



MACRO BRIEFING

MONTHLY MARKET REVIEW:

Turkey shoots and contagion reigns

August 2018

The World in five bullet points

- ▶ Turkey's currency collapsed along with its stock market, with the main question mark hanging over whether the country can pay its dollar-denominated debt, particularly after the central bank declined to tighten rates to curb rapidly rising inflation. Venezuela also saw its currency implode, Argentina was forced to approach the IMF for a bailout after its currency devalued 24% against the dollar over a single month, while Brazil's real lost 7%, and Russia's ruble fell by 7% after fresh sanctions were applied by the US. Asian currencies were more resilient but some emerging market currencies, it seems, have caught the currency contagion.
- ▶ Some commodity prices fell sharply during the month as a slowing economic picture, higher US interest rates and currency fluctuations took their toll. Copper, which is often taken as a proxy for world growth, is now officially in a bear market (a 20% fall from its peak) and hit a one-year low during the month. Zinc futures fell their most in two years and crude touched a four-month low. Even gold, usually reliable in turbulent markets, went below \$1,200 per ounce, to hit its lowest level in 18 months.
- ▶ Australia got a new Prime Minister, Scott Morrison. The incumbent, Malcolm Turnbull, chose not to stand in an internal Liberal Party leadership election, held just days after he had survived a separate challenge. Australia has now had five PMs in five years, and it is now more than a decade since a PM completed his or her first term in office. The Aussie dollar fell on the news.
- ▶ News emerged that not only had President Trump's personal lawyer, Michael Cohen, paid, on the President's instructions, "hush" money to two women with whom the President allegedly had affairs but also that the President's former campaign chairman, Paul Manafort, had been convicted on nine charges including tax fraud. US equities, focused on still rising earnings forecasts and the Mexican-US trade agreement, shrugged off both events.
- ▶ A bridge built in the 1960s in the Italian port of Genoa collapsed, killing 43 people. Among the subsequent events, the Italian government blamed EU fiscal rules for the lack of infrastructure spending and pledged more to counter the decay in post-war building boom projects. This in turn led to speculation that the country's budget submission to the EC in October could lead to a fiscal responsibility confrontation. These worries sent Italian bond yields to four-year highs and Italian stocks down by 9.5%.

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

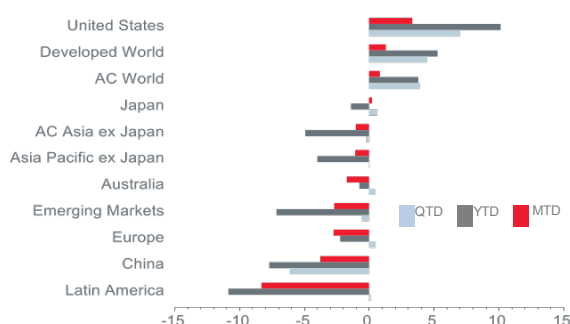
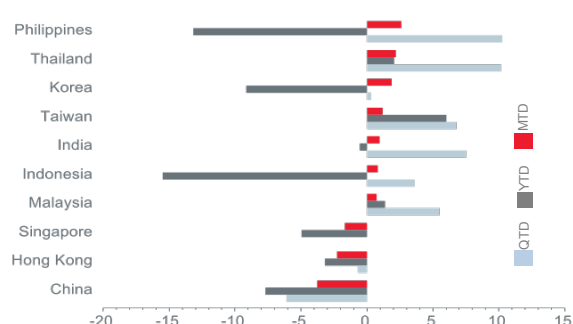


Fig.2. Asia Equity Indices Performance, US\$ %



Equity Markets

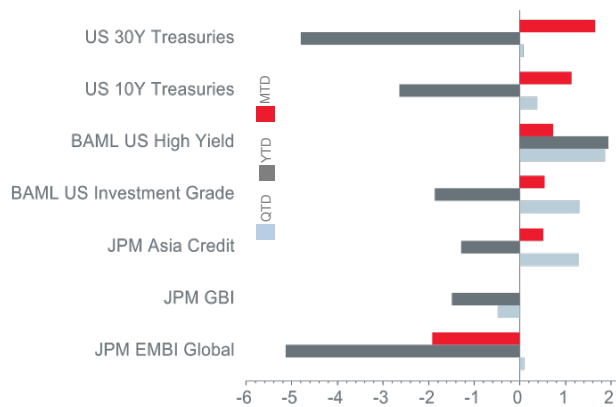
- ▶ Global equity markets fell early in August but a final-week rally, driven by relief the new Mexico-US trade deal was not as disruptive as once feared, blunted the losses and led the MSCI AC World Index to end 0.8% higher. The US's 3.3% rise helped Developed Markets outperform Emerging Markets for the fifth month in a row but Europe fell 2.8% on concern over contagion from Turkey as well as weakness in Italy. Japan also outperformed most global markets with a 0.2% gain.
- ▶ The MSCI Emerging Markets Index fell 2.7% led lower by Turkey as its index lost 29% in US dollar terms, making an over 50% loss for the year to date. Russia also fell sharply as its currency came under attack on the imposition of new sanctions, while Greece fell 10% despite emerging from its ECB-backed bail out scheme. In Latin America, Brazil pulled the continent lower as opinion polls began to favour a left-wing leaning candidate, leading to fears that much needed reform will not take place. The collapse of the Venezuela bolivar currency did little to help sentiment there either.

Source: Eastspring Investments. Chart data from Thomson Reuters Datastream as at 31 August 2018. For representative indices and acronym details please refer to notes in the appendix.



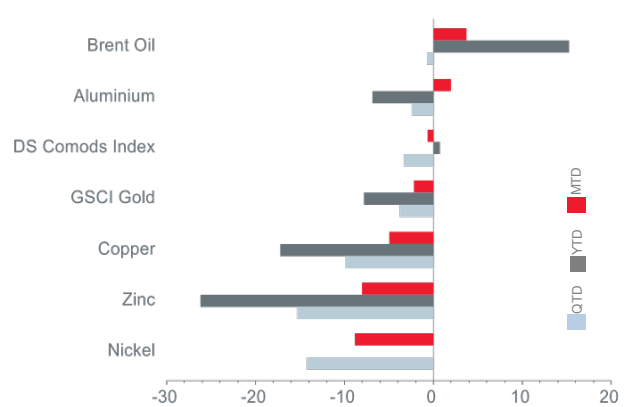
- ▶ The currency contagion that dominated the month affected Asia to a lesser extent with the MSCI Asia ex Japan index falling 1.0% to be down 4.7% for the year. The region was led lower by China, which lost 3.8%, with technology stocks in particular under pressure as US tariffs began to bite while President Trump was threatening to impose more.
- ▶ With the near collapse of several EM currencies, countries with lower levels of US dollar-denominated debt fared better, even with the dollar rising further. In Asia, ASEAN indices continued their recent outperformance with Thailand, Malaysia and Indonesia recording modest gains, while Korea and Taiwan also turned around mid month to end slightly higher.
- ▶ Among other notable equity market moves, Italy fell 9.5% on worries over its upcoming budget, Australia also underperformed to close 1.8% down after its currency fell on the political upheaval as well as news the country had banned Huawei and ZTE from supplying to the country's 5G network. Russia's markets came under pressure after its ruble fell 7% on contagion from Turkey and news the US had imposed fresh sanctions on the country.

Fig 3. Bond Indices Performance, USD %



Source: Thomson Reuters Datastream

Fig 4. Commodities Performance in USD (%)



Source: Thomson Reuters Datastream

Fixed Income

- ▶ Performance of global government bond markets was generally mixed over the month. In the US, 10-year US Treasury yields fell by 6 basis points to close the month at 2.86% as the ongoing Sino-US trade tensions and a deepening market rout in Turkey weighed on risk sentiment and supported flight-to-quality flows. Nevertheless, positive news flow surrounding a trade deal between the US and Mexico reversed some of the earlier yield declines towards the end of the month.
- ▶ In contrast, the Japanese government yield curve bear steepened with longer-term maturity rates rising as investors tested the upper limits of BOJ's yield curve control policy range after the central bank announced tweaks in its monetary policy, allowing more trading flexibility in interest rates.
- ▶ USD-denominated credits in Asia benefited from the lower US interest rates, which contributed to an overall modest gain in August. However, the risk averse environment led to moderate credit spread widening across sectors, which negated some gains. In particular, high-yield sovereigns saw more significant spread widening pressure, in tandem with the broader emerging markets' sovereign bond market sell-off.
- ▶ Divergent performance was also seen in the local currency bond markets. While local currency bond yields in Korea and Singapore declined in sympathy with the US, yields rose in higher-beta markets such as India and Indonesia.

Commodities

- ▶ For the month, Brent rose 4.3% and WTI gained 1.5%. This is despite data showing the growth of imports of oil into Asia falling in July, with the "Big Five" economies of China, India, Japan, South Korea and Taiwan growing imports by just 2% from an average of 3.5% in the previous six months. The impact of the trade dispute was largely to blame with separate data also showing that charters for super-tankers from the Middle East were also dipping.
- ▶ Copper prices fell again, although this time losses were capped as the US dollar stabilised and more positive indicators on demand from China began to filter through. Coal prices fell over the month although are still higher for the year by some margin; imports into China especially from the US fell ahead of the start of import tariffs with Chinese steel mills being encouraged to source their raw material from domestic mines while several ports remain closed to imports.
- ▶ In the soft commodity sphere, wheat inventory levels hit lows not seen since 2007/08, with the hot northern hemisphere summer forcing stockpiles down and prices up. In emerging market currency terms, wheat prices are back to 2013 and 2008 levels; the last time this combination of low inventories and high prices happened food riots broke out in parts of Asia and Africa.



Currencies

- US dollar (USD) strength resumed in August following a stream of negative headlines related to emerging markets. The US imposed sanctions on Turkey on 1 August but President Erdogan responded defiantly sparking a sharp depreciation in the Turkish lira and other emerging market currencies including the Argentine peso, South African rand and Brazilian real. Contagion fears left the euro particularly vulnerable given eurozone's banks' exposure to Turkey. Safe haven currencies within G10 like the Swiss franc and Japanese yen outperformed against the USD during the month.
- The Chinese Renminbi (RMB) was closely watched as it traded near the key level of 7 versus the USD. Authorities reintroduced the "counter cyclical factor" in the USDRMB fixing mechanism as a means to stabilise the currency. Because details of what this entails exactly remain vague, it adds to the opaqueness of how the rate fixing is set but it has proved to be an effective means to keep the fixing relatively stable. The move led to a sharp rally in the RMB but the economy continues to slow and concerns over an all out trade war with the US linger. The Minister of Commerce led a delegation to the US at the end of August to resume trade talks but these appear to have gone nowhere. The next round of tariffs could be announced as soon as 7 September.
- In Asia, both the Indian rupee and Indonesian rupiah lost the most against the USD. Turkey contagion fears struck these two current account deficit countries with both central banks having hiked interest rates in recent months but for different reasons: India has hiked rates to anchor inflation while Indonesia has hiked rates to stabilise the currency.
- In Brazil, the real has fallen about 7% against the USD. Fundamentals in Brazil remain weak but it also suffered from contagion fears as well as the approaching election with recent polls showing former President Lula, who is serving a prison sentence for corruption, in the lead. The candidate who is a distant second is a controversial right-wing candidate, Jair Bolsonaro.

Fig 5. Currencies Performance versus USD (%)

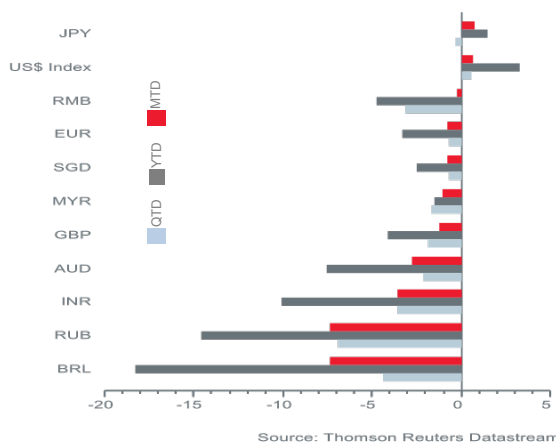
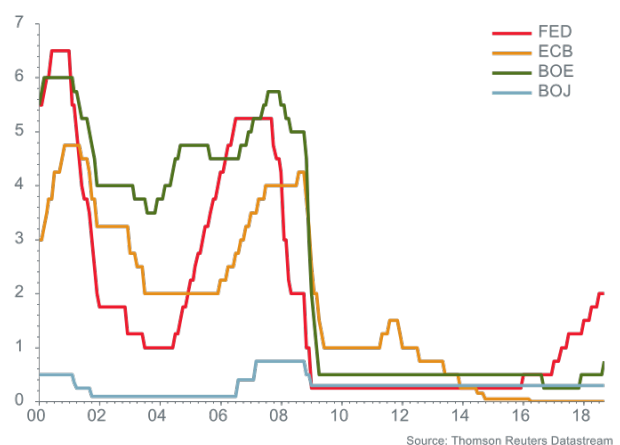


Fig 6. Central Banks Interest Rate (%)



Economics

- The **US** steams on. The ISM manufacturing index remained in expansion mode during July, albeit with the 58.1 reading a little lower than June. Unemployment dipped to 3.9% with average hourly earnings steady at 2.7%. But consumer prices increased just 0.2% in July to give a year-on-year increase of 2.4%, while Producer Prices showed no increase. Against this backdrop, the Fed kept its rate on hold during its August meeting but gave a clear indication that a 25bps is imminent in September.
- Real GDP in **Japan** grew 1.9% in Q2 to reverse the modest contraction seen in Q1. Data released in August saw the country enjoy a multi-decade high in wage growth in July; inflation figures, however, didn't budge.
- German** Q2 GDP rose a better-than-expected 2.0% year on year but it was still the slowest annual growth since Q4 2016, and below its 2.4% average from the past four quarters. The UK grew at a more modest 1.5% in the same period. Italy asked the ECB to offer a guarantee to cap yield spreads after Italy, Spain and Portugal saw yields rise after Turkey's currency implosion. The ECB turned it down. Eurozone manufacturing PMI missed consensus, falling to 54.6 and adding fuel to the debate that growth in mainland Europe is leveling off.
- China** saw its retail sales growth slow to 8.8% from 9%; Industrial Production growth also slowed a smidge while infrastructure spending dropped to 5.7% from 7.3%. But in a sign the government's economic shift was beginning to bite, real estate investment rose 13% and new construction was up 32% yoy to the highest rate since 2014.
- Argentina's central bank raised rates to an eye-watering 45% from 40% as its currency came under renewed attack post the Turkey meltdown but it couldn't stop the rot and on the final day of the month it asked the IMF for a \$50bn bail out. Indonesia also raised its base rate to 5.50% from 5.25% with its currency falling 5% over the month.

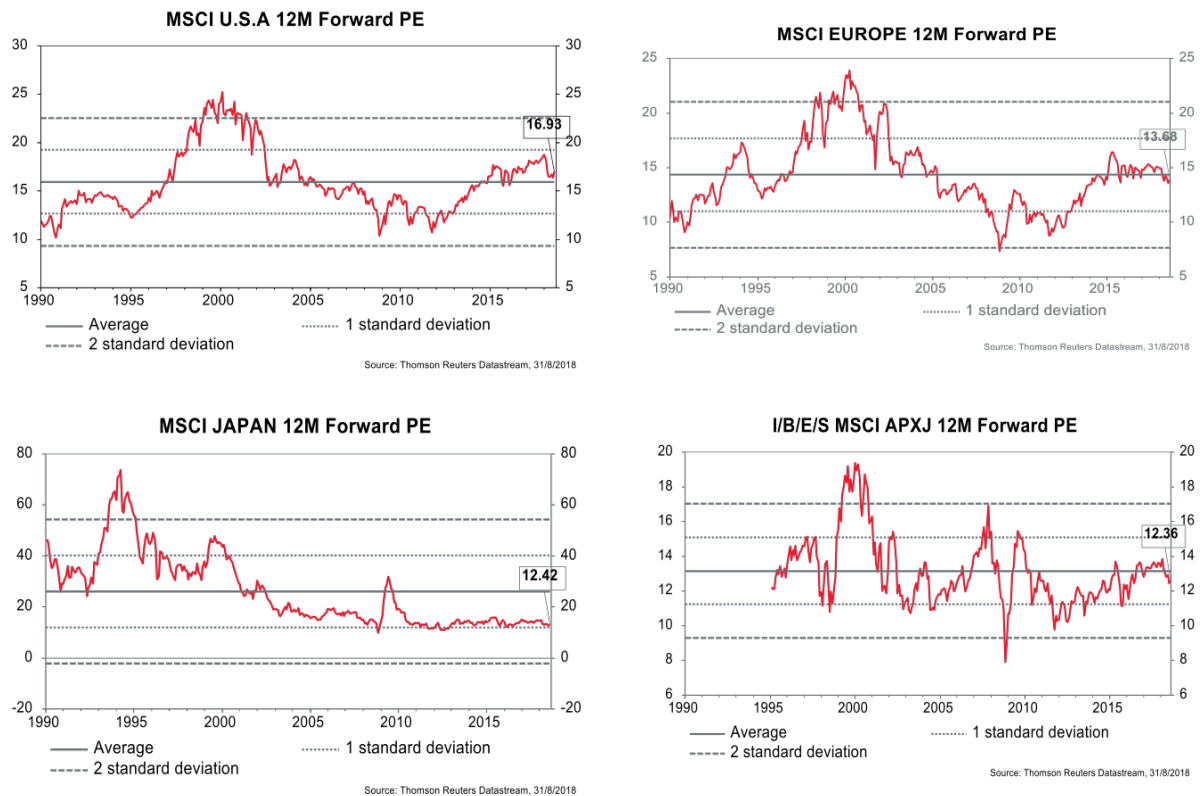
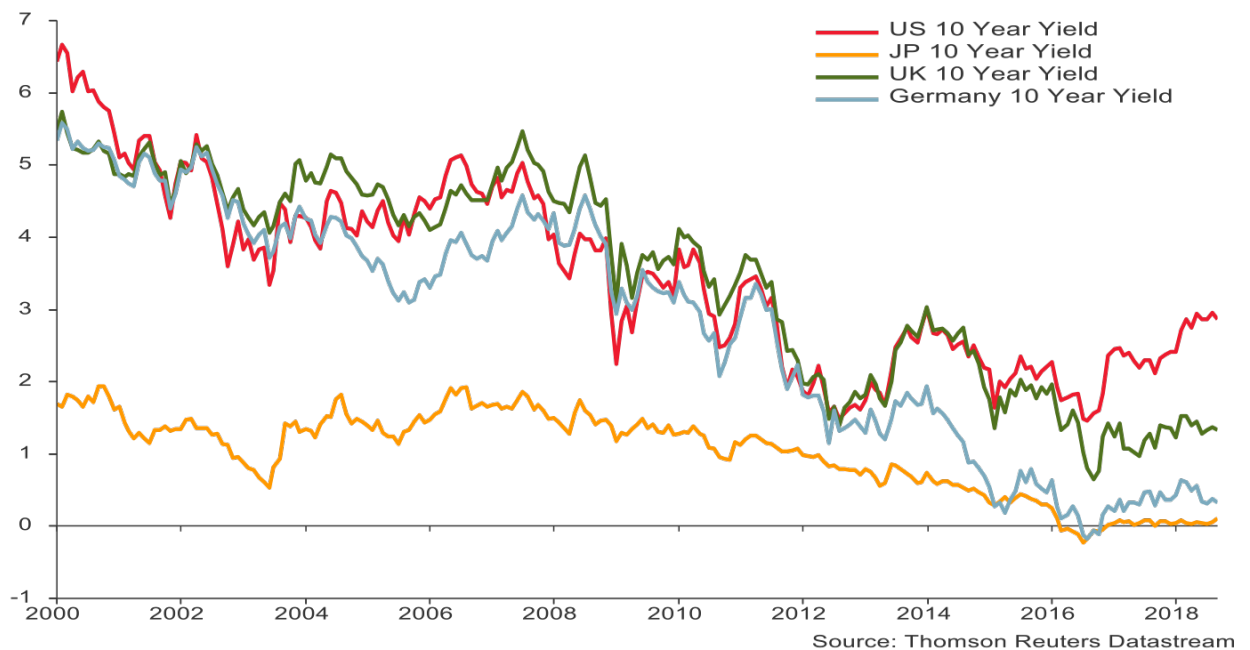


Fig 8. Key Bond Yields (%)





MSCI monthly, quarterly and year-to-date data

	Aug-18	QTD	YTD	Q2 18	Q1 18	Jul-18	June 18	2017
World	0.8	3.9	3.8	0.7	-0.8	3.0	-0.5	24.6
Developed World	1.3	4.5	5.3	1.9	-1.2	3.1	-0.0	23.1
United States	3.3	7.0	10.1	3.5	-0.6	3.6	0.7	21.9
Europe	-2.8	0.5	-2.3	-0.9	-1.9	3.3	-0.6	26.2
Japan	0.2	0.6	-1.2	-2.8	1.0	0.4	-2.5	24.4
Emerging Markets	-2.7	-0.5	-6.9	-7.9	1.5	2.3	-4.1	37.8
Asia Pac Ex Japan	-1.1	0.0	-4.0	-3.5	-0.6	1.1	-3.7	37.3
Asia Ex Japan	-1.0	-0.1	-4.7	-5.3	0.7	0.9	-4.7	42.1
Latin America	-8.3	0.1	-10.9	-17.7	8.1	9.2	-3.0	24.2
Brazil	-11.3	-0.8	-17.8	-26.4	12.5	11.8	-8.3	24.5
EMEA	-7.7	-3.2	-13.6	-10.0	-0.9	4.9	-2.2	25.2
	Aug-18	QTD	YTD	Q2 18	Q1 18	Jul-18	June 18	2017
Australia	-1.8	0.4	-0.8	5.3	-6.1	2.2	1.3	20.2
New Zealand	5.1	4.6	5.3	5.8	-4.9	-0.5	2.1	12.7
Hong Kong	-2.3	-0.7	-3.2	-1.2	-1.4	1.6	-4.9	36.2
China	-3.8	-6.1	-7.7	-3.4	1.8	-2.4	-5.2	54.3
Korea	1.9	0.3	-9.2	-9.1	-0.4	-1.5	-6.6	47.8
Taiwan	1.2	6.8	6.0	-6.1	5.7	5.6	-1.4	28.5
Thailand	2.3	10.2	2.3	-14.9	9.0	7.8	-10.3	34.9
Malaysia	0.7	5.5	1.4	-11.4	8.5	4.7	-2.8	25.1
Singapore	-1.7	0.0	-4.9	-7.5	2.8	1.7	-7.4	35.6
Indonesia	0.8	3.6	-15.5	-12.2	-7.1	2.8	-7.3	24.8
India	1.0	7.5	-0.5	-0.6	-7.0	6.5	-1.0	38.8
Philippines	2.6	10.3	-13.2	-11.1	-11.4	7.5	-5.7	25.2
	Aug-18	QTD	YTD	Q2 18	Q1 18	Jul-18	June 18	2017
Mexico	-3.1	5.3	2.6	-3.5	0.9	8.7	9.3	16.3
Chile	-8.9	-4.8	-13.8	-11.0	1.6	4.5	-5.0	43.6
Hungary	1.6	4.1	-11.8	-14.4	-1.0	2.5	0.3	39.9
Poland	0.8	12.3	-8.9	-11.6	-8.2	11.4	-2.2	55.3
Czech Republic	-2.1	3.7	6.8	-3.2	6.4	5.9	1.0	38.9
Russia	-7.0	-3.0	-0.0	-5.8	9.4	4.3	0.6	6.1
Turkey	-29.0	-34.1	-53.4	-25.7	-4.8	-7.2	-4.6	39.1
South Africa	-10.0	-5.4	-19.9	-11.8	-4.0	5.1	-4.3	36.8
United Kingdom	-4.2	-3.3	-4.3	3.0	-3.9	0.9	-1.0	22.4
Germany	-3.0	1.1	-5.7	-3.4	-3.5	4.3	-2.4	28.5
France	-2.0	1.6	2.3	0.3	0.4	3.6	-0.9	29.9
Netherlands	-1.9	2.1	1.5	-1.6	1.0	4.1	0.1	32.7
Austria	-4.4	0.5	-5.5	-8.4	2.7	5.1	-2.7	52.1
Italy	-9.5	-6.5	-8.1	-6.8	5.4	3.3	-0.6	29.6
Spain	-5.9	-2.3	-7.8	-4.1	-1.6	3.9	2.7	27.7
Greece	-10.0	-10.2	-18.0	-2.0	-6.7	-0.2	4.2	29.1
Portugal	-2.1	2.7	8.2	2.2	3.1	5.0	0.4	25.2
Switzerland	0.6	7.2	0.7	-2.2	-3.9	6.5	0.9	23.6
Sweden	-1.4	3.9	-1.2	-3.1	-1.9	5.4	-0.5	21.8
Norway	-0.8	0.0	5.4	3.0	2.4	0.9	1.5	29.6

Source: Thomson-Reuters Datastream, MSCI. All data Total Returns, in US dollar terms, as of 31 August 2018

**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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