INVESTMENT INSIGHT – July 2019

Investment Services Department

Altruist®

Altruist Financial Group Limited
進邦滙理有限公司

CIB 香港保險顧問聯會會員 Member of the Hong Kong Confederation of Insurance Brokers

Worldwide economic slowdown vs. Bullish global equity markets

Global equity markets DISCONNECT from economic fundamental?

Time flies, we are already halfway through 2019. In line with our anticipation in the previous "Investment Insight", most of the investment markets continued its rally and delivered moderate return in the 2nd quarter. Among the developed countries, the U.S. stock market was the most robust. The three major U.S. stock indexes, Dow Jones Industrial Average, S&P 500 and Nasdaq Composite Index, have all reached record high in the 2nd quarter and the bullish momentum continued after the "Trump-Xi Meeting" during the G20 Summit in Japan.

In the emerging markets, the Russian stock market was the most eye-catching. Due to the reasons of strong oil price and stabilized relationship between Russia and those Western countries, both Russian share prices and Ruble surged. In U.S. dollar term, the Russian stock market has delivered over 30% return this year which was one of the best performing stock markets in the world in the 1st half of 2019.

TABLE 1: Investment markets rebounded in the 1st half of 2019

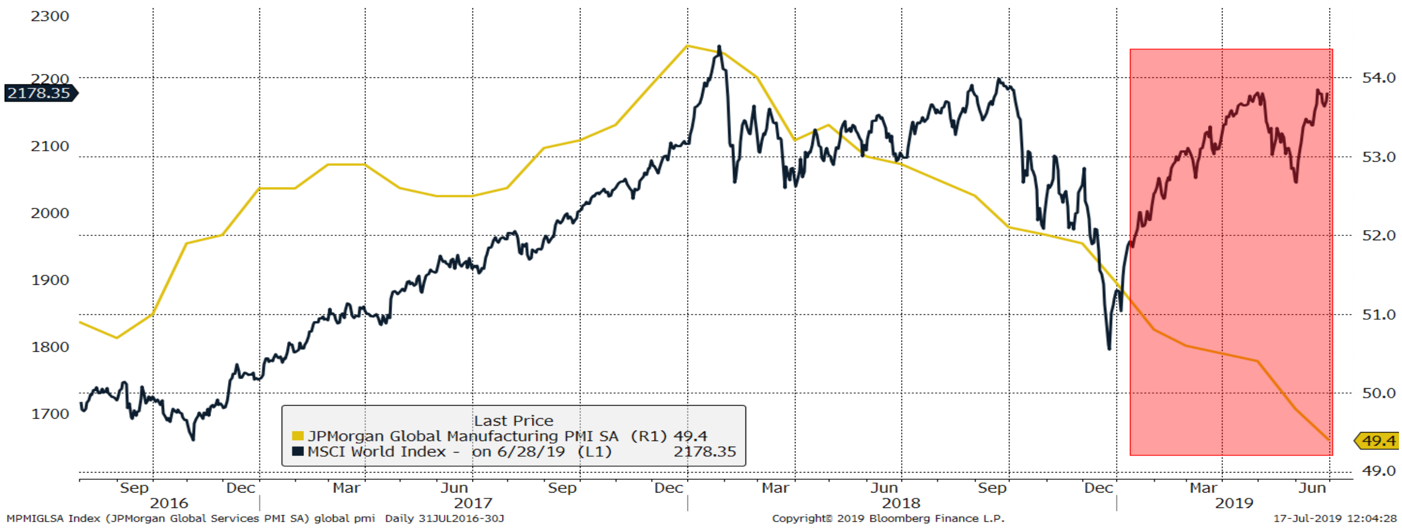
	2018	1st half of 2019
MSCI World Index	-8.19%	17.39%
MSCI Asia Pacific Index	-13.14%	10.78%
Bloomberg Barclays Global Aggregated Bond Index	-1.20%	5.57%
Crude Oil WTI	-14.57%	22.84%
Spot Gold	-1.56%	9.91%

Source: Bloomberg (as at 30/06/2019)

The performance of global investment markets in the 1st half of 2019 was extraordinary and it was mainly because of significant discounted market valuation in last year end and abundant market liquidity.

However, from the perspective of fundamental, the global economic outlook is still full of variables and challenges. Although the U.S. suspended new tariffs and restarted trade talks with China after the "Trump-Xi" Meeting in late June, it is believed that there is still a long way for both countries to reach the deal since there is a huge difference in value between both countries. The tight trade relationship between China and the U.S. was not only affecting the two countries but also the global economy. According to the data from IHS Markit and JP Morgan, the global manufactory activities have already slumped to contraction zone. The JP Morgan Global Manufacturing PMI fell to 49.4 in June from 49.8 in May, the lowest reading since October 2012. Only 12 of the 30 countries covered by the surveys reported improved business conditions and deteriorating business conditions were seen in the Eurozone, UK, China, Japan and the rest of Asia. The U.S. meanwhile remained close to stagnant and the past two months have registered the worst performance seen over the past decade.

EXHIBIT 1: Global stock rallied while manufactory activities slumped to contraction zone



Source: Bloomberg (as at 30/06/2019)

The threat of worldwide economic slowdown is becoming more obvious. At the same time, the central banks of those global major economies have started to adopt a more accommodative monetary policy. The central banks of Australia and India have already lowered interest rate 2 and 3 times respectively this year. In China, the People's Bank of China has cut the reserve rate of requirement ratio 5 times by 3.5% since early 2018. Although the U.S. Federal Reserve ("Fed") still did not take any action in the 1st half of 2019, according to the data of U.S. interest rate futures at the end of June, there was more than 50% chance that the Fed will cut the Federal Funds Rate by 0.75% or more in the 2nd half of the year.

Risk may coexist with opportunity. Although the risk of global economic slowdown is increasing, the expectation of loosening monetary policy environment supports the market sentiments and it explains why the recent performance of global investment markets disconnects with the fundamental. However, it is believed that liquidity may only stimulate the market in the short term. In medium-to-long term, the main driver of the market will ultimately swing back to economic and corporate fundamental. As the investment markets have already rebounded significantly in the 1st half of 2019, it may be prudent to take a more defensive investment approach in the remaining of the year.

TABLE 2: Global Stock Markets Performance

	2019 Q2 Return		2019 YTD Return	
Indexes	**Local Currency**	**USD**	**Local Currency**	**USD**
Dow Jones Industrial Average	3.21%	3.21%	15.40%	15.40%
Nasdaq Composite	3.88%	3.88%	21.34%	21.34%
Euro STOXX 600	3.44%	4.71%	17.16%	16.21%
DAX	7.57%	8.90%	17.42%	16.58%
CAC 40	6.19%	7.50%	20.41%	19.43%
Nikkei 225	0.46%	3.15%	7.53%	10.05%
Hong Kong Hang Seng	-0.08%	0.42%	12.75%	13.05%
Hang Seng China Enterprises	-2.07%	-1.58%	10.07%	10.37%
Shanghai Stock Exchange Composite	-2.41%	-4.61%	20.96%	21.16%
Shanghai Shenzhen CSI 300	-0.15%	-2.40%	28.47%	28.69%
Singapore FSSTI	5.15%	5.27%	10.51%	11.28%
Korea KOSPI	-0.46%	-2.24%	4.59%	0.69%
Taiwan TWSE	1.85%	1.46%	11.42%	9.81%
India SENSEX	2.27%	2.85%	9.86%	11.08%
Indonesia JCI	0.32%	1.24%	4.78%	7.72%
Thailand SET	6.60%	10.34%	19.59%	12.76%
Russia RTS	18.02%	18.02%	33.02%	33.02%
Brazil IBOV	7.66%	5.82%	14.88%	16.04%
S&P Pan Arab Composite	2.39%	2.39%	12.10%	12.10%
MSCI World	4.18%	4.18%	17.39%	17.39%

Source: Bloomberg (as at 30/06/2019)

TABLE 3: Major Currencies Performance (In terms of USD)

	Change in 2019 Q2	Change in 2019
Currencies	**In terms of USD**	
Euro	1.38%	-0.82%
British Pound	-2.60%	-0.45%
Japanese Yen	2.79%	1.71%
Hong Kong Dollar	0.50%	0.27%
Chinese Renminbi (CNY)	-2.25%	0.17%
Australian Dollar	-1.07%	-0.41%

New Zealand Dollar	-1.26%	-0.01%
Singapore Dollar	0.20%	0.73%
Korean Won	-1.69%	-3.36%
Taiwanese Dollar	-0.78%	-1.13%
Indian Rupee	0.18%	1.08%
Indonesian Rupiah	0.80%	1.85%
Thai Baht	3.49%	6.12%
Russian Ruble	3.83%	10.29%
Brazilian Real	1.83%	0.64%

Source: Bloomberg (as at 30/06/2019)

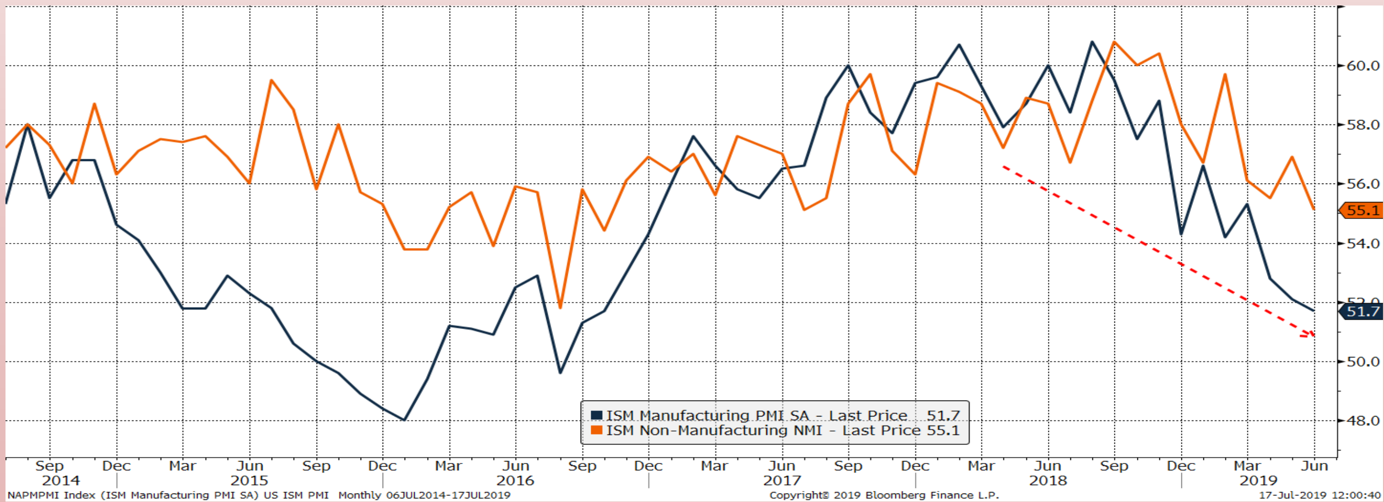
Review Highlights and outlook around the globe:

U.S.

- According to the data from the U.S. Department of Commerce, the U.S. economy grew by an annualized 3.1% in the 1st quarter of 2019, following a 2.2% expansion in the previous three-month period. However, many economists believe that the economic growth will slow sharply to around 2% in the coming quarters since the impact of the tax cuts and the higher government spending are expected to fade this year. Besides, the trade conflict between China and the U.S. may further impede the growth.

- Slowdown in factory activities was obvious. The ISM Manufacturing PMI in the U.S. fell to 51.7 in June from 52.1 in the previous month, which was the weakest pace of expansion in the manufacturing sector since October 2016. At the same time, the growth momentum in the non-manufacturing sector was also weakened, the ISM Non-Manufacturing PMI dropped to 55.1 in June from 56.9 in May which was the weakest reading since July 2017.

EXIBIT 2: Manufacturing and non-manufacturing activities were slowing down in the U.S.



Source: Bloomberg (as at 30/06/2019)

- The U.S. trade deficit widened to USD 55.5 billion in May 2019, above market expectations of USD 54.0 billion, and that was the largest trade gap since December last year. The deficit in the trade of goods with Mexico rose 18.1% to a record $9.6 billion. The goods gap with China also widened 12.2% to $30.2 billion.

- The U.S. job market was still robust. According to the data from the U.S. Labor Department, the U.S. non-farm payrolls increased by 224,000 jobs in June, the most in the past five months. Job growth averaged 172,000 per month in the 1st half of the year which was cooled from an average of 223,000 jobs per month in 2018. However, it remained at a healthy pace of job growth. The unemployment rate rose 0.1% to 3.7% in June but was still near 50-year low level. The annual wage growth was at 3.1% in June, the trend in wage growth has slowed from late last year when wages were rising at their fastest rate in a decade.

- So far this year, the S&P 500 Index has both set new record highs and experienced more than a 6% drop in a single month. From the perspective of fundamental, it seems that the U.S. economy is still the most healthy and robust among those developed countries. In term of valuation, the S&P 500 was traded at around 19 times at the end of June which was still at historical average level. In the coming few months, the Fed is very likely to ease its monetary policy, stock market sentiment may be further boasted and it is not a surprise if the U.S. stocks continue to set new record highs. Although we are still positive towards the investment outlook of the U.S. stock markets in medium-to-long term, please don't forget that the S&P 500 and Nasdaq Composite Index have already rallied over 17% and 22% respectively in the 1st half of the year. It may not be a bad idea to have certain profit taking as the U.S. stock markets may enter into over-bought zone in the near term.

Europe

- The Eurozone's quarterly economic growth was at 0.4% in the first 3 months of 2019 and the region grew 1.2% year-on-year. The GDP of Germany, the bloc's largest economy, advanced 0.4% quarter-on-quarter, after being unchanged in the previous quarter. The main contribution of the growth came from strong fixed investment and household consumption. On an annual basis, the German economy expanded 0.7%.

- The GDP of Eurozone rebounded in the first 3 months of 2019, however, the outlook of the region's economic growth in the coming quarters may still be gloomy since the trade war between U.S. and China has dragged down international trade volumes and hurt the region's manufacturing activities. Whereas the services economy enjoyed a solid rise in activity that was the best in 8 months, the recent downturn in manufacturing continued. The June IHS Makit Eurozone Manufacturing PMI fell to 47.6 from 47.7 in May. Operating conditions were generally weak across the Eurozone, Germany remained as the weakest performing country.

- The inflation of the Eurozone remained unchanged at 1.2% in June and far below the European Central Bank ("ECB")'s 2% target. The poor economic growth and low inflation increased the chance of the ECB to cut interest rate and reactivate its quantitative easing program in the 2nd half of the year.

EXHIBIT 3: The inflation of the Eurozone was below ECB's target

Source: Bloomberg (as at 30/06/2019)

- The coming few months would be crucial to the U.K. in both political and economic sides. Theresa May had already stepped down as the head of the Conservative Party and her successor would replace her as the Prime Minster of the U.K. The risk of "No Deal" Brexit was heightening since the final 2 Prime Minister candidates, Boris Johnson and Jeremy Hunt, have both expressed that they were willing to take Britain out of the European Union("EU") without a deal. The date of Brexit has been delayed to 31st October and there are only few months left. If the U.K. and the EU cannot reach a withdrawal agreement, there will be no 21-month transition period for both parties. Consequently consumers, businesses and public bodies of the U.K. would have to respond immediate changes as a result of leaving the EU.

- Dark clouds have already gathered over the U.K. economy, the June Markit Composite PMI fell to 49.2, which was the first contraction in business activity since July 2016, just after the Brexit referendum. The Bank of England has already cut the GDP growth forecast from 0.2% to 0% in the 2nd quarter and many economists even believed that the U.K. economy would contract due to the Brexit uncertainty.

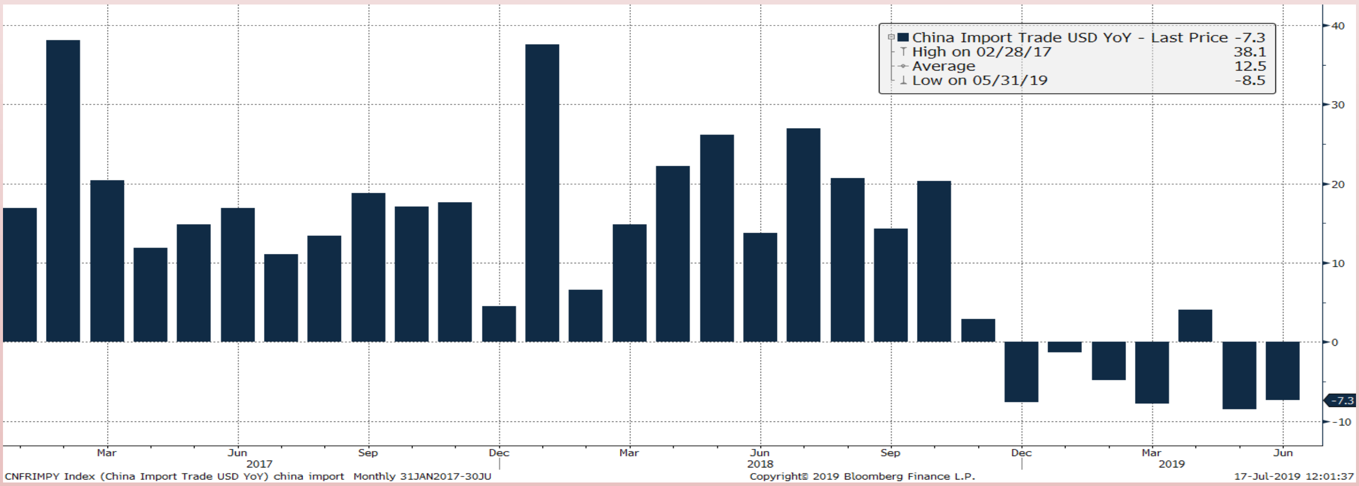
- The downside risk of economic slowdown was surging due to falling manufacturing activities in the region and the uncertainty of Brexit. At the same time, more and more people believed that the ECB would provide more stimulus to the market in the near future. It explained why the German 10 Government bond yield fell into negative zone and the Euro Stoxx 600 Index rose more than 17% in the 1st half of the year. As mentioned in the last "Investment Insight", the European economy is gradually approaching to "japanization" which has the features of low economic growth, low inflation, zero interest rate and negative government bond yield. In the medium-to-long term, we tend to be more conservative towards the investment outlook of European markets.

Asia

- China's consumer price inflation rose to 2.7% year-on-year in May 2019 from 2.5% in the previous month and matched market consensus. It was the highest inflation rate since February last year, as food cost increased 7.7%, the most since January 2012, with pork prices being persistently high following the outbreak of African swine fever. Meanwhile, the producer price inflation rose 0.6% in May from a year ago which also aligned with market expectations.

- China's trade surplus widened to USD 50.98 billion in June 2019 from USD 40.91 billion in the same month a year earlier and above market consensus of USD 44.65 billion. This was the largest trade surplus since December last year. Exports from China fell 1.3% year-on-year to USD 212.84 billion in June, compared to market expectations of a 2% drop. It was the first full month result of higher US tariffs on USD 200 billion of Chinese goods. Imports plunged 7.3% from a year earlier to USD 161.86 billion in June, much worse than forecasts of a 4.5 % drop, a further sign of weak domestic demand.

EXHIBIT 4: Falling Imports in China



Source: Bloomberg (as at 30/06/2019)

- The Chinese economy advanced 6.2% year-on-year in the 2nd quarter of 2019 which was the lowest growth rate since the 1st quarter of 1992, amid ongoing trade tensions with the U.S., weakening global demand and alarming off-balance-sheet borrowings by local governments.

- The economy of South Korea suffered a contraction of 0.4% during the first 3- month of 2019 as compared to the last quarter. On an annual basis, the growth in the 1st quarter of 2019 was at 1.7%

and this was the first time that the growth rate dipped below 2% in nearly a decade. The last time which happened was in the 3rd quarter of 2009, when the economy expanded only 0.9%.

- It seems that the outlook of South Korean economy was quite bearish. South Korea is an export-oriented economy and its exports accounts for more than 50% of economic growth. However, the export growth of the country has fallen for the 7th consecutive month. In June, South Korea's exports recorded 13.5% negative growth from a year ago and the exports were down 8.5% in the first half of the year. With the trade war between the U.S. and China continues, global trade conditions are deteriorating, the South Korea's exports have already been seriously affected. Moreover, the situation was further worsened recently since Japan tightened exports of key materials used to make semiconductors and displays to South Korea. Japan's export curbs could disrupt the production of chipmakers like, Samsung Electronics and SK Hynix, who represented a quarter of South Korea's exports last year.

EXHIBIT 5: South Korean KOSPI Index and Export Growth

Source: Bloomberg (as at 30/06/2019)

- Not only South Korea, the Singaporean economy also performed badly. The preliminary 2nd quarter GDP only expanded 0.1% from a year earlier, which was the slowest in decade. On a quarterly basis, the country's GDP growth even shrank 3.4%, the poorest performance in nearly seven years.

- Since it is believed that the trade conflict between China and the U.S. will not be solved in the near term, those Asian countries that rely on global trade will continue to suffer and their economies may be getting worse in the 2nd half of the year. Although most of the Asian stock markets underperformed those global major equities indexes in 2018 and the 1st half of 2019, we are still cautious towards the overall investment outlook of the Asian equity markets.

Fixed Income

- According to the data from the U.S. interest rate futures at the end of June, the probability of interest rate cut in the Fed meeting on 31st July 2019 reached 100%. Besides, it also reflected that there was 50% chance that the Fed will cut the Fed Funds Rate by 0.75% or more at the end of the year. Under the expectation of falling interest rates, the bond yield of the U.S. 10-year treasury has taken the lead to decline from about 2.7% in the beginning of this year to about 2% at the end of June, which was the lowest level since November 2016. Not surprisingly, the Bloomberg Barclays Global Aggregate Bond Index rose nearly 6% in the 1st half of this year.

- The current state of investment markets is often forward-looking for the future economic and investment environment. Although the recent strong performance of fixed income may have reflected interest rate cuts in the future, due to the reasons of sluggish global economic growth and low inflationary pressures, major central banks in the world would maintain a more market friendly monetary policy for a longer period of time and it is believed that the investment outlook of fixed income is still cautiously optimistic. Bonds with higher credit quality would be more preferable as they could be more defensive even the global economies have further slowdown.

EXHIBIT 6: The movement of U.S Federal Funds Rate and U.S. 10-Year Treasury Bond Yield

Source: Bloomberg (as at 30/06/2019)

Commodities

- OPEC and its alliance countries led by Russia agreed to extend oil supply cuts until March 2020 during their recent meeting on 2 July. The oil price has rallied over 20% in the first half of the year. It is believed that the extent of compliance of the supply cut pact and the progress of U.S.-China trade negotiation will be crucial to the oil price performance over the rest of 2019. In addition, the worsening tensions between the U.S. and Iran may potentially add volatility to the oil price as well.

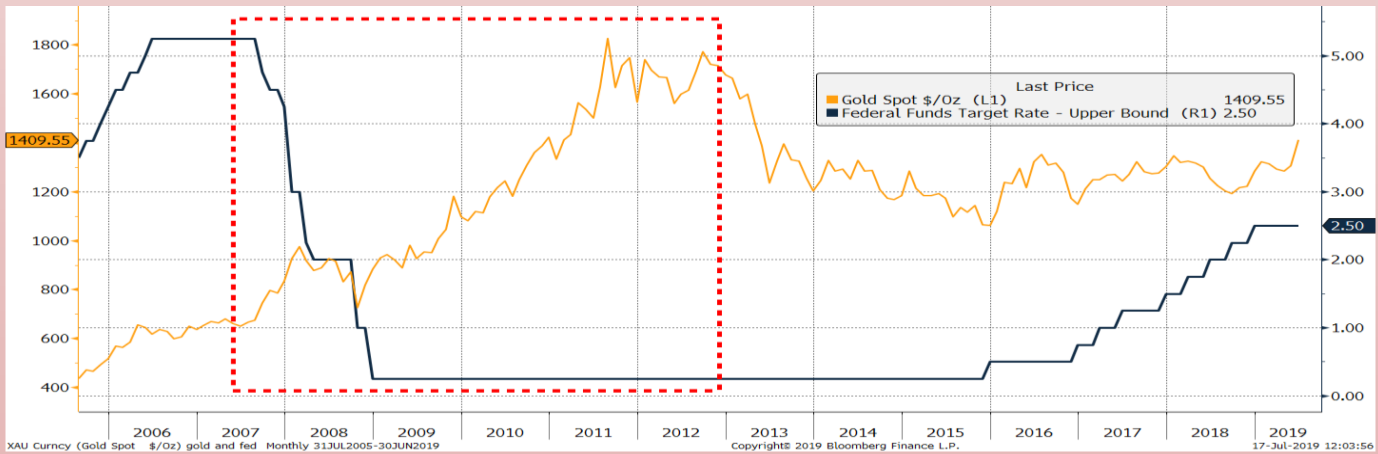
- Gold is always viewed as a kind of “safe haven” asset; investor would like to hold more gold when they tend to have lower risk appetites. In the 1st half of 2019, worries of global economic slowdown, escalating trade war between China and U.S. have stimulated the gold price to rally. In the past few years, gold was traded at range but at the end of June, the gold price rose to around USD 1,400 per ounce level and has broken through its long term resistance.

EXHIBIT 7: Gold price broke through the long term resistance

Source: Bloomberg (as at 30/06/2019)

- Gold also offers no yield or interest. However, under a low interest rate and low bond yield environment, the opportunity cost of holding gold would be largely reduced. When we look at the last U.S. interest rate cutting cycle after the 2008 Financial Crisis, the gold price rose substantially to over USD 1,900 per ounce level. Although it may be too early to say the U.S. is entering into an interest rate cutting cycle, it is quite clear that there would be no more monetary tightening in the near term and the Fed may move towards a looser monetary policy and it would be a favorable environment for gold.

EXHIBIT 8: Gold rallied in the previous U.S. interest rate cutting cycle



Source: Bloomberg (as at 30/06/2019)

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