MACRO BRIEFING

eastspring investments
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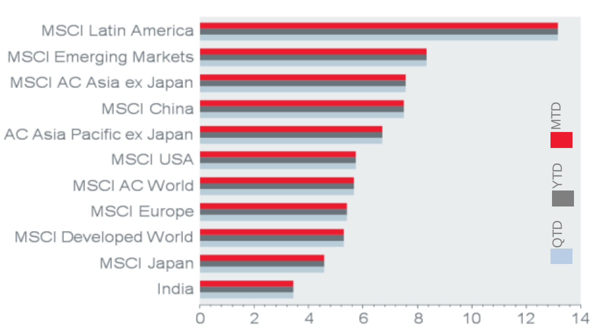
MONTHLY REVIEW: The calm before the storm

January 2018

The World in five bullet points

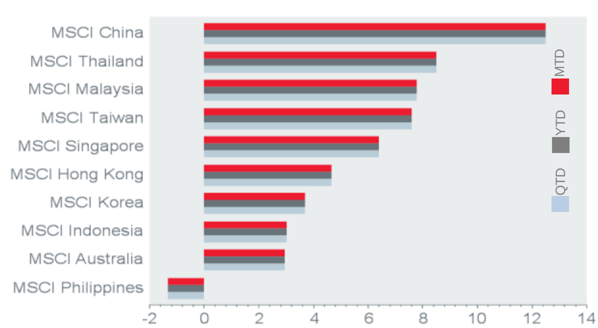
- **Equity markets** started 2018 where they left off in 2017 and rose strongly through January although most fell in the final few days as US bond yields climbed to multi-year highs. This led to concerns that interest rates would rise faster this year than previously expected and put a dampener on returns for the month.
- The **US government** shut down for a long weekend. At least that was what it felt like, while Democrats and Republicans both claimed the other side had capitulated and they had won. The two sides will have another bout over the Federal Government funding in mid-February when the temporary funding bill runs out and they have to arrive at another deal. President Trump also announced that the US would impose tariffs on solar cells and washing machines, hurting some Korean manufacturers.
- **Bond yields finally rose**, surging to a four-year high of 2.75%, indicating that investors are more convinced inflation will return this year. A rising US 10-year inflation breakeven rate (defined as the difference between the yield on a nominal 10-year Treasury bond and the yield on a 10-year inflation-linked bond) ended at a four-year high. Rising energy prices added to the sentiment that inflation may be at a crossroads while real wages appear to be finally ticking higher. Meanwhile in Japan and Europe, inflation remains bumping along the bottom (See Fig 8).
- **Davos** came and went with a lot of snow on the ground. The annual get-together for the world's economic policy makers confirmed many things we already knew: global economic activity is robust, inflation may be returning while the politics swirling around globalisation and trade is getting louder. But there was little in the way of concrete decisions made.
- In **Brazil**, a court upheld the conviction of former president Lula for corruption and money laundering. The ruling means he is unlikely to be able to stand as a presidential candidate in elections later this year. The local stock market soared on the news.

Fig.1. Regional Equity Indices Performance, US$ %



Source: Thomson Reuters Datastream

Fig.2. Asia Equity Indices Performance, US$ %



Source: Thomson Reuters Datastream

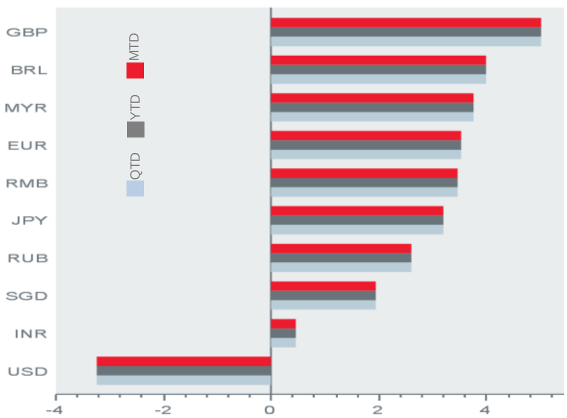
Equity Markets

- Despite the dip into the close of the month, **Global Equity** markets continued their bull run in January fuelled by the three pillars that had maintained 2017's run: liquidity, low inflation and corporate earnings. For the latter, the signs were good that earnings would make their mark with 80% of the S&P 500 Index that reported in January exceeding analyst expectations.
- **US markets** had another month of gains although indices here and in Europe underperformed their Emerging Market counterparts. The momentum that began in December with the tax reform boost continued into the first few weeks of January and the major US indices all reached record highs, before the concerns around inflation and the subsequent rate of interest rate rises pushed stocks lower and bond yields higher.
- **European** equities also continued their trend with the MSCI Europe index up 5.4% in January. This was partly pulled higher by Italy, which had underperformed substantially in December, but which rallied in the first few weeks as worries over its March election outcome waned.

Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 31 December 2017. For representative indices and acronym details please refer to notes in the appendix.

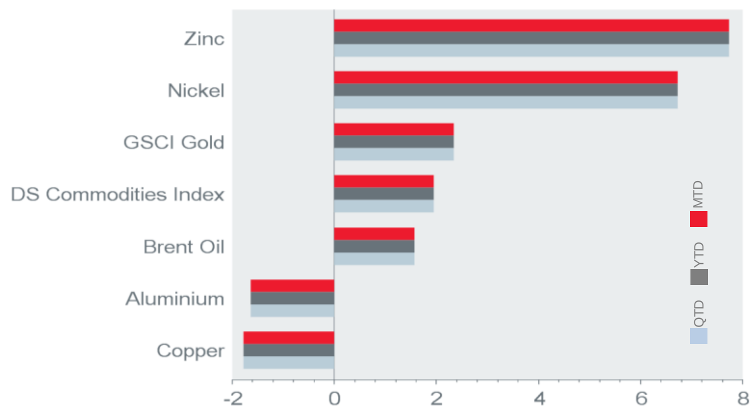
- **Emerging Markets** were very strong in January with Latin America and in particular Brazil very strong on relief that former president Lula would be unlikely to be able to stand for president again after having his corruption conviction upheld. A higher oil price and evidence that consumer sentiment was recovering also boosted markets there.
- In **Asia**, equities continued to gain with Chinese markets leading the way. MSCI China was 12.5% higher boosted by a stronger than expected GDP figure and renminbi strength. In the markets, volumes were very strong as full convertibility of H-Shares and listing of dual-class shares were factored in for the first time, leading to strong south-bound flows on Stock Connect.

Fig 3. Currencies Performance versus USD (%)



Source: Thomson Reuters Datastre

Fig 4. Commodities Performance in USD (%)



Source: Thomson Reuters Datastream

Currencies

- The **US dollar** fell again in January, this time on hints from President Trump as well as Treasury Secretary Steven Mnuchin that a weaker dollar would be good for the US economy, countering a long-held policy by successive US governments. However, this time the comments were supported by economic data which showed the global economies returning robust growth in the fourth quarter against a more subdued US economy.
- The **euro** rose against the greenback and hit a three-year peak toward the end of the month on expectations the ECB would take steps towards unwinding of its stimulus measures amid a strengthening eurozone economy. But amid the euro's strength, ECB President Mario Draghi moved to take the pressure off by reminding investors that inflation may not reach its target this year.
- The **UK pound** also reached its highest level against the dollar since the Brexit referendum, largely because of a strengthening economy, a strong labour market and progress in Brexit negotiations. The strong pound led to the export-heavy UK equity market to underperform their European counterparts.
- Japan also saw the **yen** appreciate against the dollar, falling 3.5% after the Treasury Secretary's comments and the BoJ saying it would keep its short-term policy rate unchanged.
- Also amid the dollar's weakness, China's **yuan** passed the 6.4 barrier for the first time in two years the day after the country beat expectations with its GDP figures.

Commodities

- **Crude** ended January higher as colder than usual winter weather in the US together with a weaker dollar pushed Brent up to US$69 per barrel and WTI to US$65. Strong macro economic conditions globally and a capped supply also helped boost prices. OPEC also committed to maintain its cuts through 2018, lending further support. Gas prices also rose strongly with an almost 30% rise in US and European natural gas.
- **Metal** prices also rose, recording the seventh consecutive monthly gain and with some reaching five-year highs. Nickel and zinc prices led the charge while iron ore also extended gains. Precious metals rose 5.5% while gold and silver also gained around 6%.
- But it wasn't all higher: the **Baltic Dry Index**, an indicator of dry commodity pricing, continued its fall through the month and by the end was at levels not seen since last July. It fell further in the first few days of February.

Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 31 December 2017. For representative indices and acronym details please refer to notes in the appendix.

Fixed Income

- A persistently weak dollar and robust growth conditions in the US stoked investor fears on inflation, causing the yield on the benchmark 10-year Treasury note to surge to a high of 2.73% in January, the highest since April 2014. Over the month, the US Treasury yield curve staged a near-parallel upward shift, with 19-30 bps rise in yields across the curve.
- January's FOMC meeting, also Chairman Yellen's last, saw the Federal Reserve Board unanimously vote to keep rates unchanged. On the heels of the US$1.5 trillion in tax cuts that went into effect in January, the Fed said the economy continued to grow at a "solid rate" and that the labour market continued to show improvement.
- In Asia, performance of Asian USD-denominated bonds turned negative, as accrual income and generally tighter spreads failed to offset rising risk-free benchmarks. High-yield once again outperformed high-grade, supported by higher accrual income. Overall, the representative JPMorgan Asia Credit index fell by 0.52% in January.

Fig 5. Bond Indices Performance, USD %

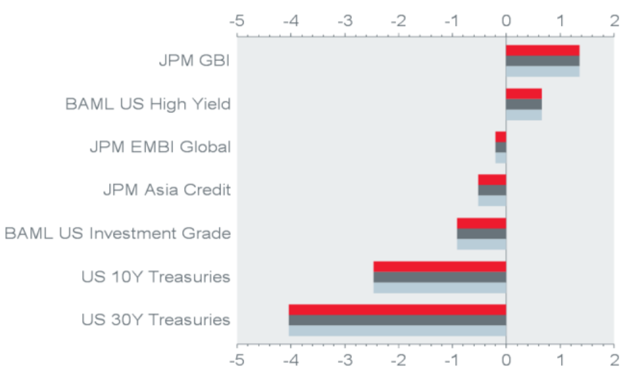
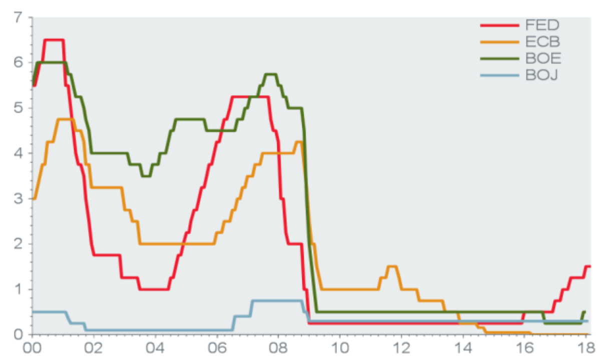


Fig 6. Central Banks Interest Rate, %



Economics

- **US** economic data was mixed. ISM Business surveys continued to show robust growth in manufacturing but a weakness in non manufacturing. 4Q17 GDP figures slightly missed forecasts although was still a robust 2.6%. And the monthly jobs report was very strong with unemployment remaining at record low levels, while inflation was slightly higher than expected at 1.8%.
- **Eurozone** data continues to show strength with consumer confidence figures and the purchasing managers' index touching record highs. Inflation nudged down to 1.3% from 1.4% while Q4 GDP came in at a stable 2.7% growth.
- **China's** economy grew by 6.8% in the fourth quarter yoy. Industrial production stabilised albeit still at high levels but retail sales were below forecasts. **Mexico's** GDP grew 2.1% in 2017, below expectations and showing a sharp drop from last year amid accelerating inflation, a drop in oil production and renegotiations of the NAFTA agreement. **Philippines** Q4 real GDP fell to 6.6% growth yoy from 7% in Q3 as net exports began to drag, while Singapore GDP beat expectations with a 3.1% yoy gain vs an expected 2.6%.
- **Malaysia** raised its interest rates by 25bps to 3.25%, as was largely expected. It is the first hike by the BNM since 2014 and the first among ASEAN Central Banks in this cycle. Korea and Thailand both kept their interest rates on hold, both at 1.5%.

Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 31 December 2017. For representative indices and acronym details please refer to notes in the appendix.

Fig 7. Key Regional Price to Earnings Valuations (x)

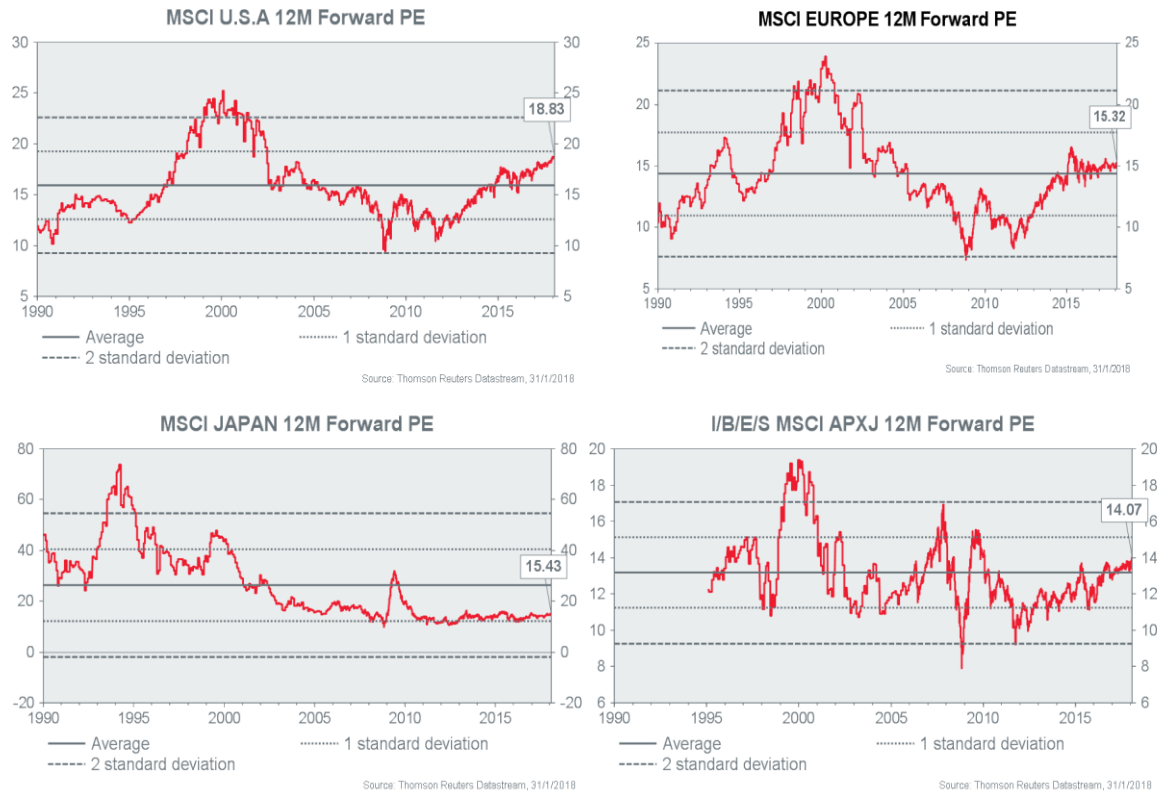
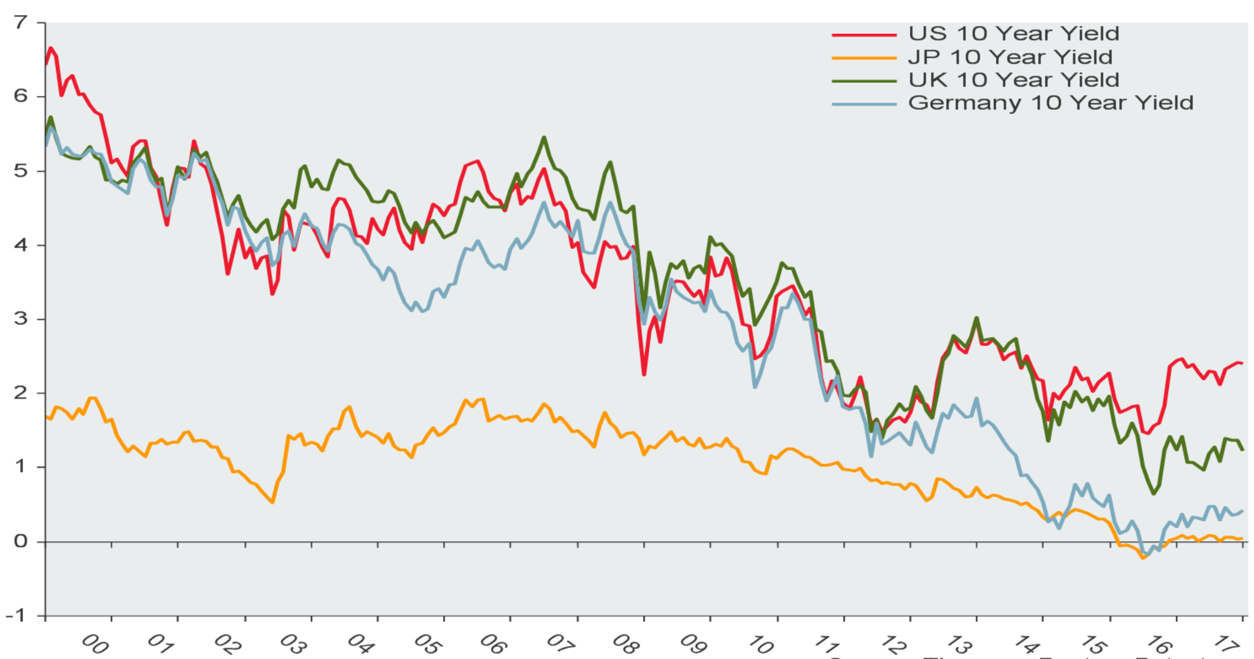


Fig 8. Key Bond Yields (%)



KEY TERMS	
CA	Current Account
CBR	Central Bank of Russia
COPOM	Central Bank of Brazil
CPI	Consumer Price Index
DM	Developed Markets
ECI	Employment Cost Index
EM	Emerging Markets
EM Currencies	MSCI Emerging Markets Currency Index
EM Equities	MSCI Emerging Markets Index
EM Local Currency Bonds	JP Morgan Emerging Local Currency Bond Index
EM USD Bonds	JP Morgan Emerging Market Bond Index
EMU	European Monetary Union
EU	European Union
Fed	The Federal Reserve Board of the United States
FOMC	Federal Open Market Committee
GDP	Gross Domestic Product
Global Developed Equities	MSCI Developed Markets Index
Global Equities	MSCI All Country World Index
Global Government Bonds	Citigroup World Government Bond Index
IP	Industrial Production
M2	M2 Money
mom	Month on month
PBoC	Peoples Bank of China
qoq	Quarter on quarter
Repo	Repossession
SDRs	Special Drawing Rights
SELIC	Sistema Especial de Liquidação e CU.S.todia (SELIC) (Special Clearance and Escrow System)
Tankan	Japan Large Business Sentiment Survey
TSF	Total Social Financing
UK	United Kingdom
y/y	Year on year
REPRESENTATIVE INDICIES	
Aluminum	S&P GSCI Aluminum Index
Asia Local Bond (ALBI)	HSBC Asia Local Bond Index
Brent Oil	Cash settlement price for the InterContinental Exchange (ICE) Brent Future based on ICE Futures Brent index
Commodities	Datastream Commodities Index
Copper	S&P GSCI Copper Index
EMU 10 Year	Datastream EMU 10 Year
Global Emerging Bond	JPM Global Emerging Bond Index
Gold	S&P GSCI Gold Index
Japan 10 Year	Datastream Japan 10 Year
JACI	JP Morgan Asia Credit Index
MSCI Dev World	MSCI Developed Markets Index
MSCI EM	MSCI Emerging Markets Index
MSCI Europe	MSCI Europe Index
MSCI Japan	MSCI Japan Index
MSCI Latam	MSCI Latin America Index
MSCI Russia	MSCI Russia Index
MSCI U.S.	MSCI U.S. Index
MSCI World	MSCI All Country World Index
Steel (HRC)	TSI Hot Rolled Coil Index
UK 10 Year	Datastream UK 10 Year
U.S. 10 Year Treasuries	Datastream U.S. 10 Year Treasuries
U.S. 30 Year Treasuries	Datastream U.S. 30 Year Treasuries
U.S. High Yield	BAML U.S. High Yield Constrained II
U.S. Investment Grade	BAML Corporate Master
DXY	U.S. Dollar Index
Zinc	S&P GSCI Zinc Index

Source: Eastspring Investments

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