Market Review

1 April 2019

Review of markets over the first quarter of 2019

The new year has brought with it a new wave of optimism, with equities and credit rallying strongly across the world. The sell-off in equities and credit in the final quarter of last year was caused predominantly by concerns about the potential for an escalation in the trade war between the US and China, fears that higher interest rates could hurt the US economy, and broader worries about a slowdown in global growth.

Exhibit 1: Asset class and style returns in local currency

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	1Q 2019
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 16.7%
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%	Growth 15.1%
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%	Small cap 13.9%
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 12.8%
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%	Value 10.4%
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%	MSCI EM 9.9%
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%	Global Agg 2.2%
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%	Cmdty -0.2%

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. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2019.

In many ways, the weakness in Q4 set the stage for the recovery in equity markets this quarter. The Federal Reserve (Fed) reacted to the market weakness and weaker global growth by becoming more patient. Much of the rally this year has been built on market expectations that the Fed now won't raise interest rates again at any point in the next few years—in fact, the next move expected from the Fed by the bond market is now a cut, with 10-year Treasury yields down to 2.4%. The sharp fall in the US stock market late last year was probably also a factor in deterring the US administration from further increasing tariffs on China over the quarter. So the stock market decline last year helped to reduce two of the major risks that had caused it in the first place.

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Exhibit 2: World stock market returns in local currency

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	1Q 2019
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 13.6%
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 Europe ex UK 12.6%
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 Asia ex Japan 11.6%
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 EM 9.9%
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%	UK FTSE 100 9.5%
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%	Japan TOPIX 7.7%

Source: FactSet, FTSE, MSCI, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2019.

The key questions, then, are: will the Fed now be as dovish as expected, and will the US administration become more confrontational in its trade policy now that equity markets have rallied? In addition, if the Fed does cut rates, as the market now expects, will it be because the worries about a slowdown in global growth that plagued markets late last year prove to have been warranted?

On interest rates, there is some reason for optimism. Despite the recovery in markets, commentary from some key Fed officials suggests that the US central bank is considering changing the way it responds to inflation. The brief version of their argument is that, with inflation having stood below 2% for most of the last decade, perhaps it should be allowed to run above 2% for a while so that inflation averages 2% over an as-yet unspecified period of time, rather than the punch bowl being taken away from the party as soon as inflation picks up above target.

Exhibit 3: Fixed income sector returns in local currency

2012	2013	2014	2015	2016	2017	2018	1Q 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 7.4%
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 6.6%
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 5.3%
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 4.2%
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 3.9%
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. 2.5%
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. 2.1%

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. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2019.

Time will tell whether the Fed will act pre-emptively to support activity in the coming months. In the meantime, a more dovish Fed, combined with the news that quantitative tightening will end in September, has supported fixed income markets this year, from government bonds to credit.

On trade, while some progress seems to have been made this quarter between the US and China, there is still uncertainty as to how the negotiations will evolve. Some of the underlying tension is unlikely to be resolved easily given that the US and China are ultimately competing with each other in several key industries, such as technology. In addition, even if an ongoing truce can be agreed between the US and China, there is no guarantee that the US administration won't turn towards a more confrontational trade policy with Europe.

So, on monetary policy and trade there are reasons for optimism, but also some risks given a fairly optimistic outcome on both fronts is now already priced in.

For the recovery in markets to continue, the weakness in global growth will also have to recede, extending what has already been a very long economic expansion by historical standards. On this front, the data in the first quarter was more mixed.

The weakness in the global economy has been most stark in the manufacturing and export sectors. Eurozone industrial production is down 2.5% since its peak in December 2017. Korean and Taiwanese exports both declined about 8% year on year (y/y) in March. While it is tempting to blame this global manufacturing and export slowdown on the trade war, softer Chinese domestic demand has also been a contributor. Again, on this front there are reasons for optimism, but also some caution. China's non-manufacturing purchasing managers' index (PMI) increased to 54.8 in March, while its manufacturing PMI rebounded to slightly over 50, indicating a return to expansion. On the other hand, China's imports declined 5.2% y/y in US dollar terms in February having grown by 27% y/y in July last year.

The Chinese authorities are now stimulating domestic demand with a package of tax cuts, infrastructure investment and measures designed to support bank credit growth. This should lead to a stabilisation in Chinese growth. On the other hand, the magnitude of credit expansion is likely to be less significant than the last time global manufacturing went through a weak patch, in 2015-16. Chinese stimulus may therefore be less effective at boosting exports across the rest of Asia and Europe than in the past. The manufacturing business surveys for March so far show little sign of an improvement in the outlook, with the eurozone manufacturing PMI declining to 47.5 and the new export orders component declining to 44.8. Korea and Taiwan's manufacturing PMIs did improve in March, but only to around 49. Readings below 50 indicate continued weakness ahead.

Exhibit 4: Fixed income government bond returns in local currency

2012	2013	2014	2015	2016	2017	2018	1Q 2019
Italy 21.3%	Spain 11.3%	Spain 17.0%	Italy 4.9%	UK 10.7%	US 2.5%	Spain 2.6%	UK 3.6%
Spain 6.0%	Italy 7.4%	Italy 15.7%	Spain 1.7%	Spain 4.2%	UK 1.9%	Germany 2.3%	Spain 2.9%
Germany 4.5%	Japan 2.2%	UK 14.1%	Global 1.3%	Germany 4.1%	Global 1.3%	Japan 1.1%	Global 2.3%
Global 4.1%	Global -0.4%	Germany 10.5%	Japan 1.3%	Japan 3.6%	Spain 1.1%	Global 1.0%	US 2.2%
UK 2.6%	Germany -2.3%	Global 8.5%	UK 1.2%	Global 2.9%	Italy 0.8%	US 0.8%	Germany 2.2%
US 2.2%	US -3.4%	US 6.1%	US 0.9%	US 1.1%	Japan 0.2%	UK 0.6%	Japan 1.7%
Japan 1.8%	UK -4.2%	Japan 4.8%	Germany 0.4%	Italy 0.8%	Germany -1.4%	Italy -1.4%	Italy 1.6%

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. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2019.

Business investment intentions have been another notable area of weakness, with some business surveys, such as the Duke CFO survey in the US, suggesting that there could be downside for business investment's contribution to growth from here. Again, it's tempting to blame this on political uncertainty around trade negotiations. However, lower corporate profitability, as global growth slows, wage growth erodes margins, and the benefits of US tax cuts fade, could also weigh on business investment.

Despite a weaker growth and profit outlook, labour markets have held up well so far, with unemployment continuing to decline, to 7.8% in the eurozone and to 3.8% in the US in February, and wage growth picking up. The key for investors will be whether a still relatively healthy global consumer can lift the manufacturing sector and business investment intentions out of their current soft patch, or whether the weakness in manufacturing and business confidence will infect consumer confidence and labour markets. The Conference Board's US consumer confidence index is worth monitoring with this in mind, given its decline in March. The US payrolls report will also be important to monitor given that job growth slowed to only 20k in February.

The UK economy, too, is being supported by a strong labour market, with unemployment at 3.9% and wages rising by 3.4% y/y for January. Inventories have also contributed positively to growth over the last few quarters. This combination has kept growth in positive territory despite weak consumer confidence and a contraction in business investment, both caused by Brexit-related uncertainty. Due to both this Brexit uncertainty and the mixed economic data, the Bank of England remained on hold throughout the quarter, despite rising wage pressures.

The European Central Bank (ECB) also kept the deposit rate steady at -0.4% and said it would not raise rates until at least next year, having previously said it wouldn't hike until at least the summer. The ECB also announced a new round of cheap financing for the banking sector and discussed measures to reduce the drag that negative rates have had on bank profits.

Overall, markets end the first quarter with equities, credit and government bonds up for the year to date, buoyed by more dovish central banks and hopes for a truce on trade between the US and China. Easier monetary policy and less disruptive trade policies could continue to support markets. However, given the age of this economic expansion and the uncertainty over whether manufacturing, exports and business investment intentions will recover, or whether a squeeze on profits will lead to corporate cost cutting, a more balanced portfolio probably makes more sense than has been the case for most of the last decade.

Exhibit 5: Index returns for March 2019 (%)

INDEX	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	3.5	1.4	0.8	2.8	1.7
MSCI USA	4.0	1.8	1.3	3.3	1.8
MSCI Europe ex UK	2.7	0.6	0.0	2.0	1.7
MSCI United Kingdom	3.2	1.1	0.5	2.5	3.2
MSCI Japan	2.8	0.7	0.2	2.2	0.2
MSCI AC Asia ex JP	3.8	1.7	1.1	3.2	1.7
MSCI EM Latin America	-0.5	-2.5	-3.1	-1.1	0.4
MSCI EM (Emerging Markets)	3.0	0.9	0.3	2.3	1.4
Bonds					
JP Morgan GBI Global (Traded)	3.5	1.4	0.8	2.8	1.8
JP Morgan GBI United States (Traded)	4.1	2.0	1.4	3.5	2.0
JP Morgan GBI Japan (Traded)	3.6	1.5	0.9	2.9	0.9
JP Morgan GBI United Kingdom (Traded)	3.5	1.4	0.8	2.8	3.5
JP Morgan EMU	2.5	0.4	-0.2	1.8	1.8
Currencies					
Sterling	n/a	-2.0	-2.6	-0.7	n/a
US dollar	2.1	n/a	-0.6	1.4	n/a
Yen	2.7	0.6	n/a	2.0	n/a
Euro	0.7	-1.4	-2.0	n/a	n/a

Source: MSCI, FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2019.

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