# Market Review

1 August 2019

## Review of markets over July 2019

After an exceptionally strong start to the year, financial markets paused for breath in July, with most asset classes delivering muted returns. The Federal Reserve (the Fed) lowered US interest rates for the first time in 11 years, and the European Central Bank (ECB) gave strong hints that an easing package is on the way.

Developed market equities continued their solid run, returning 1.2% over the month and outperforming their emerging market counterparts. Growth stocks outperformed value stocks by over 1%. The S&P 500 reached new all-time highs during July, closing 1.4% up over the month and more than 20% up year to date. In the UK, the FTSE 100 delivered 2.2% in July, boosted by a weaker pound. Global government bond indices posted modest gains, with strength in European bonds partially offset by mild weakness in US Treasuries. Ten-year UK Gilt yields rallied through July, ending the month 22 basis points lower at 0.61%. The US dollar was the biggest winner of the major currencies, gaining 3.9% vs. the British pound and 2.3% vs. the euro.

### Exhibit 1: Asset class and style returns in local currency

| 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | YTD | July 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 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% | Growth 23.2% | Growth 1.8% |
| 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% | REITS 20.6% | REITS 1.6% |
| 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% | DM Equities 18.5% | Small cap 1.4% |
| 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% | Small cap 17.5% | DM Equities 1.2% |
| 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 13.8% | Value 0.6% |
| 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 9.2% | Global Agg -0.3% |
| 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 5.3% | Cmdty -0.7% |
| 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 4.4% | MSCI EM -0.9% |

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 July 2019.


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Investors were forced to wait until the last day of July for the main event, when the Fed reduced US interest rates by 0.25%. The immediate market reaction implied that some investors had been hoping for more stimulus, and they were therefore disappointed by Fed chair Jerome Powell's suggestion that the move in interest rates did not signal the start of a "lengthy cutting cycle". Yet in our view, a slowing, not stalling, economy with moderate domestic inflation does not currently warrant more aggressive action. Parts of the US economy have been showing tentative signs of improvement, with the jobs market bouncing back from an especially weak print in June and second-quarter GDP growing at 2.1% (quarter-on-quarter annualised), beating analyst expectations. Manufacturing remains a weak spot, with July purchasing managers' index (PMI) data suggesting that this part of the US economy is on the cusp of moving into contractionary territory.

The US earnings season is now in full swing, with over 60% of S&P 500 companies having reported by the end of July. US corporates look set to deliver low single-digit earnings growth for the second quarter. Approximately three-quarters of companies have beaten analyst earnings estimates so far, although this was largely driven by share buybacks and, in part, reflects a lower hurdle after analysts had grown more pessimistic. We believe that companies can still grind out positive earnings growth in the quarters ahead, but consensus expectations for US earnings growth of 11% in 2020 appear too high at the current juncture.

## Exhibit 2: World stock market returns in local currency

| 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | YTD | July 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 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 20.2% | UK FTSE 100 2.2% |
| 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 18.3% | US S&P 500 1.4% |
| 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% | UK FTSE 100 15.7% | Japan TOPIX 0.9% |
| 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 Asia ex Japan 9.6% | MSCI Europe ex UK 0.2% |
| 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% | MSCI EM 9.2% | MSCI EM -0.9% |
| 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 6.2% | MSCI Asia ex Japan -1.3% |

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 July 2019.

July was a busy month for European leaders as nominations for many of the top jobs in Brussels were decided. After several days of tense talks, the most important outcome for investors was the nomination of Christine Lagarde to take over from Mario Draghi as ECB leader at the start of November. Lagarde was one of the most dovish options out of the potential candidates, and has previously been vocal in her support for Draghi's accommodative stance on monetary policy. Given the ECB's struggles to normalise interest rates during this economic cycle, it is likely that Europe's response to the next downturn will require greater coordination between central bankers and politicians to support the economy. Lagarde's expertise in political negotiations may therefore have strengthened her case relative to other candidates with more traditional experience for such a role. Confident in the knowledge that a successor is unlikely to reverse course, the ECB's Governing Council used its July meeting to send strong signals to the market that a stimulus package is coming. Interest rate cuts into deeper negative territory (potentially using a tiered system in an effort to reduce the negative impact on the financial sector) and new rounds of asset purchases are both being considered. The dovish tone from policymakers helped European sovereign bonds to perform strongly in July. Constructive talks between Italy and the European Commission around Rome's fiscal trajectory were a further plus for European investors. However, ongoing deterioration in economic data offset the better political news. Manufacturing data from Germany – traditionally Europe's exporting powerhouse – continued its slide, and business sentiment surveys have now declined to six-year lows.

## Exhibit 3: Fixed income government bond returns in local currency

| 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | YTD | July 2019 |
|---|---|---|---|---|---|---|---|
| Spain 11.3% | Spain 17.0% | Italy 4.9% | UK 10.7% | US 2.5% | Spain 2.6% | Spain 9.8% | Italy 3.3% |
| Italy 7.4% | Italy 15.7% | Spain 1.7% | Spain 4.2% | UK 1.9% | Germany 2.3% | Italy 9.0% | UK 2.2% |
| Japan 2.2% | UK 14.1% | Global 1.3% | Germany 4.1% | Global 1.3% | Japan 1.1% | UK 7.4% | Spain 1.1% |
| Global -0.4% | Germany 10.5% | Japan 1.3% | Japan 3.6% | Spain 1.1% | Global 1.0% | Global 5.8% | Germany 1.0% |
| Germany -2.3% | Global 8.5% | UK 1.2% | Global 2.9% | Italy 0.8% | US 0.8% | US 5.3% | Global 0.7% |
| US -3.4% | US 6.1% | US 0.9% | US 1.1% | Japan 0.2% | UK 0.6% | Germany 5.2% | Japan 0.2% |
| UK -4.2% | Japan 4.8% | Germany 0.4% | Italy 0.8% | Germany -1.4% | Italy -1.4% | Japan 3.1% | US -0.1% |

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 July 2019.

With little change to the outlook for US/China trade relations during the month, investors were more focused on the Chinese economy in July. Second-quarter growth data highlighted the slowdown in China, but retail sales and industrial production data showed some tentative signs of stabilisation. Beijing's determination to keep their economy stable remains in no doubt, although we recognise that the effects of policy stimulus could yet take some time to feed through.

In the UK, Boris Johnson was appointed as the new prime minister after his victory in the Conservative party leadership contest with roughly two-thirds of the vote. The British pound came under pressure during July – reaching lows versus the US dollar last seen in 2017 – as markets became increasingly jittery about the potential for the UK to leave the European Union without a deal. Johnson will be hoping that the threat of a no-deal exit will strengthen his hand in subsequent negotiations with the EU. Pricing of UK assets could yet reflect higher concerns of a disorderly exit ahead of the 31 October deadline, but the current configuration of parliament has regularly demonstrated that it is not willing to allow the UK to leave the EU without a deal. A no-deal exit therefore remains unlikely unless a general election or referendum were to provide a mandate for it. Against an unstable political backdrop, cracks are appearing in the UK consumer outlook, with retail sales contracting for a third consecutive month in July.

## Exhibit 4: Fixed income sector returns in local currency

| 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | YTD | July 2019 |
|---|---|---|---|---|---|---|---|
| Euro HY 8.8% | Euro Treas. 13.1% | Euro Treas. 1.6% | US HY 17.5% | EM Debt 9.3% | Euro Treas. 1.0% | EM Debt 11.9% | Euro Treas. 1.7% |
| US HY 7.4% | EM Debt 5.5% | EM Debt 1.2% | EM Debt 10.2% | Global IG 9.1% | US Treas. 0.9% | US HY 10.7% | EM Debt 1.2% |
| Euro Treas. 2.2% | Euro HY 5.5% | US Treas. 0.8% | Euro HY 10.1% | IL 8.7% | US HY -2.3% | Global IG 8.3% | US HY 0.5% |
| Global IG 0.3% | US Treas. 5.1% | Euro HY 0.5% | Global IG 4.3% | US HY 7.5% | Global IG -3.6% | Euro HY 8.1% | Euro HY 0.5% |
| US Treas. -2.7% | IL 3.4% | Global IG -3.6% | IL 3.9% | Euro HY 6.1% | Euro HY -3.6% | Euro Treas. 7.8% | IL 0.1% |
| IL -3.2% | Global IG 3.1% | US HY -4.6% | Euro Treas. 3.2% | US Treas. 2.3% | IL -4.1% | IL 6.4% | Global IG 0.1% |
| 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. 5.1% | US Treas. -0.1% |

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 July 2019.

Central bank policy looks set to be supportive of all assets in the second half of this year, but this may now be largely reflected in market prices. The path of least resistance for the stock market could yet be higher if policy action drives an improvement in economic data, but downside risks warrant an element of caution. Within equities, investors may wish to focus on companies with strong balance sheets, which may be less exposed to slowing growth than more highly levered counterparts. Despite historically low yields, we still see government bonds playing an important role in portfolios given their scope to rally further if sentiment deteriorates. Alternative strategies such as global macro hedge funds and core infrastructure may also warrant consideration for investors looking to add ballast to their portfolios at this stage of the cycle.

## Exhibit 5: Index returns for July 2019 (%)

| INDEX | GBP | USD | JPY | EUR | LOC |
|---|---|---|---|---|---|
| **Equities (MSCI)** | | | | | |
| MSCI World Index | 4.5 | 0.5 | 1.3 | 2.8 | 1.2 |
| MSCI USA | 5.5 | 1.5 | 2.3 | 3.9 | 1.5 |
| MSCI Europe ex UK | 1.9 | -2.0 | -1.2 | 0.3 | 0.2 |
| MSCI United Kingdom | 2.1 | -1.8 | -1.0 | 0.4 | 2.1 |
| MSCI Japan | 4.1 | 0.1 | 0.9 | 2.4 | 0.9 |
| MSCI AC Asia ex JP | 2.2 | -1.7 | -0.9 | 0.5 | -1.3 |
| MSCI EM Latin America | 4.1 | 0.1 | 0.9 | 2.4 | -0.9 |
| MSCI EM (Emerging Markets) | 2.8 | -1.1 | -0.4 | 1.1 | -0.9 |
| **Bonds** | | | | | |
| JP Morgan GBI Global (Traded) | 3.5 | -0.4 | 0.3 | 1.8 | 0.7 |
| JP Morgan GBI United States (Traded) | 3.9 | -0.1 | 0.7 | 2.2 | -0.1 |
| JP Morgan GBI Japan (Traded) | 3.3 | -0.6 | 0.2 | 1.7 | 0.2 |
| JP Morgan GBI United Kingdom (Traded) | 2.2 | -1.6 | -0.9 | 0.6 | 2.2 |
| JP Morgan EMU | 3.4 | -0.5 | 0.2 | 1.7 | 1.7 |
| **Currencies** | | | | | |
| Sterling | n/a | -3.8 | -3.0 | -1.6 | n/a |
| US dollar | 3.9 | n/a | 0.8 | 2.3 | n/a |
| Yen | 3.1 | -0.8 | n/a | 1.5 | n/a |
| Euro | 1.6 | -2.2 | -1.5 | 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 July 2019.

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