Market Review

2 September 2019

Review of markets over August 2019

The times when investors were able to enjoy a quiet summer seem to be over. August was a volatile month for financial markets, with the VIX averaging 19, compared to 13 in July.

The tone of the month was set on its first day with a tweet from the US president announcing an intention to impose a 10% tariff on the remaining approximately USD 300 billion of Chinese imports that were not yet subject to tariffs. This decision took markets by surprise as China and the US had agreed a ceasefire in their trade dispute at the G20 in May. The announcement of new tariffs triggered retaliatory measures from China, which announced three weeks later that it would also increases tariffs on roughly USD 75 billion of US imports, including agricultural goods, crude oil and cars. This led the US president to tweet that the existing and planned tariff rates will both rise by 5 percentage points.

Exhibit 1: Asset class and style returns in local currency

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD	August 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%	REITs 24.7%	REITs 3.4%
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 22.1%	Global Agg 2.0%
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 16.2%	Growth -0.9%
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 13.6%	DM Equities -1.9%
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%	Cmdty -2.3%
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%	Global Agg 7.4%	MSCI EM -2.5%
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%	MSCI EM 6.5%	Value -3.0%
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 1.9%	Small cap -3.3%

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 August 2019.

It was only at the end of the month that both countries adopted a slightly more conciliatory tone but the damage to business and investor sentiment had already been done. The renewed escalation of trade tensions and the growing economic consequences triggered profit-taking in global equity markets in August. Developed market equities dropped 1.9% but outperformed their emerging market (EM) peers as the MSCI EM Index dropped by 2.5%.

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Exhibit 2: World stock market returns in local currency

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD	August 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 18.3%	MSCI Europe ex UK -0.8%
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 17.4%	US S&P 500 -1.6%
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%	UK FTSE 100 11.0%	MSCIEM -2.5%
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%	MSCIEM 6.5%	MSCI Asia ex Japan -3.3%
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 Asia ex Japan 5.9%	Japan TOPIX -3.4%
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 2.6%	UK FTSE 100 -4.1%

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 August 2019.

Safe havens were sought after by investors and global bond yields continued to decrease, bringing the total market value of negative yielding debt in the Bloomberg Barclays Global Aggregate Index to over USD 16 trillion. Fixed income segments with positive real yields rallied, including 30-year US Treasuries, whose yields dropped below 2% for the first time, and global investment grade corporate credit, which delivered 1.9% over the month.

Exhibit 3: Fixed income government bond returns in local currency

2013	2014	2015	2016	2017	2018	YTD	August 2019
Spain 11.3%	Spain 17.0%	Italy 4.9%	UK 10.7%	US 2.5%	Spain 2.6%	Italy 12.9%	UK 3.8%
Italy 7.4%	Italy 15.7%	Spain 1.7%	Spain 4.2%	UK 1.9%	Germany 2.3%	Spain 11.6%	US 3.6%
Japan 2.2%	UK 14.1%	Global 1.3%	Germany 4.1%	Global 1.3%	Japan 1.1%	UK 11.5%	Italy 3.6%
Global -0.4%	Germany 10.5%	Japan 1.3%	Japan 3.6%	Spain 1.1%	Global 1.0%	US 9.1%	Global 2.9%
Germany -2.3%	Global 8.5%	UK 1.2%	Global 2.9%	Italy 0.8%	US 0.8%	Global 8.8%	Germany 2.3%
US -3.4%	US 6.1%	US 0.9%	US 1.1%	Japan 0.2%	UK 0.6%	Germany 7.7%	Japan 1.7%
UK -4.2%	Japan 4.8%	Germany 0.4%	Italy 0.8%	Germany -1.4%	Italy -1.4%	Japan 4.8%	Spain 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 August 2019.

10-year UK Gilt yields also continued to rally through August on the back of growing Brexit uncertainties, ending the month 13 basis points lower at 0.48%. In foreign exchange markets, while the US dollar remained stable on a trade-weighted basis, it rallied versus most EM currencies, gaining 4.0% against the Chinese renminbi and 3.8% against the Indian rupee.

Exhibit 4: Fixed income sector returns in local currency

2013	2014	2015	2016	2017	2018	YTD	August 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 12.5%	US Treas. 3.4%
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 11.1%	Euro Treas. 2.5%
Euro Treas. 2.2%	Euro HY 5.5%	US Treas. 0.8%	Euro HY 10.1%	IL 8.7%	US HY -2.3%	Euro Treas. 10.4%	IL 2.3%
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 10.4%	Global IG 1.9%
US Treas. -2.7%	IL 3.4%	Global IG -3.6%	IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	Euro HY 8.8%	Euro HY 0.7%
IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Treas. 3.2%	US Treas. 2.3%	IL -4.1%	IL 8.8%	EM Debt 0.5%
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. 8.6%	US HY 0.4%

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 August 2019.

In the US, after the Federal Reserve (the Fed) cut rates by 25 basis points at the end of July, the August headlines were once again dominated by trade tensions but also increasingly by the risk of an economic downturn.

Indeed, most recent economic data releases have shown that the US economy is not immune to global trade tensions. The manufacturing part of the economy remains the weak spot as shown by the drop in the August flash US Manufacturing purchasing managers' index (PMI) to 49.9, its lowest reading since September 2009.

There are also increasing signs that the manufacturing weakness is spreading to other areas of the economy as the flash Services Business Activity index fell to a three-month low of 50.9, while the University of Michigan Consumer Sentiment index weakened.

The drop in consumer confidence has probably been driven to a large extent by the extensive media commentary on the increased risk of a recession, following the inversion of the US yield curve, which first occurred in mid-August.

However, domestic demand has so far remained relatively resilient, with retail sales jumping 0.7% in July, showing that so far the strength of the labour market and rising wages continue to outweigh trade and recession concerns.

In this context, we continue to believe that the US economy is slowing, not stalling. Jerome Powell's Jackson Hole speech was largely in line with expectations and paves the way for the Fed to make another 25 basis point rate cut in September followed perhaps by one more rate cut at either the October or December meetings.

This move should be welcomed by US corporates as it will lower their financing costs at a time when margins are under pressure from lower top-line revenue growth and higher wage costs. The second-quarter earnings season showed that US earnings-per-share growth was below 5% on average, broadly in line with sales growth, with next to no margin expansion.

Nevertheless, we continue to believe that companies can still grind out positive earnings growth in the quarters ahead. However, consensus expectations for US earnings growth of 10% in 2020 appear too high and we believe that these expectations could be halved by the end of the year.

In Europe, the August headlines were dominated by weak economic data, especially in Germany, and by increasing political uncertainties.

On the economic front, the second-quarter GDP releases confirmed the economic slowdown in Europe, as growth was left unrevised at just 0.2% compared to the prior quarter.

The country level detail showed that Germany is now on the verge of a recession, as its economy contracted by 0.1% in the second quarter, while the Bundesbank expects the downturn in orders for cars and industrial equipment to continue in the third quarter. The fall in the IFO business climate index later in the month further confirmed this weak outlook. This economic slowdown has fuelled stimulus hopes and the German finance minister has left the door open to a possible fiscal package if the situation deteriorates further.

Overall though, the latest release of the flash composite PMI for the eurozone showed that growth stabilised in August, which confirms our view that Europe's economy is slowing but not yet approaching a recession, with the service sector continuing to grow.

Nevertheless, it's not a time for complacency. The recent political shifts in Italy remind investors of the regular political volatility experienced in Europe but borrowing costs remain low, helped by the fact that the European Central Bank (ECB) is expected to unveil new stimulus measures in September. On top of the already announced new targeted longer-term refinance operations, the ECB is expected to further lower interest rates and could restart quantitative easing.

Meanwhile, in the UK, Boris Johnson has so far not managed to solve the Brexit impasse. Brexit is already weighing on the UK economy, with second-quarter GDP shrinking by 0.2%, while the outlook for retail sales has weakened according to the CBI's August survey.

All eyes have been on China since the beginning of the year and the country has taken several measures to counterbalance the effects of the trade war on its economy. However, even though Chinese authorities have this time delivered both fiscal and monetary stimulus, the results have so far been mixed as July data, including retail sales, came in short of expectations.

In this context and without the prospect of a trade deal in the near term, the Chinese authorities were obliged to take additional stimulus measures in August. The People's Bank of China announced a lending rate reform to lower financing costs and let the renminbi break the psychological barrier of 7 versus the US dollar. The currency move triggered an official condemnation from the US, who labelled China a currency manipulator. Elsewhere in emerging markets, Argentina experienced major difficulties in August with the peso weakening 26% vs the dollar and the Merval equity index dropping over 40% after the national primary election results showed that the current government could lose power in October.

In the coming months, new monetary and fiscal stimulus should support the global economy but these measures won't be able to fully offset the negative effects of the trade war and hence the economic slowdown should continue. We continue to think that these 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 their 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 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 August 2019 (%)

INDEX	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	-1.5	-2.0	-4.2	-0.9	-1.9
MSCI USA	-1.2	-1.7	-3.9	-0.7	-1.7
MSCI Europe ex UK	-1.2	-1.7	-3.9	-0.6	-0.8
MSCI United Kingdom	-4.1	-4.7	-6.8	-3.6	-4.1
MSCI Japan	-0.5	-1.0	-3.2	0.1	-3.2
MSCI AC Asia ex JP	-3.8	-4.4	-6.5	-3.3	-3.3
MSCI EM Latin America	-7.6	-8.1	-10.2	-7.1	-1.0
MSCI EM (Emerging Markets)	-4.3	-4.8	-7.0	-3.8	-2.5
Bonds					
JP Morgan GBI Global (Traded)	3.5	3.0	0.6	4.1	2.9
JP Morgan GBI United States (Traded)	4.2	3.6	1.3	4.8	3.6
JP Morgan GBI Japan (Traded)	4.6	4.0	1.7	5.2	1.7
JP Morgan GBI United Kingdom (Traded)	3.8	3.3	0.9	4.4	3.8
JP Morgan EMU	1.9	1.4	-0.9	2.5	2.5
Currencies					
Sterling	n/a	-0.5	-2.8	0.6	n/a
US dollar	0.5	n/a	-2.2	1.1	n/a
Yen	2.8	2.3	n/a	3.4	n/a
Euro	-0.6	-1.1	-3.3	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 August 2019.

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