MACRO BRIEFING

A member of Prudential plc (UK)

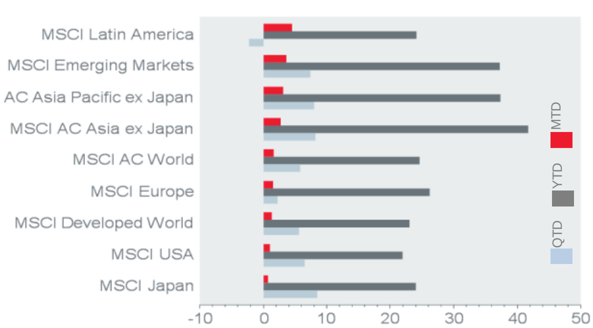
MONTHLY REVIEW: Ending on a high

December 2017

The World in five bullet points

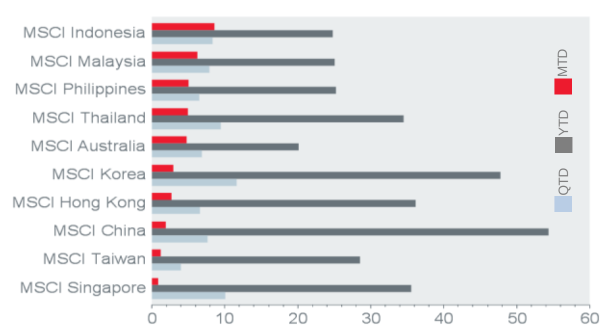
- **Global Equity markets** ended the month close to their highs, but it wasn't all smooth sailing as many experienced a rotation at the beginning of the month, from momentum to low volatility and from technology to financials as investors grew nervous ahead of the Fed's interest rate decision and US tax reform legislation.
- But they needn't have worried; the Senate passed its bill which would see corporate tax slashed as well as a plethora of other measures that are likely to favour equity markets with the reforms potentially leading directly to increased share buybacks or improved dividends from higher earnings.
- **Economic developments** in December saw US third-quarter GDP growth revised up by 0.3% to a seasonally adjusted 3.3% annual rate while US consumer confidence climbed to a 17-year high. The Fed raised interest rates by 25bps as expected. The ECB raised its Eurozone GDP growth forecast for 2018 to 2.3% from 1.8% while inflation came in below expectations.
- Supporting the economic growth figures was **oil**. Members and non-members of the Organization of Petroleum Exporting Countries (OPEC) agreed to extend production cuts, which together with an outage in the North Sea, led to higher crude prices.
- As for the year, it was an **outstanding one for equities:** The MSCI AC World Index closed at record highs on 61 separate occasions with risk assets almost everywhere returning gains not seen in ten years or more. Emerging Markets outperformed Developing Markets, and Asia markets outperformed other Emerging Markets. As much as the positives supported the equity markets, so did the lack of negatives: fears of populist movements gaining ground in Europe, or an aggressive US trade policy dampening global growth, or a nuclear stand-off with North Korea developing…all failed to materialise. As did inflation which kept bond yields flat even with fundamental economic indicators continuing to improve globally.

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



Source: Thomson Reuters Datastream

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



Source: Thomson Reuters Datastream

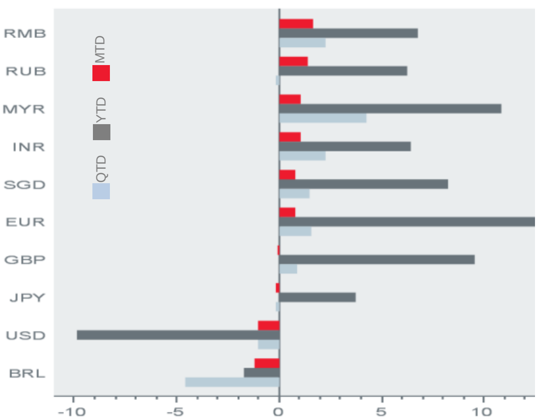
Equity Markets

- **Global Equity** markets rose again in December with Emerging Markets once more outperforming Developed Markets. However, this month, the gains were led by Latin American markets that benefitted from the more tech-heavy Asian indices underperforming on profit taking.
- **US markets** closed at near their year highs, with only a final-day-of-the-year bout of profit taking preventing the indices ending 2018 on a perfect high note. Jitters over the passage of tax reform led to a small round of profit taking early in the month but once this passage was assured, equities surged once again as investors calculated how the reform would benefit stocks.
- Returns in **Europe** were more subdued as a strong euro began to take its toll on performance while lingering doubts over the future German government make up, and the re-emergence of political instability in Italy, led some investors to take profits on the year. UK stocks underperformed their European counterparts modestly despite the breakthrough in Brexit talks.

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.

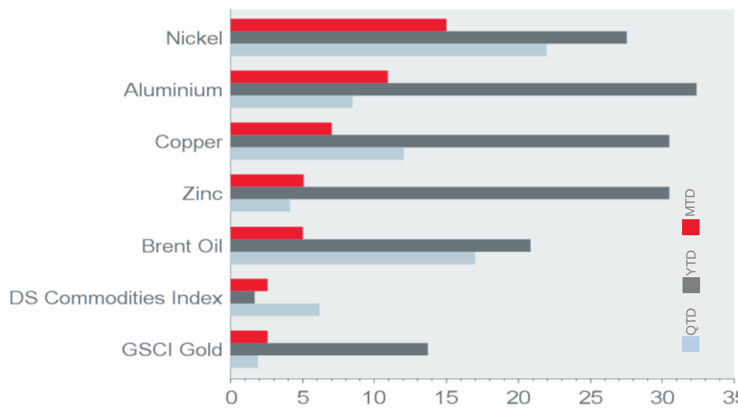
- In **Asia**, ASEAN markets outperformed, led by Indonesia, which has lagged for most of the year. Many of the northern tech-rich indices lagged with Taiwan weak on news that Apple's iPhone X sales were below expectations, while China and Hong Kong also were subdued on credit tightening measures, as well as year-end profit taking.
- **Latin America** stocks were strong despite a weakening of most of the region's currencies with Chile the strongest market on news the market-friendly Sebastian Piñera had won the presidential election. Brazil was 4.7% higher to end the year up around 24%, in line with the region, with December held back by a government pension reform vote being postponed to February.

Fig 3. Currencies Performance versus USD (%)



Source: Thomson Reuters Data

Fig 4. Commodities Performance in USD (%)



Source: Thomson Reuters Datastream

Currencies

- The **US dollar** resumed its slide in December and loitered around three-month lows by the end as the effects of the US tax-reform boost wore off. For the year, the dollar lost 9.8%, its worst performance since 2003.
- The **euro** closed in on four-month highs by the end of December on the back of strengthening economic data in the main industrial European states, and would finish the year with its best run against the dollar since 2003. Investors looked ahead to the unwinding of the ECB stimulus program as a catalyst for 2018 as this would likely boost the euro's value.
- The UK agreed to meet the European Union's Brexit bill demands, postponed a decision about the North-South Irish border, and also caved in on EU demands for citizens rights, however both sides agreed to move on to trade negotiations. The **UK pound** rose to a two-month high versus the US dollar on the news before sinking back slightly on the government's defeat in parliament in a Brexit-related piece of legislation.
- The **South African rand** surged after the ruling ANC party in South Africa elected a new leader. Cyril Ramaphosa will succeed President Jacob Zuma as party leader and in all likelihood, become the next President post elections in 2019. But the election was closely fought, with President Zuma's ex-wife Nkosazana Dlamini-Zuma securing over 48% of the vote. The rand advanced by about 13% in 2018, almost all of which came after the ANC vote.

Commodities

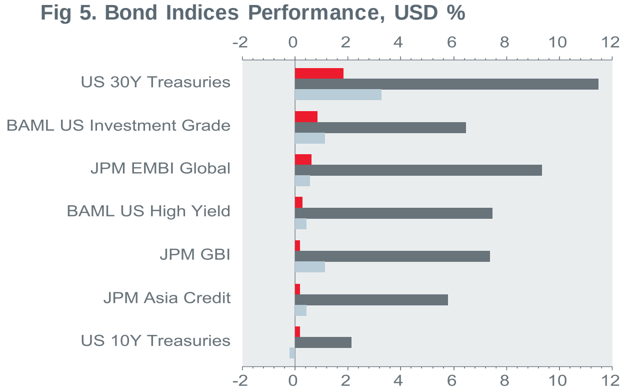
- **Crude** ended the month at multi-year highs as both members and non-members of OPEC agreed to extend oil production cuts then an outage in the North Sea extended gains for Brent. The gains came despite increased production figures from the US as demand rose higher than expectations.
- **Gold** extended its recent gains to end the year at three-month highs, as political tensions in Iran and receding concerns over the impact of US interest rates coupled with a sinking US dollar contributed to performance. Gold had its best year in 2017 since 2010.
- **Iron Ore** surged over the month as traders bet that restocking in China would resume ahead of an end to steel production cuts, which were imposed over the winter in an attempt to curb pollution. Iron ore ended the year around 16% higher, its second straight year of gains.
- **Copper** and **aluminium** both posted strong gains after China proposed the cutting of scrap metal imports, also in an attempt to cut pollution. Investors are betting the country will have to import more refined metals as a result of the move. Copper ended the year at four-year highs.

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

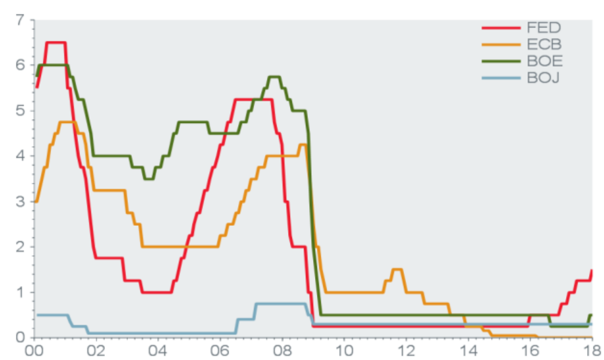
- The US Federal Reserve raised the federal funds target range by 25bps to 1.25-1.50%. It also raised its 2018 GDP estimate from 2.1% to 2.5%, reflecting more bullish growth expectations for the coming year. However, inflation has remained tepid all year and consistently undershot the Fed's 2% target despite low unemployment. The accompanying statement subsequently noted the jobs market "will remain strong", an upgrade from the last assessment in November.
- Following the rate hike, which saw committee members voting 7-2 in favour, the Fed also confirmed that monthly roll-offs from the central bank's balance sheet would step up, as scheduled, to $20bn from $10bn in January. However, neither this nor the tax reform passage succeeded in giving the US dollar or longer-term Treasury yields a lift, as markets priced in a decidedly less sanguine economic outlook than the Fed's 'dot plot'.
- Over the month, the 2-year US Treasury yield rose by just 10 bps to 1.88%, while the 10-year yield remained virtually unchanged, bringing the full-year flattening of the 2-10 UST spread just shy of 2017's record 74bps. Investors are now betting that inflation would remain benign for 2018, and at the same time the Treasury would increase short-term borrowing to pay for the tax reform.
- Performance of Asian USD-denominated bonds generally ended flat, as modest short-term Treasury yield rises were offset by modest spread tightening and accrual income. High-yield outperformed high-grade, supported by higher accrual income. Overall, the representative JPMorgan Asia Credit index rose by 0.17% in December.

Fig 5. Bond Indices Performance, USD %



Source: Thomson Reuters Datastream

Fig 6. Central Banks Interest Rate, %



Source: Thomson Reuters Datastream

Economics

- Along with Europe and the US, Japan also upgraded its GDP growth target with growth for 2017 now seen at 1.9% and 1.8% for 2018. However inflation estimates remained well below target at 0.7% for 2017 and 1.1% for 2018 against a 2% target rate. The low inflation estimates suggests its huge stimulus plan will continue.
- Global banking regulators finalised tougher post-crisis capital requirements after years of debate, ending uncertainty in the sector. Although many of the provisions had been expected, analysts said the final rules were more lenient on European banks than had been expected, spurring a small rally throughout Eurozone financial names.
- In Europe, the Purchasing Managers' Index – historically a proven leading indicator of GDP growth – grew in November across the large industrial countries of Germany, France, Italy and Spain. Also in Germany, the Ifo business sentiment index hit 117.5 in November, a level not seen since 1969 (in the same month as man landed on the moon), however the optimism was tempered by inflation hitting five-year highs in December. Inflation in the UK also hit multi-year highs in November of 3.1%, above the Bank of England's upper target of 3.0%.
- In Latin America, Brazilian economic activity accelerated in Q3 with GDP growing 1.4% while upward revisions to Q2 data meant year-end forecasts are likely to be beaten comfortably. A caveat in the form of accompanying high consumption levels led to an increase in imports, which may lead to future pressure on the real. In political developments, Congress delayed a vote on pension reform to February.
- Central Banks in Turkey, Mexico and Chile all raised their base interest rates during December, to add to the hike in the US.

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)

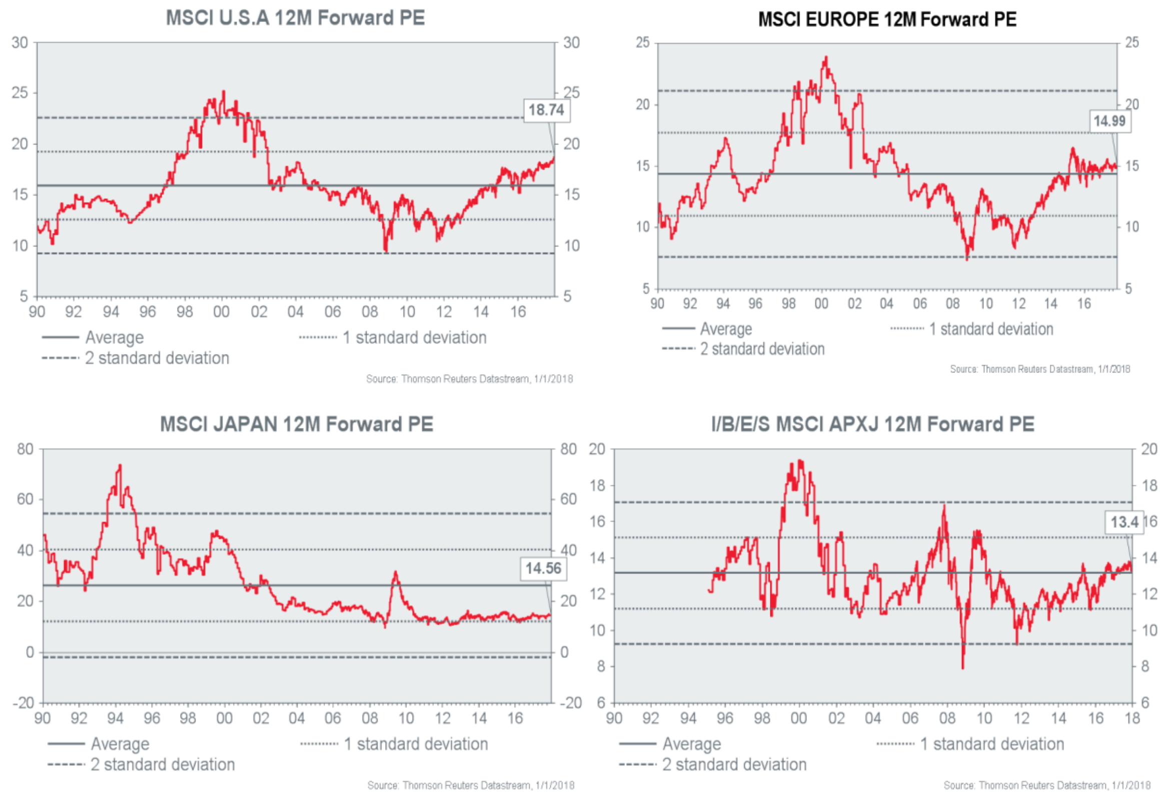
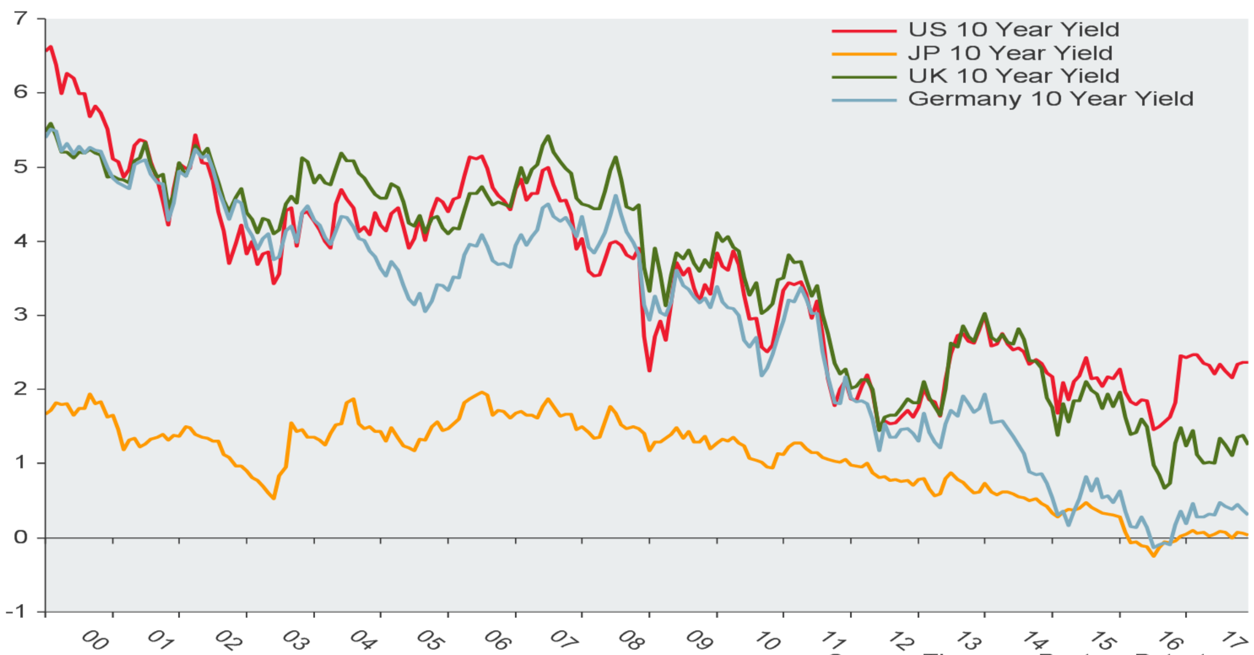


Fig 8. Key Bond Yields (%)



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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

For more information visit eastspring.com

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