

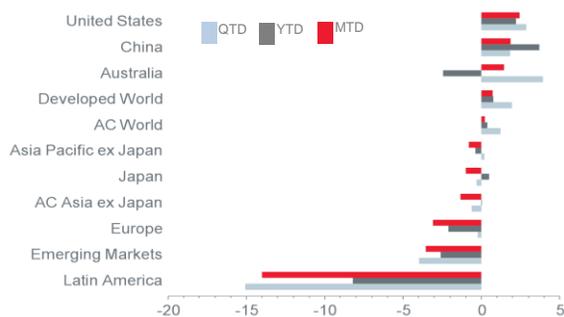
## MONTHLY REVIEW: Markets learn that politics matters

May 2018

### The World in five bullet points

- ▶ The US pulled out of the nuclear deal with **Iran** although it remains in place with the other “Big Power” signatories. The US promised sanctions against any company dealing with Iran, leading to some, including Maersk and Total, to cancel agreements with Tehran. President Trump also cancelled a meeting with **North Korea** due to take place in mid June, although in the final days of the month, had seemingly reinstated the possibility of talks taking place. The world awaits the next tweet.
- ▶ The rise in the US dollar began to take its toll on some emerging markets. **Argentina** was arguably the worst hit and was forced to go cap in hand to the IMF for help (see Currencies section below). **Indonesia** also saw currency investors take flight along with those from **Hungary, Poland, Greece** and **South Africa** as a reaction to higher US interest rates and a higher dollar. **Turkey**, was another victim and, like others, this was mainly due to its large current account deficit, with the lira duly slumping – it is now down more than 25% year to date despite the central bank’s 3% rate increase in May alone.
- ▶ **Brazil** slipped into yet another political crisis with truck drivers blocking roads across the country to protest against high diesel prices: fuel ran out, deliveries were cut, and several companies had to temporarily shut operations. A temporary cut to fuel prices failed, more subsidies were proposed and this time accepted. But the strike may lead to a deterioration in the country’s fiscal account, slower economic growth, higher inflation and a yet more fragile government unable to move forward with reform. And with the spectre of military intervention being whispered quietly in dark corners, Brazil suddenly looks wobbly again.
- ▶ **Italy** also tumbled into a political quagmire with two anti-establishment parties dropping a coalition plan after two months of talks after the country’s President rejected its choice of a euro sceptic as the economy minister. The President then appointed an interim prime minister to prepare for snap elections but the decision sent equity and bond markets into freefall, dragging Eurozone markets down with it.
- ▶ **Malaysia** elected a new government in a surprise win for the Pakatan Harapan (PH) opposition, led by 92-year old former Prime Minister Tun Dr Mahathir. Given the electoral hurdles in its way, this was a considerable achievement for PH which almost instantly began a probe into the 1MBD investment vehicle and questioned many proposed infrastructure projects.

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



Source: Thomson Reuters Datastream, MSCI

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



Source: Thomson Reuters Datastream, MSCI (in USD)

### Equity Markets

- ▶ Equity markets dipped into the end of the month when domestic political developments in Italy, Brazil and elsewhere combined with concerns over developing economy debt levels to send many indices lower, especially in emerging markets.
- ▶ Among the developed markets, the US comfortably outperformed Europe, which saw Italy fall 11%, dragged lower by its banking sector that is heavily invested into its domestic bond market. Greece lost 19% on concerns its banks would follow suit while Spanish markets also suffered after the Prime Minister faced a no-confidence vote. Hungary fell 14% and Turkey lost 13% as its currency woes continued.



- ▶ Not surprisingly, the MSCI EMEA index fared poorly in May, losing 5.8%. But it wasn't the worst performing region with Latin America falling 14%, dragged down by index heavyweight Brazil which lost more than 16% as the truckers' strike began to bite. Leading fuel provider Petrobras lost 30% at one point as the government lent heavily on it to increase fuel subsidies. Meanwhile the Argentinian Merval index (not part of the MSCI family) lost 6% with investors' wrath here reserved for the bond market.
- ▶ In contrast, Asia only just ended in the red with the MSCI Asia ex Japan index down just 1.3%. Here, the Greater China markets markedly outperformed and ended with small gains while the beleaguered Indonesian market ended flat. But elsewhere, Asia markets followed the global trend lower. Malaysia lost 8.1% with most of the losses coming in the couple of weeks post its election as investors grew nervous on the economic direction of the new government.
- ▶ Japan fell 1.0% with declines in the final week for automakers on reports the Trump administration was considering tariffs of 25% on imports of cars.

Fig 3. Bond Indices Performance, USD %

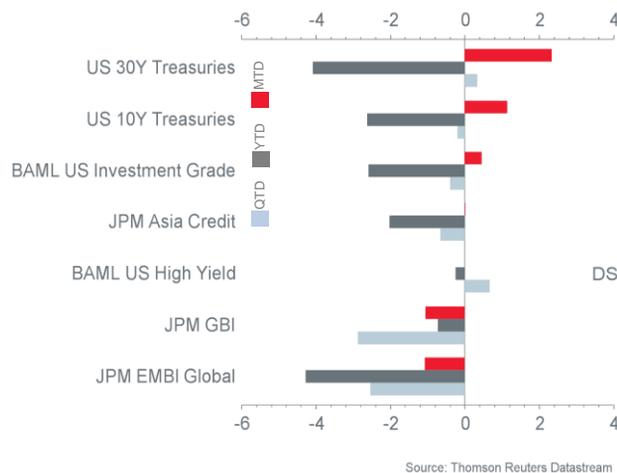
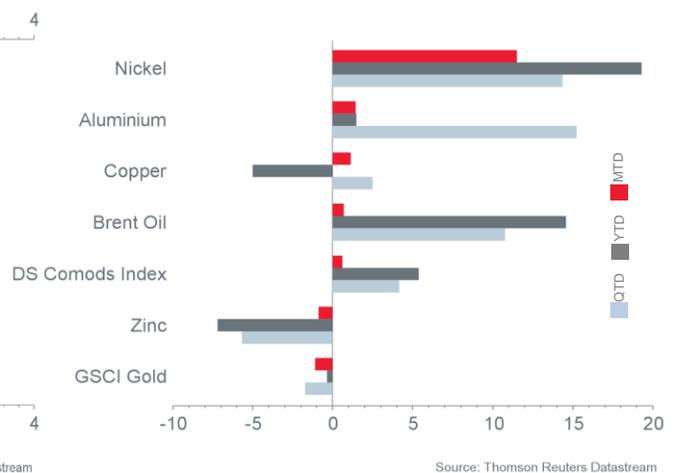


Fig 4. Commodities Performance in USD (%)



## Fixed Income

- ▶ Ten-year US Treasury yields dipped below 3% as investors sought out safe havens away from several emerging markets as well as the more risky European developed bond markets such as Italy, Spain and Greece.
- ▶ Italian Bond prices suffered their worst day in 25 years at the end of the month after the President rejected a eurosceptic as economy minister and paved the way for new elections. Investors fear new elections could deliver a deeply anti-euro government while domestic public finances continue to struggle.
- ▶ Some central banks appear to be wobbling on the easy money exit ramp: the Bank of England left interest rates on hold just weeks after it signalled a likely 25bps hike and the Reserve Bank of New Zealand signalled it would leave rates on hold until later into 2019. But the Fed Reserve was firm indicating it remained on track to raise policy rate in coming months but it did leave interest rates unchanged at its May meeting. Several emerging market central banks hiked rates to defend their currencies.

## Commodities

- ▶ Crude oil continued to maintain elevated levels helped by Saudi Arabia hinting at wanting to push oil to \$80 per barrel as well as the prospect of reduced flow from Iran following the re-imposition of sanctions. However, in the final week, prices dropped sharply as the Saudis reversed their message and suggested easing production cuts that have held in place since the beginning of 2017 while an unexpected jump in crude inventories also put pressure on crude.
- ▶ Natural gas prices rose as storage deficits lingered while US gasoline prices surged on the re-imposition of sanctions against Iran. Warmer weather in the US also gave support.
- ▶ Away from oil and gas, commodity prices struggled to gain direction under the weight of a higher US dollar. Gold drifted lower as the US dollar strengthened in the early part of the month and as bond yields also initially rose. But prices rebounded on political developments in Europe. Copper prices also came under pressure from the dollar's strength.
- ▶ Aluminium gained a little over the month but for the most part the metal eased back from gains in April following the initial suggestion of sanctions against Rusal. It then fell in the final week when the US came closer imposing tariffs on EU imports. Nickel prices continued to rise and had its best month in six.
- ▶ The Baltic Dry Index, a key indicator of the health of the commodity market, fell steadily alongside most bulk commodities and is now close to year lows. The index was particularly hurt by demand for capsize vessels that typically carry coal or iron ore.



## Currencies

- ▶ The US dollar was strong in May, with a combination of robust US economic data, and a sell off in the euro and some emerging market currencies stimulating a flight to quality. The yen also gained against the euro and some emerging markets but was slightly weaker against the US dollar. Weakness in sterling caused by weak economic data and Brexit uncertainty also sent cable to six-month lows.
- ▶ The euro endured a difficult month as political uncertainties in Italy caused a sell off as questions began re-circulating about the future of the currency. In Italy, the anti-establishment 5-Star Movement and the far-right League proposed some changes to Italy's debt structure, an amnesty for certain tax offenders and higher pension payments for retirees, before nominating a euro sceptic as economy minister. This crossed the line in the sand as far as the president was concerned but it didn't stop the euro from selling off against the dollar with the big fear being that a second general election could become a de facto referendum on membership of the eurozone. For the month, the euro lost 3.2% of its value and is at six-month lows against the dollar.
- ▶ Among emerging market currencies, the Turkish lira's dramatic 20% three-month fall may not end anytime soon. Snap elections in June may see a consolidation of power by President Erdogan and he is likely to pressure the central bank to re-cut rates. With inflation remaining at in the double-digit levels and forex reserves low, any reprieve from a rate cut could prove short lived.
- ▶ Argentina's peso fell to all-time lows against the US dollar with the currency recording a monthly 10% drop at one point. In response, its central bank announced three rate increases in less than a week and promptly approached the IMF for help. The cause is the country's 5% current account deficit and specifically the need for this to be financed from inflows from abroad or a weakening domestic currency. Argentina's lack of forex reserve meant the central bank had to drive down its currency, and subsequently doth its cap for an IMF bail out.

Fig 5. Currencies Performance versus USD (%)

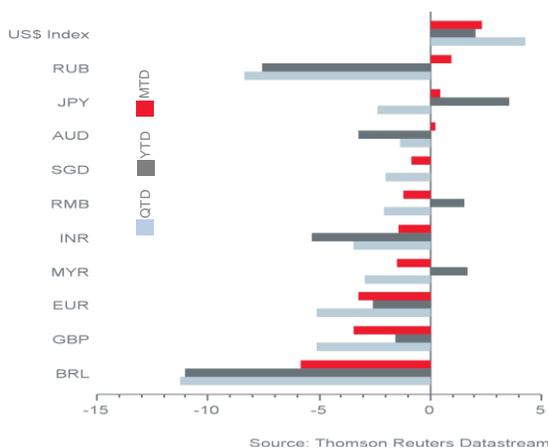
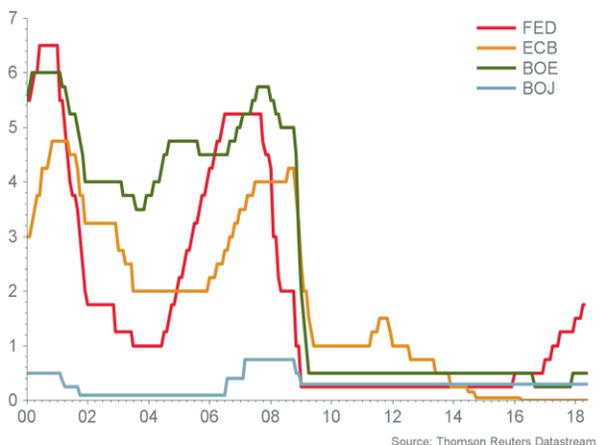


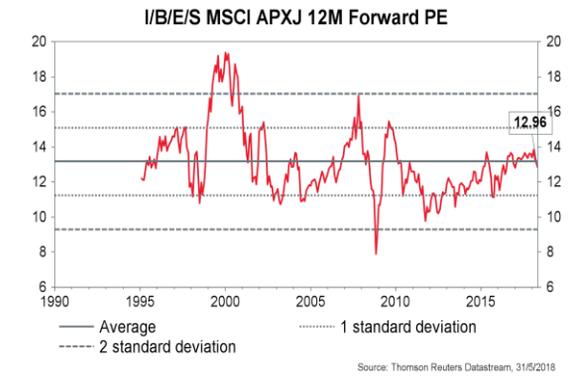
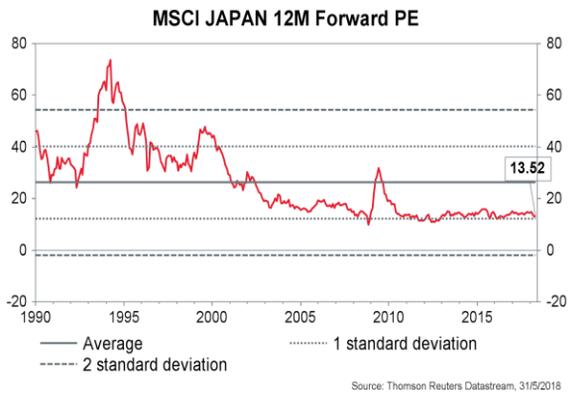
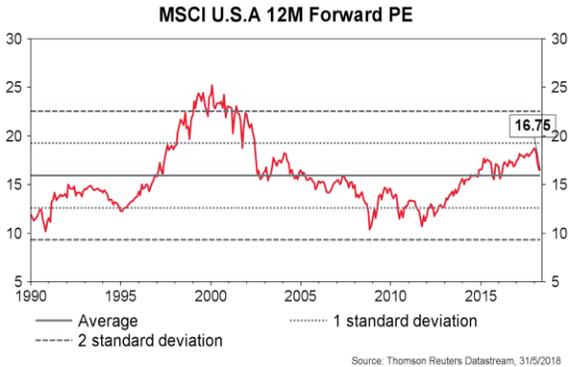
Fig 6. Central Banks Interest Rate, %



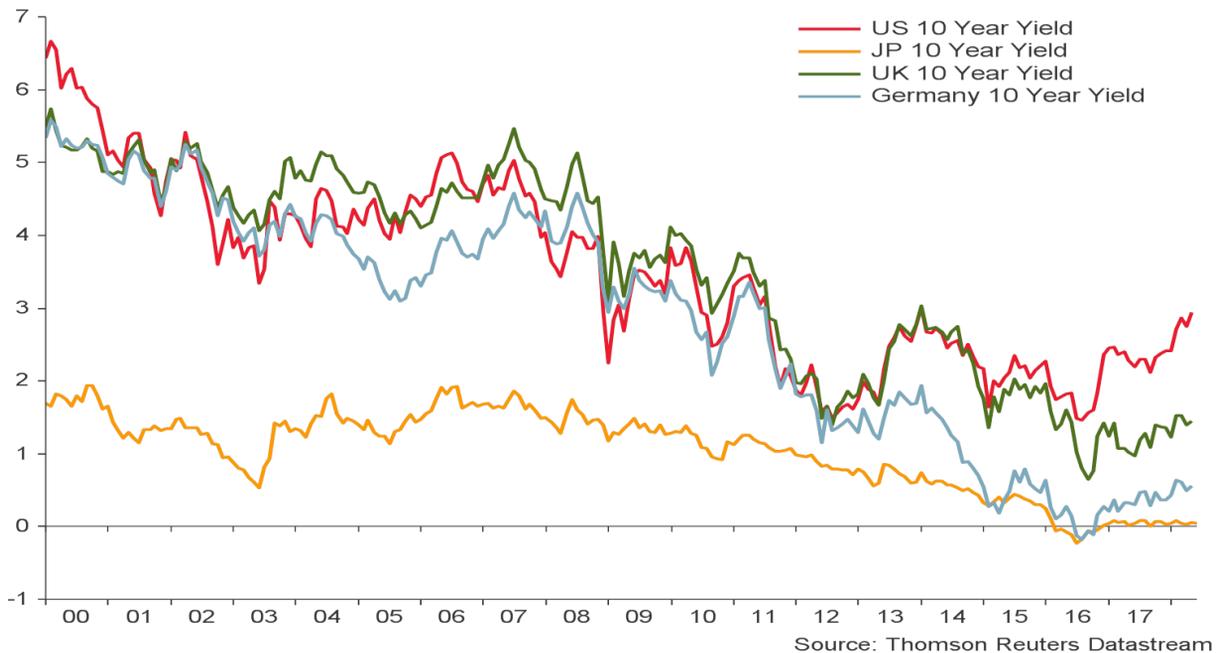
## Economics

- ▶ US Personal Consumption Expenditure price index (PCE) for March hit 2.0%. This is significant because it now has reached the Fed's target and the accompanying comments point to a June increase of 25bps. Core consumer prices rose just 0.1% leading some to speculate on just two more rises but for the moment, the Fed Funds rate continues to suggest three more rises this year. In other data points, jobless numbers fell to below 4% for the first time since 2000 while wages edged up.
- ▶ The Eurozone economy grew more slowly than expected with the Purchasing Manager's Index for May sinking to an 18-month low of 54.1, well below all forecasts although still representing growth. Eurozone inflation also fell to 1.2% in April, also lower than expected; the combination now presents the ECB with an interesting choice when it comes to interest rate policy, especially when factoring in Italian political developments.
- ▶ In the UK, the Bank of England reduced its forecast for Q2 inflation to 2.4% from 2.7% while GDP growth forecasts also fell to 1.4%; Q1 GDP growth was a weak 0.1%. Retail sales fell the most since 1995 and as a result of this, several other weak datapoints and a struggling Brexit negotiation, the BoE kept rates on hold at its May meeting.
- ▶ In Asia, Japan announced a drop in quarterly GDP growth figures although faltering export demand, tepid private consumption and weak housing data early in the month flagged the soft patch. China saw its PMI rise to 51.9 from 51.4 in April, marking its 22nd month in succession above the critical 50 point level representing growth. New Orders rose to eight-month highs aided by strong commodity prices, while the growing services PMI came in at 54.9, a smidge above April's print.
- ▶ Brazil's central bank surprisingly kept its key rate on hold rather than reducing it by 25bps as had been flagged last month. Although inflation remains low, recent market turbulence and the depreciation of the real caused the bank to think again, and keep its Selic rate at 6.5%. The decision came before the economy was rocked by the truckers' strike.

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



**Fig 8. Key Bond Yields (%)**



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



## MSCI monthly, quarterly and year-to-date data

	May 18	QTD	YTD	Q1 18	Apr 18	Mar 18	Feb-18	2017
<b>World</b>	0.2	1.2	0.4	-0.8	-2.1	-2.1	-4.2	24.6
<b>Developed World</b>	0.7	1.9	0.8	-1.2	-2.1	-2.1	-4.1	23.1
<b>United States</b>	2.4	2.9	2.2	-0.6	-2.4	-2.4	-3.7	21.9
<b>Europe</b>	-3.1	-0.2	-2.1	-1.9	-1.1	-1.1	-5.9	26.2
<b>Japan</b>	-1.0	-0.3	0.7	1.0	-2.0	-2.0	-1.5	24.4
<b>Emerging Markets</b>	-3.5	-3.9	-2.5	1.5	-1.8	-1.8	-4.6	37.8
<b>Asia Pac Ex Japan</b>	-0.8	0.2	-0.4	-0.6	-2.2	-2.2	-4.7	37.3
<b>Asia Ex Japan</b>	-1.3	-0.6	0.1	0.7	-1.5	-1.5	-5.0	42.1
<b>Latin America</b>	-14.0	-15.1	-8.2	8.1	-0.9	-0.9	-3.6	24.2
<b>Brazil</b>	-16.4	-19.7	-9.7	12.5	-1.8	-1.8	-2.0	24.5
<b>EMEA</b>	-5.8	-8.0	-8.8	-0.9	-4.9	-4.9	-1.8	25.2
	May 18	QTD	YTD	Q1 18	Apr 18	Mar 18	Feb 18	2017
<b>Australia</b>	1.4	3.9	-8.8	-6.1	-5.6	-4.9	-3.2	20.2
<b>New Zealand</b>	3.9	3.6	-2.4	-4.9	-1.3	-5.6	-7.1	12.7
<b>Hong Kong</b>	0.6	3.9	-1.5	-1.4	-2.6	-1.3	-3.2	36.2
<b>China</b>	1.9	1.8	2.5	1.8	-3.3	-2.6	-6.4	54.3
<b>Korea</b>	-5.2	-2.6	3.7	-0.4	2.6	-3.3	-6.3	47.8
<b>Taiwan</b>	-0.2	-4.7	-3.0	5.7	1.3	2.6	-3.0	28.5
<b>Thailand</b>	-4.9	-5.1	0.7	9.0	-1.8	1.3	2.3	34.9
<b>Malaysia</b>	-8.1	-8.9	3.5	8.5	2.1	-1.8	-1.4	25.1
<b>Singapore</b>	-5.9	-0.0	-1.2	2.8	-1.5	2.1	-2.0	35.6
<b>Indonesia</b>	-0.8	-5.2	2.7	-7.1	-7.0	-1.5	-3.0	24.8
<b>India</b>	-3.6	0.4	-12.0	-7.0	-3.6	-7.0	-6.7	38.8
<b>Philippines</b>	-4.7	-5.7	-6.6	-11.4	-5.9	-3.6	-4.6	25.2
	May 18	QTD	YTD	Q1 18	Apr 18	Mar 18	Feb 18	2017
<b>Mexico</b>	-13.6	-11.7	-10.9	0.9	0.8	0.8	-7.1	16.3
<b>Chile</b>	-7.9	-6.3	-4.7	1.6	-1.6	-1.6	-3.8	43.6
<b>Hungary</b>	-13.9	-14.7	-15.5	-1.0	-0.5	-0.5	-7.7	39.9
<b>Poland</b>	-10.8	-9.6	-17.0	-8.2	-6.3	-6.3	-9.9	55.3
<b>Czech Republic</b>	-4.4	-4.1	2.0	6.4	2.9	2.9	-4.6	38.9
<b>Russia</b>	1.2	-6.4	2.4	9.4	-3.7	-3.7	0.9	6.1
<b>Turkey</b>	-12.8	-22.1	-25.8	-4.8	-7.3	-7.3	-2.1	39.1
<b>South Africa</b>	-6.7	-7.8	-11.5	-4.0	-6.4	-6.4	-0.2	36.8
<b>United Kingdom</b>	-0.8	4.0	-0.1	-3.9	-0.3	-0.3	-1.8	22.4
<b>Germany</b>	-3.1	-1.0	-4.5	-3.5	-1.9	-1.9	-7.2	28.5
<b>France</b>	-3.5	1.2	1.6	0.4	-1.4	-1.4	-4.8	29.9
<b>Netherlands</b>	-3.2	-1.7	-0.7	1.0	0.0	0.0	-5.0	32.7
<b>Austria</b>	-5.4	-5.9	-3.4	2.7	-0.5	-0.5	-5.3	52.1
<b>Italy</b>	-11.2	-6.2	-1.1	5.4	0.3	0.3	-5.9	29.6
<b>Spain</b>	-9.3	-6.6	-8.1	-1.6	-1.9	-1.9	-8.0	27.7
<b>Greece</b>	-18.7	-6.0	-12.3	-6.7	-9.1	-9.1	-8.2	29.1
<b>Portugal</b>	0.1	1.8	4.9	3.1	3.3	3.3	-4.5	25.2
<b>Switzerland</b>	-3.2	-3.1	-6.9	-3.9	-1.6	-1.6	-6.3	23.6
<b>Sweden</b>	-1.8	-2.7	-4.5	-1.9	-2.3	-2.3	-5.4	21.8
<b>Norway</b>	-1.2	1.5	3.9	2.4	-1.6	-1.6	-1.8	29.6

**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



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