A Global-Sized Tug-of-War Match

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A member of Prudential plc (UK)

July 2020

The World in five bullet points

- **The world's biggest ongoing tug-of-war match** continued in July, with equity markets and economics pulling in one, bullish direction; and surging Covid-19 virus cases and a run to safe-haven assets pulling in the opposite, bearish direction. By month end, the bulls appeared to have won with equity markets gaining more ground…but so too did the bears with global Covid-19 cases showing no signs of slowing and safe-haven assets surging, leaving the world no better off on judging 'what next'.
- **Covid-19 cases** continued to rise worldwide with more than 18 million people now affected and nearly 700,000 losing their lives since the outbreak began. Many US states and several Latin American countries added to a resurgence of cases in some European countries, Japan, Hong Kong and the Australian state of Victoria to send total infections and deaths higher. But progress was also made on a potential vaccine with as many as 100 vaccine projects ongoing and several projects moving into important Phase III trials. Although most of the potential vaccines are being fast-tracked, experts warned that it was unlikely to become widely available until the end of the year at the very earliest.
- **Global Equity markets** kept on running hot in July with the MSCI AC World index adding another 5.3% to be just 1% below where they began the year. Better-than-expected economic data formed the foundation for the equities rally however a steep rise in Covid-19 cases worldwide also supported demand for the traditional safe-haven assets such as gold, which hit all-time highs (see commodities section) and sent US Treasuries to their lowest ever closing yield (see Fixed Income). However, the US dollar also slipped (see Currencies), giving support to Emerging Market Equities which outperformed Developed Markets (see Equities).
- **The EU announced** details of its €750bn Recovery Plan aimed at reconstruction of the region's Covid-19 stricken economies. A marathon four-day summit was needed to come to a deal and was a scaled back version of an original request from the European Commission, and attached to a seven-year €1trn budget. It will allow the EU to borrow at unprecedented levels in the market then either grant or lend to member states for national recovery plans.
- The US inched its way closer to a second **fiscal proposal** aimed at supporting the US economy and in particular a replacement for the one-off $600 unemployment benefit payments introduced at the height of the economic slowdown but which ran out in July. Meanwhile, **tensions between the US and China** took another step down when the US ordered the closure of China's consulate in Houston and China retaliated with ordering the closer of the US's consulate in Chengdu.

Figure 1. MSCI AC World Index

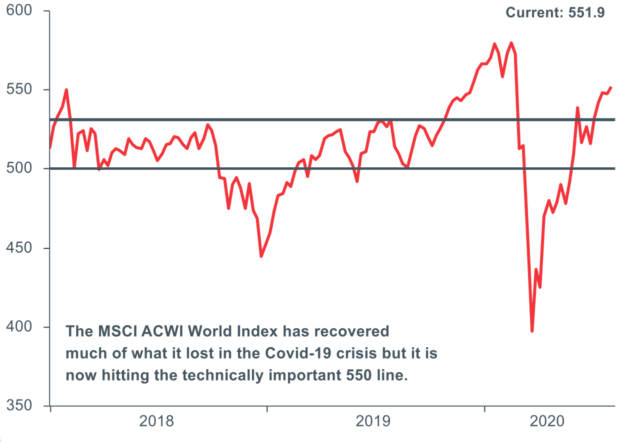
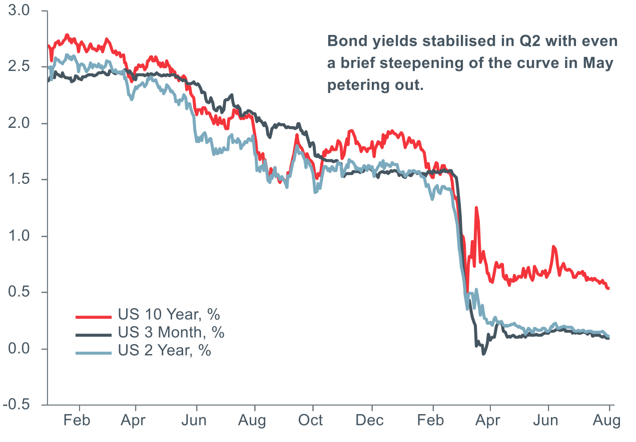


Figure 2. US 2yr, 10yr and 3-month Bond yields



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of as of 31 July 2020.

Equity Markets

- For the second month in a row, **Emerging Markets** outperformed **Developed Markets** in July with support coming from the decline in the US dollar as Covid-19 cases imperiled the economic recovery there. Nevertheless, the MSCI US still added 5.9% but the surge in tech stocks again showed the narrowness of the fourth-month long stock rally there.
- **Emerging Markets** comfortably outperformed as the MSCI EM index gained 9.0%, with Latin America gaining the most (+11.0%) despite Covid-19 cases accelerating sharply. **Asia ex Japan** added 8.6% led by Taiwan that surged 16.6%. **EMEA** underperformed adding just 3.3% largely a result of an 8.4% fall in Turkey. Factor wise, the EM Growth index gained 11.4% against the EM Value index which rose 5.6%, reflecting the narrowness of the equity rally in EM.
- The **Asia ex Japan** index is now up 3.5% for the year with its Asia Pacific cousin up 1.5%, partly reflecting an underperformance in Australia in July after the MSCI index there gained just 4.5% as Covid-19 cases spiked sharply in Victoria. Back in Asia, the **China** H Shares index rose 9.5% helped by a 15% gain early in the month on a single day after Beijing signaled its support for a “healthy bull market”. It later gave up some of the gains as tensions with the US escalated. The A Share index, meanwhile, gained 15.1%.
- **Hong Kong** underperformed again and lost 1.6% as a spike in Covid-19 cases prompted lockdown protocols to be re-introduced as well as on news the territory was to lose its special status from the US. **Taiwan** gains meant it was nearing in on record highs by month end but the narrowness of the gains was even more pronounced here with its largest stock by market cap, TSMC, adding 25% in July alone. **Korea** gained 7.2% again led by its tech sector but also supported by healthier economic indicators. **ASEAN** countries underperformed with Thailand and the Philippines both losing almost 3% and Singapore also underperforming as its banking sector continued to weigh. **India** gained 10.5% despite again recording a rise in Covid-19 cases and with strong support from its energy and software sectors.
- In other Emerging Markets, **Brazil** gained 14.2% as its currency recovered and commodity prices continued to gain, and **Chile** gained from the same drivers to add 10.7%. **Mexico** underperformed again posting a modest 2.9% gain, all of which was on currency gains. **South Africa’s** 6% rise was supported by a recovery in mining production as well as commodity prices, and another cut to interest rates. **Russia** underperformed to add just 3.1% as its currency fell against the dollar with the central bank cutting rates again, and **Turkey’s** drop was on the back of rising inflation which will hamper the central bank’s ability to lower rates.

Figure 3. Regional Equity Indices

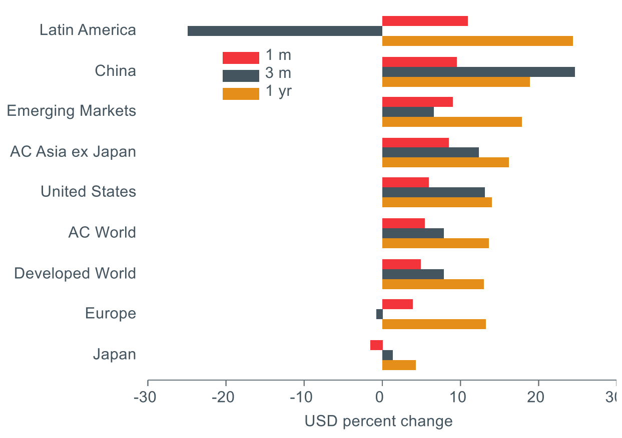
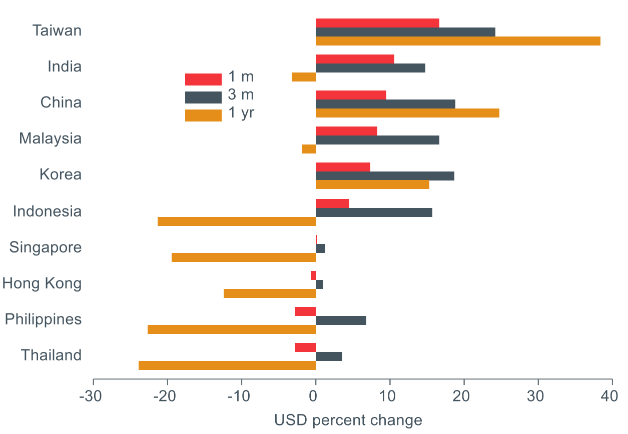


Figure 4. Asia Equity Indices



Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 July 2020. For representative indices and acronym details please refer to notes in the appendix. Quoted returns are MSCI, US dollar denominated total returns.

Fixed Income

- **Global government bond** yields ground lower in July. Despite the continued risk rally, the resurgence of Covid-19 infection rates amplified growth concerns, while the accommodative monetary policy bias of major central banks exerted downward pressure on yields.
- The tug-of-war between hope and pessimism played out in several bond markets, including the **US Treasury** (UST) market. At the start of the month, UST yields initially rose in tandem with the equities rally as well as stronger economic data. But rising Covid-19 infection rates, which forced some states to roll back their plans to re-open their economies, doused recovery hopes.
- Further, **tensions between the US and China** ratcheted higher during the month, providing support for safe-haven bids. Overall, the 10-year UST yield fell by 11 bps to a low of 0.55%. Yield declines at the short end of the curve were more muted, leading to a bull flattening of the curve. In eurozone, government bond yields similarly fell with their performance supported by €750bn Recovery Plan and the ECB's expanded bond-buying program.
- In **Asia,** most domestic bond markets saw positive performances as government bond yields in the region fell broadly. External uncertainties continued to support expectations of a low interest rate environment. Further policy rate cuts in Malaysia and Indonesia in July also pointed to the accommodative monetary policy backdrop in the region, while contributing to the outperformance of the two domestic bond markets during the month. However, the Chinese onshore and Thai domestic bond markets underperformed with moderately negative or flattish performance over the month.
- At the same time, Asia and broader **Emerging Market (EM) USD credits** benefited from the resilient risk sentiment which drove further spread tightening across sectors. This marked the credit markets' fourth consecutive month of gains as the hunt for yield remained strong.
- The gains in **Asian credit market** were led by sovereign bonds as lower US interest rates boosted performance of long-dated investment grade sovereigns, while selected high-yield sovereigns such as Sri Lanka also fared well on positive idiosyncratic developments.
- In the broader **Emerging Market** region, Latin America sovereign bond markets performed strongly, while Emerging Europe lagged, weighed down by the performance of Turkey sovereigns amid concerns over inflation and renewed currency volatility.

Figure 5. Bond Indices Performance in USD

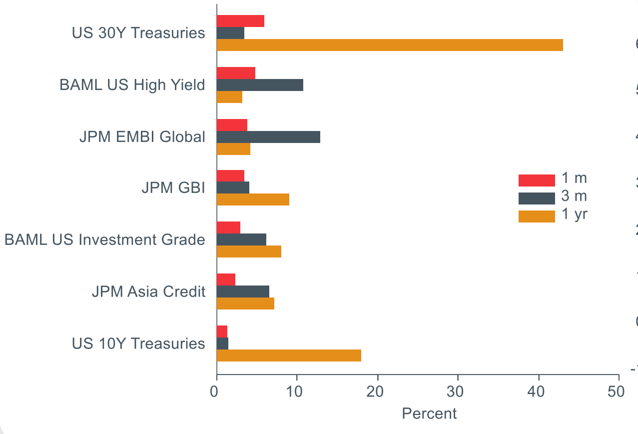
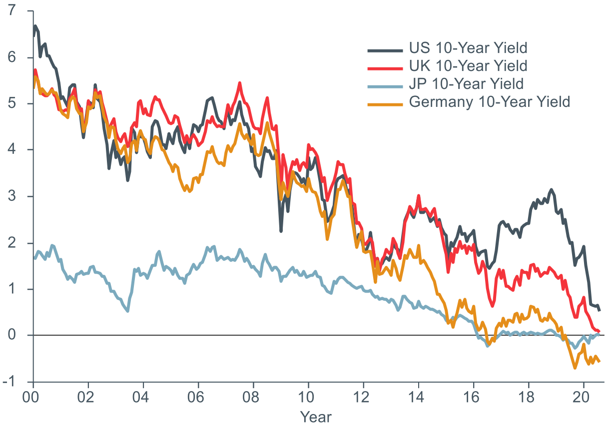


Figure 6. Key Bond Yields (%)



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Economics

- The **US** Federal Reserve left its funds rate target range unchanged at 0-0.25% and made it clear it will keep it there for some time, adding signs of a coronavirus resurgence are "starting to weigh" on economic activity.
- **US economic data** continued to show a largely positive picture. Consumer spending rose to 94.5% of the pre-virus level although the level of recovery in parts of the economy is still very low with transport still at 25% of its pre-virus level. New Orders in durable goods and capital goods increased by more than expected. New Home sales and Existing Home sales both also increased by more than expected (+13.8 and 20.7% respectively) and Housing Starts also rebounded. The Empire Manufacturing Index rebounded by a further 17.2 points in June and is now in back in expansion territory. Retail Sales data for June increased by 5.6%, well above expectations, while Industrial Production in June rose by 5.4%, again by more than expected. On the downside, Consumer confidence fell by nearly 6% in July to 92.6 while Initial Jobless Claims in the second week of July increased for the first time since spiking aggressively in March - the largest increase was in New York state.
- The **ECB** kept rates on hold and announced no new shift in monetary stance although the fiscal Recovery Fund was significant (see page one) and it did confirm an expanded QE programme. Eurozone manufacturing PMI recovered to 51.1 and services PMI to 55.1, both higher than expected and reflecting expansion. Retail Sales jumped 17.8% mom. GDP figures for Q1 in eurozone fell 3.6% qoq, with Germany falling 2.2% while France, Spain and Italy fell around 5% each.
- **China** Q2 GDP rose 11.5% qoq (3.2% yoy), much higher than expected with the ytd figure showing a decline of 1.6% versus expectations of a 2.4% decline. The industrial section of the data showed a distinct outperformance versus the retail sales side, while June Retail sales fell 1.8% against expectations of a 0.5% increase. **Korea's** Q2 GDP fell 2.2% qoq, led by a 16% drop in exports, signalling a formal dip into recession.
- The IMF approved US$4.3bn of funding for **South Africa** to support the government's fight against Covid-19 and general economic support, while the SA central bank cut rates by another 25bps to 3.5% - its lowest ever rate. South Africa joined Russia, Malaysia, Indonesia, Hungary and Colombia in a list of EM central banks that cut rates in July. **Mexico's** Q1 GDP fell 1.2% qoq, continuing a negative trend seen in the previous three quarters while its May Industrial Production output fell 1.8% mom following April's 25% fall. **Brazil** saw a recovery in May's Retail Sales data, which improved almost 14% mom albeit after a 16% fall in April.

Figure 7. Central Banks Interest Rates

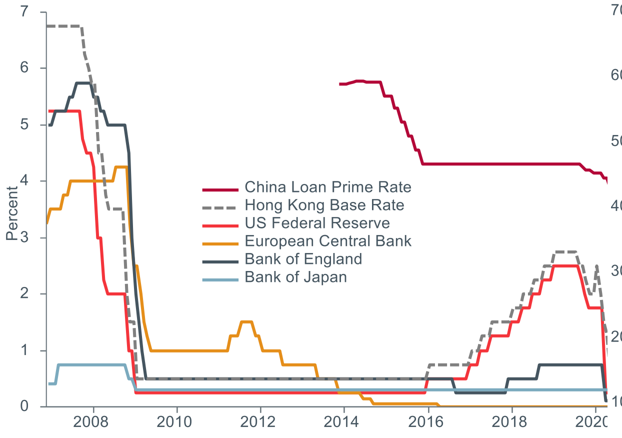
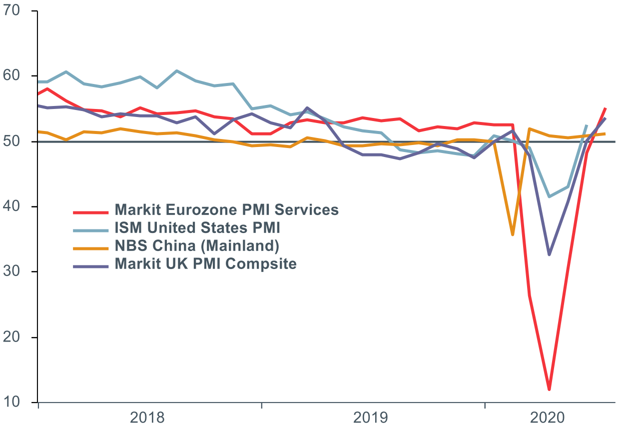


Figure 8: PMI Data



Source: Eastspring Investments, Refinitiv Datastream as of 31 July 2020.

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Commodities

- **Oil** continued its recovery but only added a couple of percentage points in July as the recovery in oil consumption in emerging markets remained sluggish, as well as on concerns the recovery in developed markets may be slowed by fresh lockdowns on a resurgence of Covid-19 cases. Brent added 4.7% and WTI 2.5%. A slide in the dollar also supported prices while OPEC and Russia maintained their production cuts.
- **Gold** rose more than 10% to hit a fresh all-time high by the month end as fears from the economic fallout from accelerating Covid-19 cases and a falling US dollar increased demand for the regular safe-haven asset of choice. The gold price has now risen 30% in 2020 and is within a hair's-breadth of $2,000 per ounce with the massive stimulus programmes around the world adding support as investors also fear the return of inflation. **Silver** recorded its best monthly performance since 1979, jumping 34%.
- The **S&P Industrial Metals** index rose 6.9% as base metals prices rose on better-than-expected global industrial production data. **Iron ore** also continued to gain with steel production in China steadily increasing, reflecting a strengthened PMI index there. **Aluminium** gained almost 6% and although **copper** prices rose over the month, much of the gain was in the first week with the rest of the month dominated by Covid-19/economic downturn fears and a lower dollar.

Currencies

- The **US dollar index** (DXY) depreciated by more than 4% in July, its largest monthly decline in nearly a decade. Crowded positioning, declining real rates, and continued momentum in risk-on sentiment as economic data continued to surprise to the upside likely drove the trend.
- All G10 currencies appreciated against the USD with the Swedish krona and Norwegian krone strengthening the most by around 6%. The British pound rallied back to March highs, while the euro rallied to its highest level in two years driven by the optimism around a potential fiscal union.
- **Emerging market currencies** underperformed G10 in July but nevertheless rallied against the US dollar. Within major EMs, Latin America FX outperformed Asian FX, led by the Chilean peso and Brazilian real that appreciated 8.4% and 4.7% against the US dollar respectively.
- **Russia's** ruble continued to remain under pressure, depreciating by 4.3% in the month. Low beta currencies, such as Japanese yen and Singapore dollar were the best performers within Asian FX, while Indonesia's rupiah struggled to hold below 14,500. The Chinese renminbi appreciated modestly taking USD/CNY back to below 7.0.

Figure 9. Commodities Performance in USD

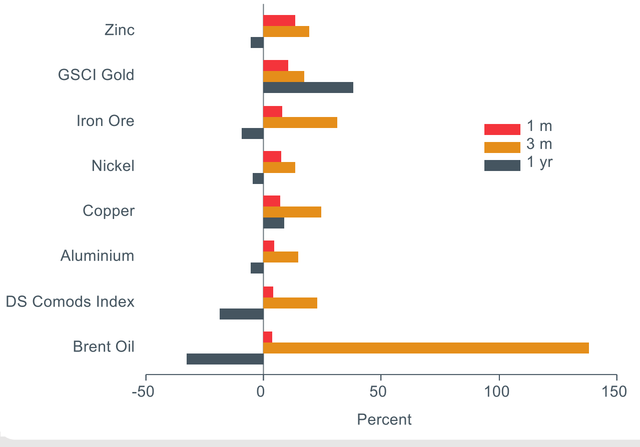
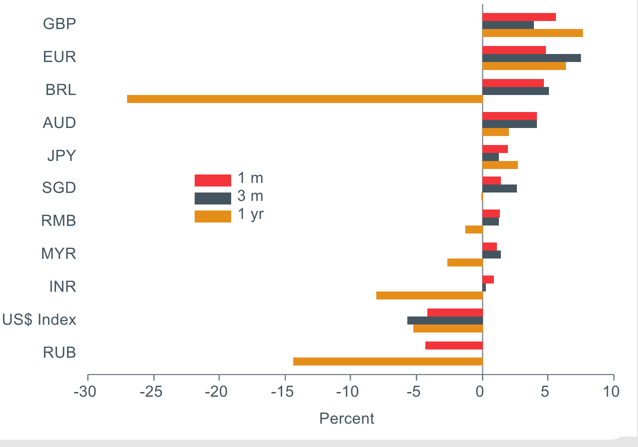


Figure 10. Currencies Performance vs USD



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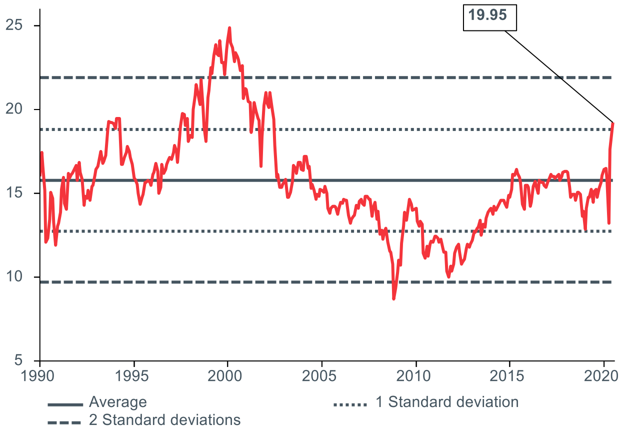
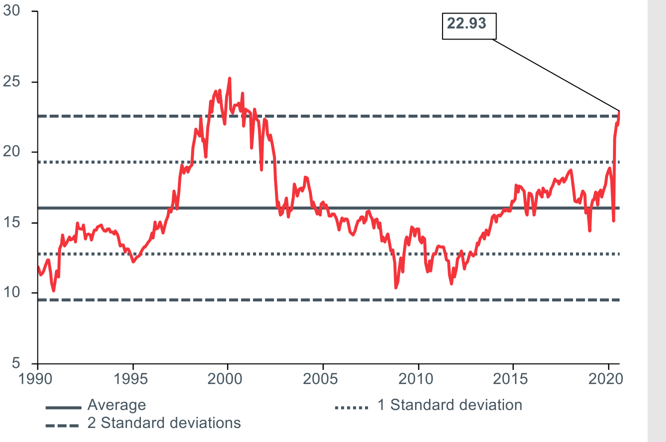
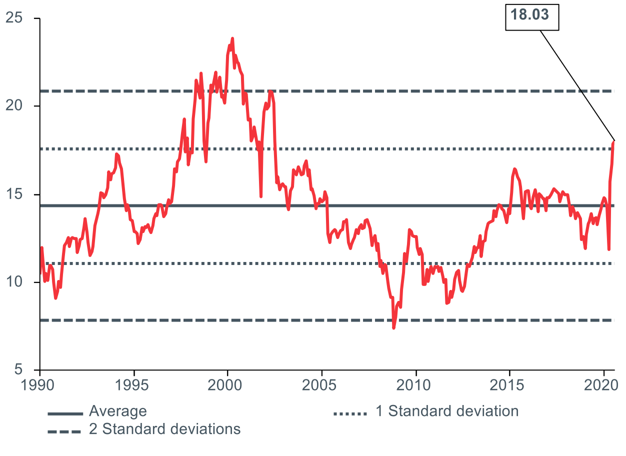
MSCI AC World 12M Forward PE



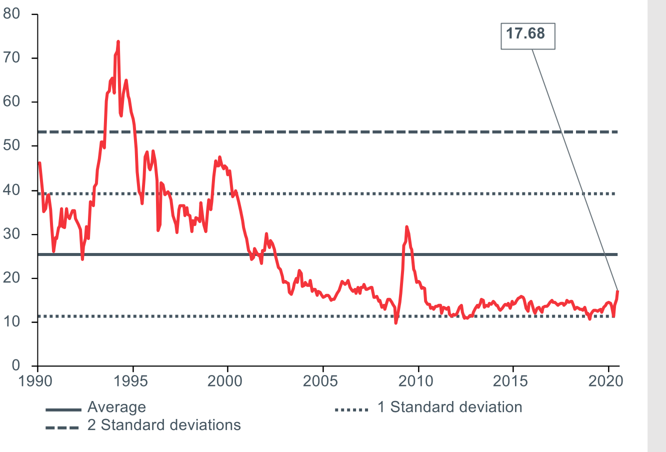
MSCI USA 12M Forward PE



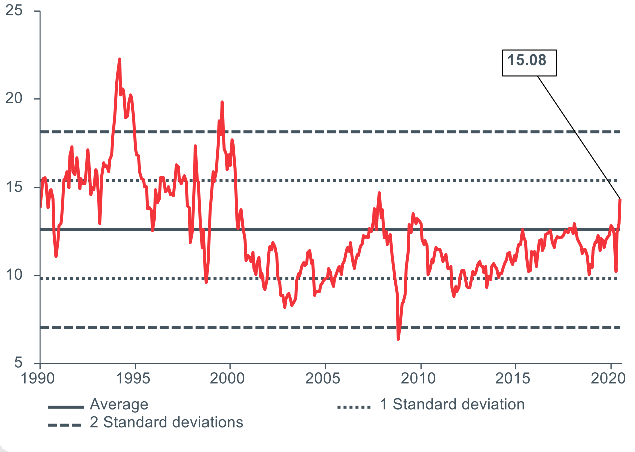
MSCI Europe 12M Forward PE



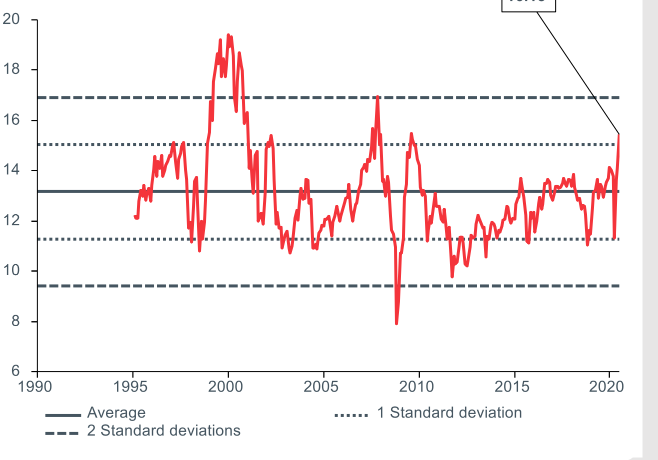
MSCI Japan 12m Forward PE



MSCI Emerging Markets 12M Forward PE



MSCI Asia Pac ex Japan 12M Forward PE



Source: Eastspring Investments. Chart data using IBES estimates from Refinitiv Datastream as of 31 July 2020.

MSCI monthly, quarterly and year-to-date data

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	Jul-20	Jun-20	May-20	Apr-20	Q2	Q1	YTD	2019
World	5.3	3.2	4.4	10.8	19.4	-21.3	-1.0	27.3
Developed World	4.8	2.7	4.9	11.0	19.5	-20.9	-0.9	28.4
United States	5.9	2.3	5.2	13.2	21.8	-19.6	3.6	31.6
Europe	3.9	4.1	4.7	6.1	15.6	-24.2	-9.0	24.6
Japan	-1.6	0.0	5.9	5.4	11.6	-16.6	-8.4	20.1
Emerging Markets	9.0	7.4	0.8	9.2	18.2	-23.6	-1.5	18.9
Asia Pac Ex Japan	8.0	8.2	-0.3	9.8	18.5	-20.7	1.5	19.5
Asia Ex Japan	8.6	8.4	-1.1	9.0	16.8	-18.4	3.5	18.5
Latin America	11.0	5.3	6.5	6.3	19.2	-45.6	-28.0	17.9
Brazil	14.2	7.4	8.5	5.4	22.9	-50.2	-30.1	26.7
EMEA	3.3	3.4	3.8	11.0	19.1	-33.9	-18.7	16.3
	Jul-20	Jun-20	May-20	Apr-20	Q2	Q1	YTD	2019
Australia	4.5	7.0	4.6	15.3	29.0	-33.2	-10.0	23.1
New Zealand	5.7	12.4	3.1	10.5	28.1	-16.3	13.2	38.8
Hong Kong	-0.7	11.0	-8.4	7.3	9.2	-17.3	-10.4	10.3
China	9.5	9.0	-0.5	6.3	15.4	-10.2	13.4	23.7
Korea	7.2	8.2	2.2	8.2	19.6	-22.4	-0.5	13.1
Taiwan	16.6	9.2	-2.5	14.1	21.5	-19.0	14.8	37.7
Thailand	-2.9	2.1	4.4	16.1	23.8	-33.7	-20.3	9.8
Malaysia	8.3	2.7	4.8	5.5	13.6	-19.2	-0.6	-2.0
Singapore	0.2	4.4	-3.2	8.4	9.5	-28.2	-21.2	15.0
Indonesia	4.4	7.2	3.3	12.2	24.4	-39.4	-21.4	9.7
India	10.5	6.8	-2.8	16.1	20.6	-31.1	-8.2	7.6
Philippines	-2.9	8.2	1.6	9.0	19.8	-32.0	-20.8	11.0
	Jul-20	Jun-20	May-20	Apr-20	Q2	Q1	YTD	2019
Mexico	2.9	-0.1	6.5	4.3	11.0	-35.4	-26.3	11.8
Chile	10.7	6.1	-5.4	16.2	16.7	-33.4	-13.9	-16.0
Hungary	4.1	0.3	6.9	6.6	14.3	-39.0	-27.5	19.4
Poland	6.6	2.3	8.2	9.2	20.8	-36.5	-18.2	-5.3
Czech Republic	0.6	7.2	4.1	11.2	24.1	-38.5	-23.2	6.6
Russia	3.1	-1.9	8.7	11.5	18.9	-36.3	-22.0	52.7
Turkey	-8.4	7.4	5.9	4.5	18.8	-30.0	-23.8	11.7
South Africa	6.0	10.4	2.0	13.2	27.5	-40.3	-19.4	10.7
Qatar	3.3	-0.0	2.2	4.9	7.2	-17.3	-8.4	-1.0
Saudi Arabia	1.9	2.2	0.1	10.6	13.1	-23.1	-11.3	9.1
United Kingdom	1.4	1.4	1.1	5.1	7.8	-28.8	-22.2	21.1
Germany	5.1	6.3	8.9	9.8	27.2	-27.0	-2.4	21.7
France	2.9	6.1	5.1	4.4	16.5	-27.5	-13.1	27.0
Netherlands	4.3	7.1	7.3	8.7	24.9	-20.6	3.4	32.7
Austria	0.3	1.9	1.7	10.6	14.5	-38.2	-29.0	18.4
Italy	3.8	7.9	5.9	1.9	16.4	-29.2	-14.4	28.7
Spain	0.3	4.3	4.3	1.5	10.5	-29.7	-22.2	12.7
Greece	7.5	-2.7	4.7	9.0	11.0	-45.1	-34.5	43.6
Portugal	2.0	0.5	11.0	1.4	13.1	-13.1	0.3	25.2
Switzerland	4.1	3.1	2.9	5.2	11.5	-11.1	3.2	33.6

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 31 July 2020. Data and commentary prepared by Peter Bennett.

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