

MONTHLY REVIEW: Equity markets on a rollercoaster

February 2018

The World in five bullet points

- ▶ In February, many equity market charts resembled that of a rollercoaster: a sharp fall from a high point followed by a recovery, then another drop into the end. The catalyst for the falls in February was US average earnings data which rose 0.3% to 2.9%. This sent investors scurrying for their inflation and interest rate calculators. On the news, and in fear of higher interest rates, equity markets fell sharply at the beginning of the month while bond yields rose to multi-year highs.
- ▶ But is global inflation really back? As Eastspring points out [here](#), the wage bill fell but hours worked fell more; that meant average wages rose. Meanwhile, eurozone inflation fell to 1.3% while commodity prices – the canary in the coal mine for global inflation – also eased.
- ▶ The ECB's monthly meeting minutes caused a stir after they suggested the US may be deliberately devaluing the dollar. US Treasury Secretary Steven Mnuchin in January suggested weak dollar was good for the US although President Trump quickly countered him. But at the ECB at least, suspicion remains.
- ▶ Germany inched closer to having a government when the Social Democrats polled their members on whether to join a coalition government with Angel Merkel's Christian Democratic Union. The result of the poll is due in the first few days of March but even if it is "no" many expect the SD to join government anyway.
- ▶ South Africa produced its first budget in the post-Zuma era, which was generally well received by the market. VAT will rise but expenditure will not while debt should stabilise giving rise to a bump in GDP growth expectations.



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

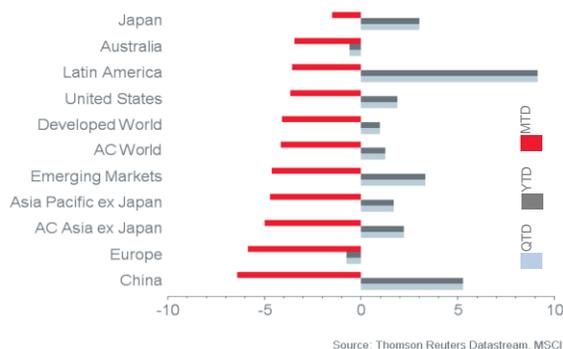
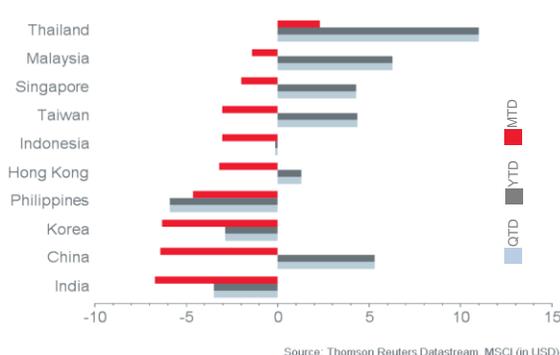


Fig.2. Asia Equity Indices Performance, US\$ %



Equity Markets

- ▶ Equity markets endured one of their most volatile months in years with investors accelerating the selling momentum which began at the end of January into a full-scale rout by the end of the first week of February. The fear index – the CBOE's VIX index – spiked sharply before tapering as the month progressed but still finished well above its starting point on 1 February.
- ▶ By the end of the month, many markets recovered to be back to where they started the year despite a final-day dip but for the calendar month almost all markets fell in February with Developed and Emerging markets performing more or less in line with one another. Europe was a slight underperformer against the US as the euro strengthened while Japan dropped just 1.5%.
- ▶ In the Emerging Market universe, EMEA outperformed although was still down, supported by South Africa (Zuma resigned as president) and Russia (currency movements), while Asia Pac underperformed against Latin America, which again was helped by a relative outperformance from Brazil.



- ▶ Within Asia, North Asia markets underperformed ASEAN and everywhere outperformed India, which fell 6.7%. China (down 6.4%) and Korea (down 6.3%) were also noticeably weak, especially during the early month sell down. Thailand took the honour of being the only Asia market to show a gain.
- ▶ India fell throughout the month even after other EMs began to recover post the first week after the India government introduced a long-term capital gains tax on stocks in its budget. Banking stocks weighed heavily after an alleged fraud against Punjab National Bank was revealed while a threat of MSCI lowering the weighting in some of its index fleet became a darkening cloud on the horizon – MSCI says this is an option after domestic exchanges barred the use of local derivative products for overseas bourses.

Fig 3. Currencies Performance versus USD (%)

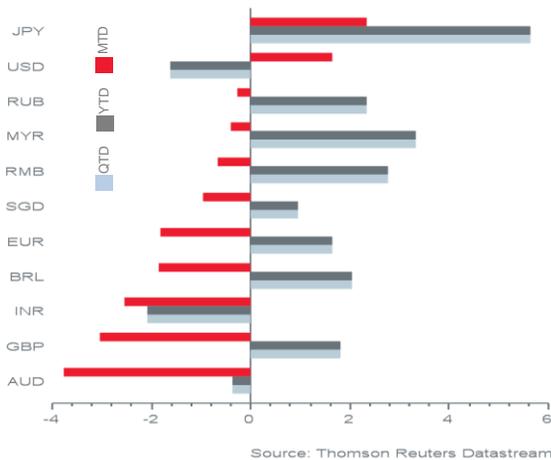
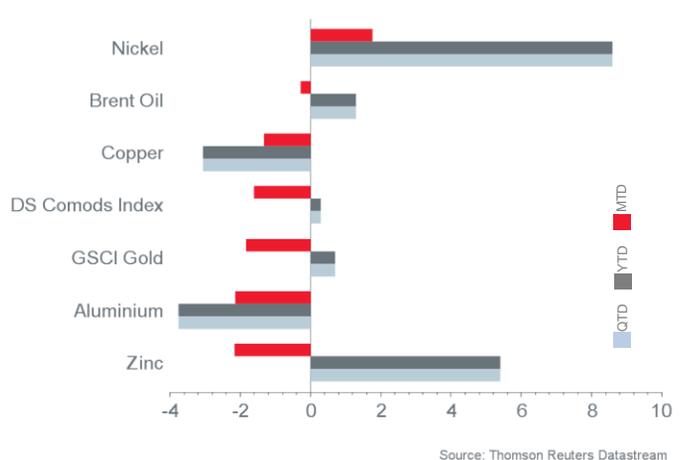


Fig 4. Commodities Performance in USD (%)



Currencies

- ▶ The yen hit a 15-month high versus the greenback during the month although most analysts attributed this to dollar weakness rather than yen strength. The US dollar index rose, primarily reflecting the yen strength, but the dollar weakened again against most other currencies.
- ▶ Against the euro, the dollar is now 13% below the level seen on 20 January 2017, President Trump's inauguration day, and 7.5% lower against the yen in the same time period. The euro gained for the month although did slip in the final week ahead of the Italian general election and over whether Germany can form a coalition government after months of talks; both results are due in the first few days of March.
- ▶ The South African rand rose to a three-year high versus the USD after President Jacob Zuma resigned and Cyril Ramaphosa was sworn in as his replacement. His subsequent first budget also provided support.
- ▶ The Australian dollar fell to reverse last month's gains, and to track commodity prices lower through the month. Domestic support this month was limited with GDP and consumer related indices continuing to look weaker rather than stronger.

Commodities

- ▶ Commodity prices in general eased after the weak start to the month, led by industrial and precious metals. Oil fell with equities at the beginning of the month but rose steadily thereafter before tipping down again at the final few days on unexpectedly high inventory builds in the US. The International Energy Agency and OPEC again forecasted increased 2018 US oil production for 2018 but for most of the month, traders focused instead on production cuts including in the US. WTI ended 6% lower at \$61.60 per barrel and Brent 7% lower at \$64.60.
- ▶ Metal prices also fell with aluminum prices down around 4% year to date as China factories ramped up production ahead of the expiration of winter/pollution-linked production curtailments in March.
- ▶ Copper fell into the end of the month despite being higher for much of February as China's ban on importing scrap metal, which began in January, started to bite. Smelters in China now need to increase their feed of refined copper to maintain production levels, which has pushed prices higher.
- ▶ In the first week of February, iron ore prices fell from their peak seen in late January but ticked higher thereafter into the close of the month to finish 8% higher. Coal prices were steady for much of the month before falling in the final week as Chinese factory output data disappointed.
- ▶ The Baltic Dry Index, a key indicator of the health of the commodity market, rose modestly albeit from multi-month lows reached during the month on worries over the health of the Chinese economy.



Fixed Income

- ▶ US 2-year Treasury yields hit the highest levels since the global financial crisis in the final week of the month, while those on the 10-year yield reached a four-year high on release of the Fed minutes, which suggested a quicker path to normalised interest rates.
- ▶ New Fed chief Jerome Powell's congressional testimony debut a few days later only added fuel to this speculative fire, as he shared his personal view that "the economy has strengthened since December", and that headwinds once holding back the US economy (export growth and fiscal policy) have transformed into tailwinds.
- ▶ Over in Asia, Asian USD-denominated bonds were not spared from the US Treasuries sell-off, as widening spreads only added to the negative effect of rising risk-free benchmarks on performance. High-yield underperformed less than high-grade, supported by higher accrual income. Overall, the representative JPMorgan Asia Credit index fell 0.75% in February.
- ▶ The BoJ also trimmed the amount of super-long government bonds it offered to buy although stressed there was no change to the underlying policy.

Fig 5. Bond Indices Performance, USD %

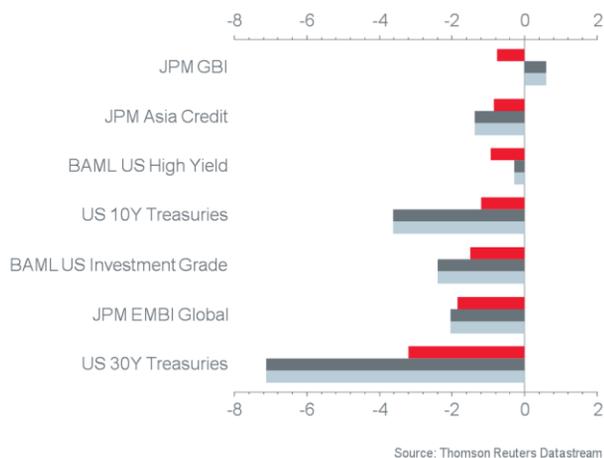
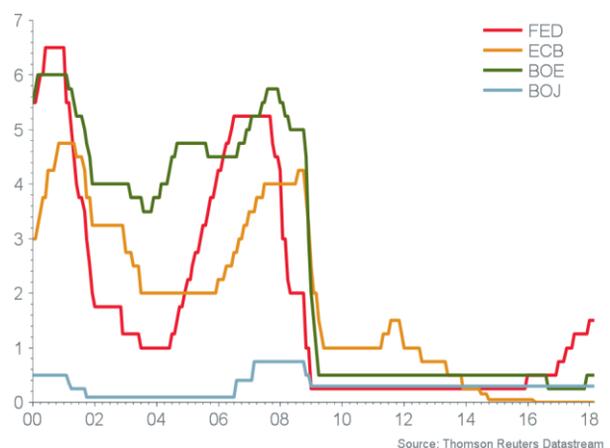


Fig 6. Central Banks Interest Rate, %



Economics

- ▶ Aside from the wage data that sent the equity markets into a sell off, the US Consumer Price Index surprised to the upside on both headline and core measures, and helped to push 10-year Treasury yields to four-year highs and above 2.9%. But retail sales also slowed reminding investors that inflation is not the only driver behind interest rates; global equities began their recovery from week one's sell off on the news.
- ▶ Eurozone GDP grew by a healthy 2.7% yoy with an added cheer given to the breadth of the growth, with almost all countries that share the euro recording GDP growth. The Purchasing Manager's Index came in at 58.8 – a measure traditionally associated with GDP growth of above 2%.
- ▶ The UK held interest rates steady and the BoE upped its GDP forecast for 2018 to +1.8%, better than many expected last year but still subdued by historical standards. GDP rose just 0.4% in Q417. Inflation remains an issue with signals from the bank that it may increase rates sooner rather than later while the market is pricing in May for a 25bps rate increase.
- ▶ Japan's Q4 GDP growth came in at 0.5% qoq, well below estimates of +1%, with exports this time taking a back seat to domestic demand. The BoJ is likely to interpret the subdued figures as reason not to change its rate policy while the reappointment of Governor Kuroda, as well as a monetary policy supporter as his deputy, will likely lead to clarification on monetary policy in coming months. Japan's core consumer inflation data was also steady but industrial output fell 6.6% in January – its largest fall since the Tohoku earthquake in 2011 – mainly due to heavy snowfall delaying parts delivery.
- ▶ China's factory data was also disappointing with growth in China's manufacturing sector in February slowing more than expected due to tough anti-pollution measures and the timing of the lunar new year holidays. The weak numbers was enough to send Chinese stocks lower on the final day of trading.

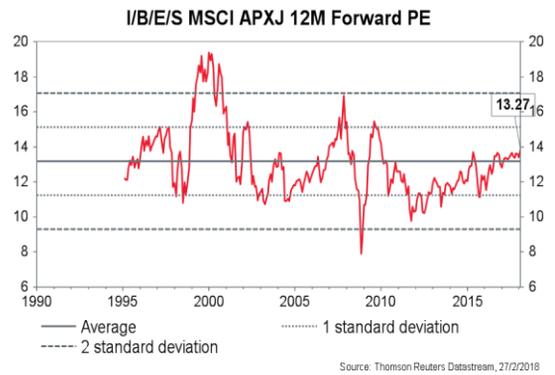
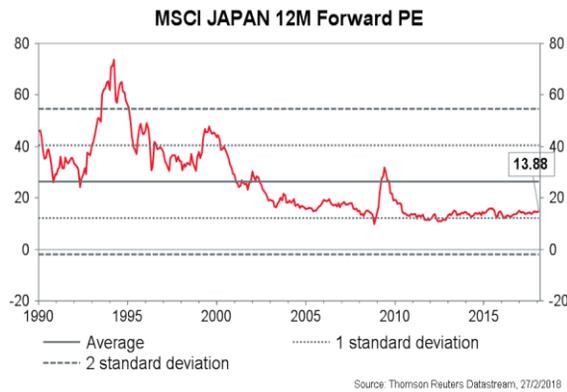
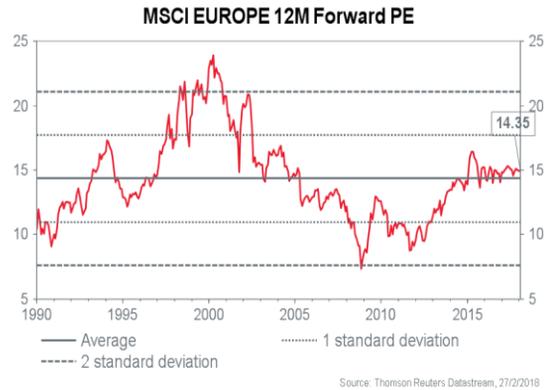
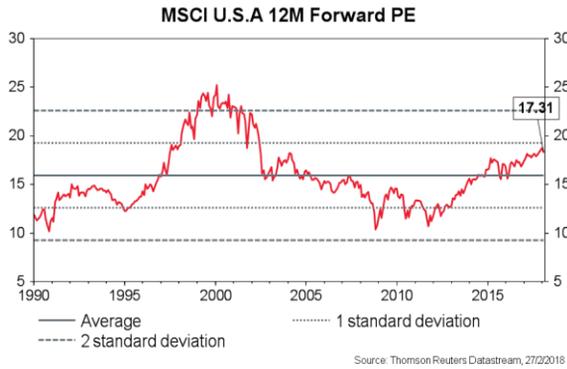
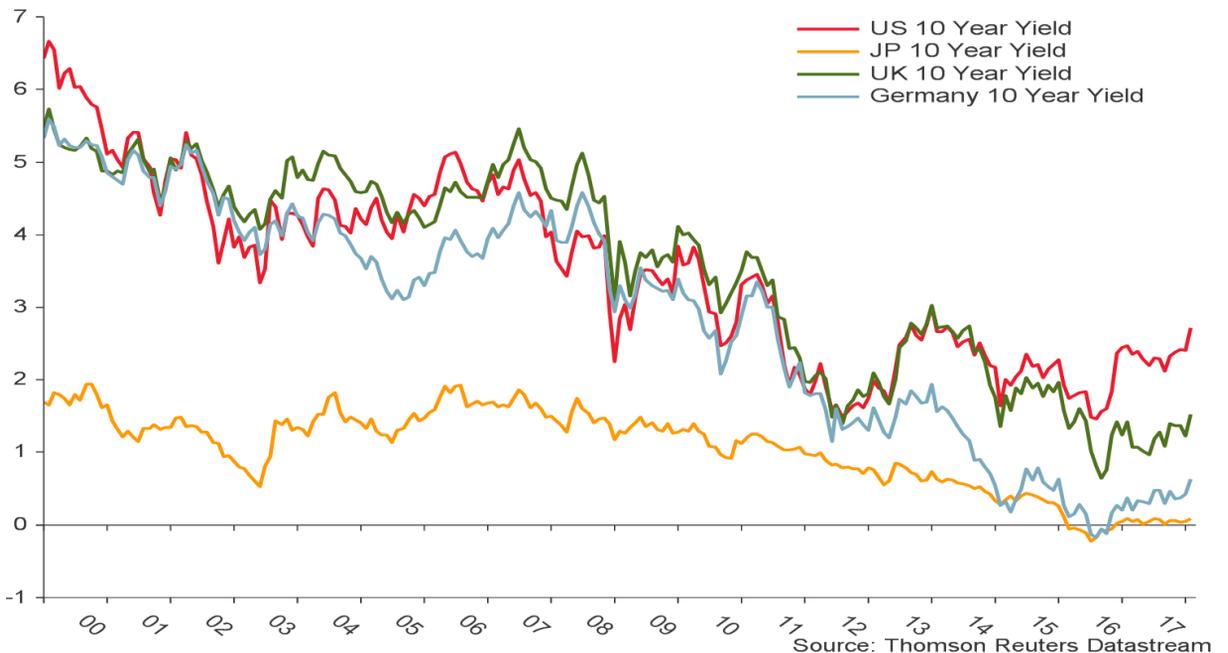


Fig 8. Key Bond Yields (%)



Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 28 February 2018. For representative indices and acronym details please refer to notes in the appendix.



MSCI monthly, quarterly and YTD data

	MTD	QTD	YTD	2017	2016	2015	Jan-18	Dec-17
World	-3.1	2.4	2.4	24.6	8.5	-1.8	5.7	1.6
Developed World	-3.1	2.1	2.1	23.1	8.2	-0.3	5.3	1.4
United States	-2.6	3.0	3.0	21.9	11.6	1.3	5.7	1.1
Europe	-4.9	0.3	0.3	26.2	0.2	-2.3	5.4	1.5
Japan	-0.9	3.7	3.7	24.4	2.7	9.9	4.6	0.7
Emerging Markets	-3.2	4.8	4.8	37.8	11.6	-14.6	8.3	3.6
Asia Pac Ex Japan	-3.7	2.8	2.8	37.3	7.1	-9.1	6.7	3.1
Asia Ex Japan	-3.9	3.4	3.4	42.1	5.8	-8.9	7.6	2.7
Latin America	-1.8	11.1	11.1	24.2	31.5	-30.8	13.2	4.5
Brazil	-0.1	16.7	16.7	24.5	66.7	-41.2	16.8	4.7
EMEA	0.0	6.2	6.2	25.2	20.5	-19.7	3.0	4.8
	MTD	QTD	YTD	2017	2016	2015	Jan-18	Dec-17
Australia	-2.6	0.3	0.3	20.2	11.7	-9.8	3.0	4.8
New Zealand	-6.9	-3.5	-3.5	12.7	19.3	-5.4	3.7	8.0
Hong Kong	-2.9	1.6	1.6	36.2	2.3	-0.5	4.7	2.7
China	-5.0	6.9	6.9	54.3	1.1	-7.6	12.5	1.9
Korea	-4.3	-0.7	-0.7	47.8	9.2	-6.3	3.7	3.0
Taiwan	-3.0	4.3	4.3	28.5	19.6	-11.0	7.6	1.2
Thailand	2.4	11.1	11.1	34.9	27.0	-23.3	8.5	5.0
Malaysia	-0.4	7.4	7.4	25.1	-3.9	-20.1	7.8	6.2
Singapore	-1.1	5.2	5.2	35.6	1.5	-17.7	6.4	0.9
Indonesia	-1.9	1.0	1.0	24.8	17.5	-19.1	3.0	8.6
India	-5.8	-2.6	-2.6	38.8	-1.4	-6.1	3.4	4.9
Philippines	-3.1	-4.4	-4.4	25.2	-6.1	-6.3	-1.3	5.0
	MTD	QTD	YTD	2017	2016	2015	Jan-18	Dec-17
Mexico	-5.5	1.9	1.9	16.3	-9.0	-14.2	7.9	-0.0
Chile	-2.2	5.0	5.0	43.6	16.8	-16.8	7.3	15.8
Hungary	-6.8	0.5	0.5	39.9	35.4	36.3	7.8	4.8
Poland	-7.4	0.8	0.8	55.3	0.7	-24.9	8.8	3.5
Czech Republic	-3.7	4.4	4.4	38.9	-2.5	-16.5	8.4	3.3
Russia	3.0	16.0	16.0	6.1	55.9	5.0	12.6	3.0
Turkey	-2.2	2.7	2.7	39.1	-8.1	-31.6	4.9	13.2
South Africa	1.6	4.5	4.5	36.8	18.4	-25.1	2.8	8.8
United Kingdom	-5.0	-2.1	-2.1	22.4	-0.0	-7.5	3.0	5.0
Germany	-6.4	-0.9	-0.9	28.5	3.5	-1.3	5.9	0.0
France	-4.2	2.6	2.6	29.9	6.0	0.8	7.0	-0.2
Netherlands	-4.4	1.6	1.6	32.7	5.3	1.7	6.3	0.7
Austria	-6.3	2.1	2.1	52.1	8.1	4.5	9.0	3.0
Italy	-5.1	6.0	6.0	29.6	-9.5	3.0	11.7	-1.5
Spain	-7.0	1.3	1.3	27.7	-0.5	-15.4	9.0	-1.0
Greece	-6.9	4.1	4.1	29.1	-11.9	-61.3	11.8	16.6
Portugal	-3.7	0.6	0.6	25.2	4.6	1.9	4.5	-1.8
Switzerland	-5.0	-0.9	-0.9	23.6	-4.0	1.2	4.3	1.4
Sweden	-4.4	1.4	1.4	21.8	1.9	-4.0	6.1	-0.3
Norway	-1.4	4.4	4.4	29.6	14.6	-14.2	6.0	3.0

**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 C.U.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



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