Market Review

1 November 2019

Review of markets over October 2019

Financial markets welcomed signs of an easing in geopolitical tensions in October, with risk assets generally outperforming traditional safe havens. The US and Chinese authorities moved closer to agreeing a partial deal on trade, while the UK once again edged back from the precipice of a no-deal Brexit. Global central banks reiterated their dovish stances and the US Federal Reserve cut interest rates for the third time this year.

October was a good month for equity markets, with emerging markets returning 4.2% compared to 2.6% from developed markets. The S&P 500 gained a further 2.2% and made new all-time highs at the end of the month. The pound rallied 5.0% and 2.9% against the dollar and euro respectively, as markets perceived that the risk of a no-deal Brexit had diminished. The rally in sterling meant that the FTSE All-Share, with approximately 70% of its revenue coming from abroad, was one of the weaker performing equity markets, falling 1.4% over the month. In fixed income, credit markets outperformed government bonds, with global investment grade returning 1.2%, while global government bonds gained 0.5%.

Exhibit 1: Asset class and style returns

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD	October 2019
MSCI EM 79.0%	Small cap 26.6%	Global Agg 5.6%	Global REITS 23.0%	Small cap 32.9%	Global REITS 22.9%	Growth 3.5%	Small cap 13.3%	MSCI EM 37.8%	Global Agg -1.2%	Global REITS 26.1%	MSCI EM 4.2%
Small cap 44.8%	Global REITS 22.8%	Global REITS 2.3%	MSCI EM 18.6%	Value 27.5%	Growth 6.6%	Global REITS 0.6%	Value 13.2%	Growth 28.5%	Global REITS -4.9%	Growth 25.8%	Growth 3.0%
Growth 33.9%	MSCI EM 19.2%	Value -4.9%	Small cap 18.1%	DM Equities 27.4%	DM Equities 5.5%	Small cap 0.1%	Cmdty 11.8%	Small cap 23.2%	Growth -6.4%	DM Equities 21.2%	Small cap 2.8%
Global REITS 32.6%	Cmdty 16.8%	DM Equities -5.0%	Growth 16.6%	Growth 27.2%	Value 4.4%	DM Equities -0.3%	MSCI EM 11.6%	DM Equities 23.1%	DM Equities -8.2%	Small cap 18.6%	DM Equities 2.6%
DM Equities 30.8%	Growth 14.9%	Growth -5.1%	DM Equities 16.5%	Global REITS 2.3%	Small cap 2.3%	Global Agg -3.2%	DM Equities 8.2%	Value 18.0%	Value -10.1%	Value 16.6%	Global REITS 2.5%
Value 27.7%	DM Equities 12.3%	Small cap -8.7%	Value 16.4%	MSCI EM -2.3%	Global Agg 0.6%	Value -4.1%	Global REITS 6.5%	Global REITS 8.0%	Cmdty -11.3%	MSCI EM 10.7%	Value 2.1%
Cmdty 18.9%	Value 9.8%	Cmdty -13.3%	Global Agg 4.3%	Global Agg -2.6%	MSCI EM -1.8%	MSCI EM -14.6%	Growth 3.2%	Global Agg 7.4%	Small cap -13.5%	Global Agg 7.0%	Cmdty 2.0%
Global Agg 6.9%	Global Agg 5.5%	MSCI EM -18.2%	Cmdty -1.1%	Cmdty -9.5%	Cmdty -17.0%	Cmdty -24.7%	Global Agg 2.1%	Cmdty 1.7%	MSCI EM -14.2%	Cmdty 5.2%	Global Agg 0.7%

Source: Bloomberg Barclays, FTSE, MSCI, Refinitiv Datastream, J.P. Morgan Asset Management. DM Equities: MSCI World; REITs: FTSE NAREIT Global Real Estate Investment Trusts; Cmdty: Bloomberg 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 US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 October 2019.

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US

The US-China trade war pendulum, which has been swinging between escalating tensions and a more constructive outlook, swung back in favour of the latter in October, with the announcement of what President Trump has called a "Phase One Trade Deal". The deal involves China committing to significantly increase purchases of US agricultural products, accelerate the opening up of its financial sector, and more transparency regarding the currency markets.

While the announcement of the first phase of a deal between China and the US is a small breakthrough, we don't expect it to lead to a resolution of the trade war for two key reasons: first, polls suggest that US voters across political parties remain sceptical about the relative fairness of Chinese trade practices; and second, both sides harbour ambitions to be the number one player in global technology. We could well see the trade war pendulum swing back towards escalation in the coming months if President Trump decides to ramp up anti-China rhetoric to boost support ahead of the presidential election in November of next year.

While financial markets welcomed the announcement of a potential trade agreement, data out of the US continued to suggest that the US economy is losing momentum. The weakness remains most pronounced in the more trade-dependent manufacturing sector, with the Institute for Supply Management's manufacturing purchasing managers' index (PMI) indicating that the manufacturing side of the economy is contracting. The more concerning development of late, however, has been that the manufacturing weakness seems to be gradually seeping into the broader economy, with cracks beginning to appear in the US consumer. Consumer confidence fell 0.4 points to 125.9 in October, while the pace of job growth has also been slowing—on average, 160k jobs have been added each month this year, compared to 220k per month in 2018. Real GDP growth for the third quarter was more positive, showing that the US economy hadn't slowed as much as had been expected and grew at an annualised pace of 1.9%.

This slowing in economic momentum led the Federal Reserve to cut interest rates by 25 basis points (bps) for a third time this year, which should help lending conditions in the economy to remain supportive. The key question now is whether easier monetary policy will be able to support the consumer and labour market from deteriorating in the same way that manufacturing already has.

The US earnings season for the third quarter of the year is well underway, with companies so far doing better than expected. Earnings per share and sales are growing at 1% and 4% year on year (y/y), respectively on the S&P 500. However, US companies continue to give lower guidance for next year's earnings, with the trade dispute an ongoing theme.

Exhibit 2: World stock market returns

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD	October 2019
MSCI EM 79.0%	MSCI Asia ex Japan 19.9%	US S&P 500 2.1%	MSCI Asia ex Japan 22.7%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE All-Share 16.8%	MSCI Asia ex Japan 42.1%	US S&P 500 -4.4%	US S&P 500 23.2%	Japan TOPIX 5.0%
MSCI Asia ex Japan 72.5%	MSCI EM 19.2%	UK FTSE All-Share -3.5%	Japan TOPIX 20.9%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex UK 9.1%	US S&P 500 12.0%	MSCI EM 37.8%	UK FTSE All-Share -9.5%	MSCI Europe ex UK 22.8%	MSCI Asia ex Japan 4.6%
UK FTSE All-Share 30.1%	US S&P 500 15.1%	MSCI Europe ex UK -12.1%	MSCI Europe ex UK 20.0%	MSCI Europe ex UK 24.2%	MSCI Europe ex UK 7.4%	US S&P 500 1.4%	MSCI EM 11.6%	Japan TOPIX 22.2%	MSCI Europe ex UK -10.6%	Japan TOPIX 14.2%	MSCI EM 4.2%
MSCI Europe ex UK 29.0%	UK FTSE All-Share 14.5%	Japan TOPIX -17.0%	MSCI EM 18.6%	UK FTSE All-Share 20.8%	MSCI Asia ex Japan 5.1%	UK FTSE All-Share 1.0%	MSCI Asia ex Japan 5.8%	US S&P 500 21.8%	MSCI Asia ex Japan -14.1%	UK FTSE All-Share 12.8%	US S&P 500 2.2%
US S&P 500 26.5%	MSCI Europe ex UK 5.1%	MSCI Asia ex Japan -17.1%	US S&P 500 16.0%	MSCI Asia ex Japan 3.3%	UK FTSE All-Share 1.2%	MSCI Asia ex Japan -8.9%	MSCI Europe ex UK 3.2%	MSCI Europe ex UK 14.5%	MSCI EM -14.2%	MSCI Asia ex Japan 10.8%	MSCI Europe ex UK 1.4%
Japan TOPIX 7.6%	Japan TOPIX 1.0%	MSCI EM -18.2%	UK FTSE All-Share 12.3%	MSCI EM -2.3%	MSCI EM -1.8%	MSCI EM -14.6%	Japan TOPIX 0.3%	UK FTSE All-Share 13.1%	Japan TOPIX -16.0%	MSCI EM 10.7%	UK FTSE All-Share -1.4%

Source: FTSE, MSCI, Refinitiv Datastream, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency, except for MSCI Asia ex-Japan and MSCI EM, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 October 2019.

EUROZONE

The trade war continues to weigh most heavily in the eurozone, particularly in Germany, due to the region's larger dependence on international trade compared to its international counterparts. The economy looks fragile—flash PMIs for October remained at 45.7 in manufacturing and rose slightly for services to 51.2, to give an only slightly expansionary composite reading of 50.2.

The labour market and consumer are also feeling the effects of the slowdown. The employment component of the composite PMI now shows that employment is increasing at the slowest pace since December 2014. Consumer confidence also fell to -7.6 in October, the lowest reading since December last year.

October's European Central Bank (ECB) meeting marked Mario Draghi's final press conference as president. Christine Lagarde, former head of the International Monetary Fund, now takes the reins. Lagarde inherits an ECB tool kit that is nearing its limits, with interest rates at -0.5% and quantitative easing of EUR 20 billion per month in place until the inflation target is close to being achieved. With a seemingly depleted monetary toolkit, the challenge will be whether or not Lagarde can convince governments to loosen the fiscal purse strings to stimulate the economy.

Exhibit 3: Fixed income government bond returns

2012	2013	2014	2015	2016	2017	2018	YTD	October 2019
Italy 20.5%	Spain 11.1%	Spain 15.9%	Italy 4.8%	UK 10.7%	Global 7.5%	Spain 2.5%	Italy 13.3%	Global 0.5%
Spain 5.4%	Italy 7.2%	Italy 15.2%	Spain 1.7%	Spain 4.1%	US 2.3%	Germany 1.9%	Spain 9.9%	US 0.1%
Germany 5.0%	Japan 2.1%	UK 14.6%	Japan 1.2%	Germany 3.4%	UK 2.0%	Japan 1.0%	UK 9.7%	Japan -0.5%
UK 2.9%	Germany -1.7%	Germany 9.0%	US 0.8%	Japan 3.2%	Spain 1.1%	US 0.9%	US 7.8%	Spain -0.7%
US 2.0%	US -2.7%	US 5.1%	UK 0.5%	Global 1.7%	Italy 0.8%	UK 0.5%	Global 6.2%	Italy -0.7%
Global 2.0%	UK -4.2%	Japan 4.5%	Germany 0.4%	US 1.0%	Japan 0.2%	Global -0.7%	Germany 4.7%	Germany -1.4%
Japan 1.7%	Global -4.3%	Global -1.0%	Global -3.7%	Italy 0.8%	Germany -1.0%	Italy -1.3%	Japan 2.4%	UK -1.9%

Source: Bloomberg Barclays, Refinitiv Datatsream, J.P. Morgan Asset Management. All indices are Bloomberg Barclays benchmark government indices. All indices are total return in local currency, except for global, which is in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 October 2019.

UK

To the surprise of markets, Prime Minister Boris Johnson was able to agree a new Brexit deal with the European Union (EU). This was made possible after Johnson agreed to put a customs border in the Irish Sea and for Northern Ireland to remain more closely tied to the EU than Great Britain, thus avoiding the need for a hard border on the island of Ireland. The new deal gained more support in the House of Commons; however, members of parliament refused to approve rushing through the legislation process in order to leave the EU on the 31 October deadline. This meant an extension to the departure deadline was agreed to 31 January 2019. A general election will now be held on 12 December, as the prime minister seeks a new parliamentary majority to pass his deal.

On the data side of things, the UK labour market showed signs of weakening – employment in August fell by 56k, with the unemployment rate rising 0.1 percentage point to 3.9% and the number of vacancies continuing the steady fall that began in early 2019. Retail sales excluding fuel rose 0.2% over the previous month in September, and consumer confidence fell 2 points to -14 for October. Inflation for September remained at 1.7% y/y. The outlook for the Bank of England remains highly Brexit dependent. Should uncertainty for businesses and households be further prolonged, a rate cut could be on the cards.

Exhibit 4: Fixed income sector returns

2013	2014	2015	2016	2017	2018	YTD	October 2019
Euro HY 8.8%	Euro Gov. 13.1%	Euro Gov. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Gov. 1.0%	EM Debt 12.5%	Global IG 1.2%
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 11.8%	EM Debt 0.4%
Euro Gov. 2.2%	Euro HY 5.5%	US Treas. 0.8%	Euro HY 10.1%	Global IL 8.7%	US HY -2.3%	Global IG 10.8%	Global IL 0.2%
Global IG 0.3%	US Treas. 5.1%	Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Euro Gov. 8.8%	US HY 0.2%
US Treas. -2.7%	Global IL 3.4%	Global IG -3.6%	Global IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	Global IL 8.3%	US Treas. 0.1%
Global IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Gov. 3.2%	US Treas. 2.3%	Global IL -4.1%	Euro HY 8.3%	Euro HY -0.2%
EM Debt -6.6%	US HY 2.5%	Global IL -5.0%	US Treas. 1.0%	Euro Gov. 0.2%	EM Debt -4.6%	US Treas. 7.8%	Euro Gov. -1.1%

Source: Bloomberg Barclays, BofA/Merrill Lynch, J.P. Morgan Economic Research, Refinitiv Datastream, J.P. Morgan Asset Management. Global IL: Barclays Global Inflation-Linked; Euro Gov.: Barclays Euro Aggregate Government; 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, except for EM and global indices, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 October 2019.

CHINA

The annual pace of real GDP growth in China eased to 6.0% for the third quarter, down from 6.2% in the previous quarter. Weaker growth is slowing Chinese demand for external goods, with imports falling 8.5% y/y in September. Industrial production and retail sales data for September were more positive, rising to 5.8% and 7.8% y/y, respectively. After last month's 50 bps cut in the reserve requirement ratio, the People's Bank of China implemented a second 50 bps cut, with a third likely to follow, collectively releasing CNY 900 billion (approximately 1% of GDP) into the banking system. Credit data for September revealed a significant pickup in total social financing and new bank loans.

CONCLUSION

Amid a slowdown in the major economies and ongoing geopolitical uncertainty, we continue to advocate building more defensive properties into portfolios to cushion returns should the economic environment continue to deteriorate. Within equities, investors may wish to focus on large-cap, high quality companies (those with strong balance sheets and healthy cash flows), which have historically been more resilient in downturns. In fixed income, government bonds, particularly in the US, can still serve to add ballast to portfolios in adverse market environments. Alternative strategies, such as macro hedge funds and infrastructure, are additional options for investors to consider.

Exhibit 5: Index returns for October 2019 (%)

INDEX	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	-2.3	2.6	2.6	0.2	1.9
MSCI USA	-2.7	2.2	2.2	-0.1	2.2
MSCI Europe ex-UK	-1.6	3.4	3.4	1.0	1.4
MSCI United Kingdom	-2.1	2.8	2.8	0.5	-2.1
MSCI Japan	-0.1	4.9	4.9	2.5	4.9
MSCI AC Asia ex-JP	-0.4	4.6	4.6	2.2	3.7
MSCI EM Latin America	-0.5	4.5	4.5	2.1	1.4
MSCI EM (Emerging Markets)	-0.7	4.2	4.3	1.9	3.0
Bonds					
Bloomberg Barclays Global Aggregate	-4.1	0.7	0.7	-1.6	-
Bloomberg Barclays US Aggregate	-4.5	0.3	0.3	-2.0	0.3
Bloomberg Barclays Japan Aggregate	-5.3	-0.5	-0.5	-2.8	-0.5
Bloomberg Barclays UK Aggregate	-2.0	2.9	2.9	0.5	-2.0
Bloomberg Barclays Euro Aggregate	-3.4	1.4	1.4	-0.9	-0.9
Currencies					
Sterling	-	5.0	5.2	2.9	na
US dollar	-4.8	-	0.0	-2.3	na
Yen	-5.0	0.0	-	-2.3	na
Euro	-2.8	2.3	2.4	-	na

Source: Bloomberg Barclays, MSCI, Refinitiv Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 October 2019.

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