If she is able to obtain these concessions from the EU around the backstop then it is likely that a version of her deal could pass in parliament. The prime minister has currently set 13 February as the date at which she would like to next put a revised deal to vote at the House of Commons.

Despite the political gridlock the UK labour market remains healthy. The unemployment rate fell to 4.0%, while wage growth picked up to 3.4% year on year. This is another sign that, were a no-deal Brexit to be taken off the table, the underlying strength of the labour market may justify moderately higher interest rates, as long as global growth holds up.

Conclusion

Ultimately, two significant shifts have helped risk assets over the course of January. First, the Fed's move to a more dovish stance regarding its rate guidance has helped to ease the market's fears about rates getting too tight at a time when the pace of global growth looks to be slowing. Second, the rhetoric from the US administration towards China also softened somewhat. The trade tensions have hurt China, Europe and now look to be biting in the US. Any deal would be a welcome relief for markets but the US and China are still some way from striking a deal, so there are risks that remain. At this stage in the cycle, where the macroeconomic data is more mixed and political uncertainties remain, we have lower conviction in the economic and market outlook. Therefore, it makes sense to be making gradual shifts in portfolios to add more resilience and to look to strategies that can more dynamically shift their exposure to risk assets.

Exhibit 5: Index returns in January 2019 (%)

INDEX	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	4.4	7.8	6.9	7.4	7.3
MSCI USA	4.8	8.2	7.4	7.8	8.2
MSCI Europe ex UK	3.0	6.4	5.6	6.0	6.4
MSCI United Kingdom	3.7	7.1	6.2	6.7	3.7
MSCI Japan	2.7	6.1	5.2	5.7	5.2
MSCI AC Asia ex JP	3.9	7.3	6.4	6.9	7.2
MSCI EM Latin America	11.3	15.0	14.0	14.5	9.0
MSCI EM (Emerging Markets)	5.3	8.8	7.9	8.4	7.2
Bonds					
JP Morgan GBI Global (Traded)	-1.9	1.3	0.5	0.9	0.7
JP Morgan GBI United States (Traded)	-2.7	0.5	-0.3	0.1	0.5
JP Morgan GBI Japan (Traded)	-1.9	1.3	0.5	1.0	0.5
JP Morgan GBI United Kingdom (Traded)	1.1	4.4	3.5	4.0	1.1
JP Morgan EMU	-1.7	1.5	0.7	1.1	1.1
Currencies					
Sterling	n/a	3.3	2.5	2.9	n/a
US dollar	-3.2	n/a	-0.8	-0.4	n/a
Yen	-2.4	0.8	n/a	0.4	n/a
Euro	-2.8	0.4	-0.4	n/a	n/a

Source: MSCI, FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. Data as of 31 January 2019.

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