



# Capital Watch

June 2019





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## A Message from IPP

### Shaken!

What a sharp turn! After gaining 17.5% for the year, the S&P500 reversed and fell -6.6% to end the month of May at 2,752.06. Nasdaq lost more ground, declining -7.9%. Europe fell too; the Euro Stoxx 50 gave up -6.7% for the month. Asia was the worst hit, with the MSCI Asia ex. Japan tumbling -8.9%. The plunge in the market was triggered by the failure of trade negotiations between the U.S. and China. In the ensuing collapse of talks, the U.S. raised the tariff on US\$200bn worth of Chinese imports from 10% to 25%. That was the first blow. Immediately thereafter, the relationship between the U.S. and China grew worse. President Trump signed an executive order giving the federal government the power to block US companies from buying foreign-made telecommunications equipment that was deemed a national security risk. The U.S. Commerce Department carried out the order and added Huawei Technologies and 70 affiliates to its "Entity List" – that bans the telecom giant from buying parts and components from U.S. companies without the U.S. government's approval. This move to pressure China has hardened the Chinese negotiating position. The escalated distrust between the U.S. and China took its toll in the global markets.

“U.S. markets turned sharply.”

A handwritten signature in blue ink, appearing to be 'DM' or similar initials, written in a cursive style.

**David Mok, CFA, MBA**  
IPP Head of Investment & research





*The U.S. economy is still the powerhouse of the world today. It remains the strongest and the most dynamic of the developed economies.*

### Regaining Composure

How do we chart our investments ahead, given the current fluid and volatile situation? Status quo is certainly disrupted, as the U.S. exerts its economic advantage to haggle for a better deal on all fronts – the latest being the use of the U.S. market as a leverage for the Mexicans to get their border security in order. Perhaps we just can't figure out where the market is going in the short term and be comfortable with it. Just like white-water rafting - going down a Class 5 rapids and steering the dinghy with our puny paddles. The immediate future is bumpy, jolting and somewhat frightening. It is hard to maintain control. What we can do is to cast our eyes a little further and know that there is ultimately an end to this rapids and calmer waters awaits.

### Calmer Waters Ahead

The U.S. economy is still the powerhouse of the world today. It remains the strongest and the most dynamic of the developed economies. China is catching up but as of today, the U.S. is still the king of the hill. The U.S. economy grew an annualized 3.1% in the first quarter of 2019, following a 2.2% growth in the previous three-month period. Unemployment rate fell to 3.6% in April 2019 from 3.8% in the previous month. It was the lowest jobless rate since December 1969. Unemployment rate in the U.S. averaged 5.75% from 1948 to 2019. The underlying economy is robust.

Structural changes to the business environment have also helped the U.S. economy. Lower corporate taxes and de-bureaucratizing of the government is certainly giving the U.S. a second wind to prolong its economic boom to a few months shy of being the longest economic expansion on record.

### Decisions, Decisions

Given the current dynamic and pulsating state of affairs, we have decided to just stay afloat and paddle our way to the end of the rapids, towards the calmer waters. We are adjusting our portfolio allocations to a lower risk by moving 10-20% from equity to fixed income. We are then likely to return to neutral position before the end of the year. It is not an easy decision as we do not usually make too many tactical decisions within 12 months. However, we need to be responsive to the market and react appropriately as it demands of us.

### June Holidays and Summer Break

June is a school holiday month and where most take a break with their children. Rightly so. You have been working hard over the first five months and you deserve a break! June is also the start of summer for those in the northern hemisphere, when most take a vacation. Market activity and performance usually drop during the summer months and hence the term 'summer doldrums' is coined. Myth or fact, the third quarter performance of the market generally trails that of the other three quarters. That is why positioning ourselves slightly on the defensive over this period is not a bad idea. What do you do if you have cash in hand? Well, one of the maxims of investment is 'buy low, sell high'. If the market in summer months is going to be under-appreciated, isn't it a good idea to enter the market in tranches over these few months?

Have a great June holidays and a fantastic summer!



## *The escalating trade war took center stage.*

### Potential Risks

#### Slowdown in Global Economic Growth and Macro Risks

Economic data took a backstage to sentiments in May 2019, as the trade war escalated. The economic data released in May 2019 pointed to continued weakness, as data mostly fell short of expectations. The Organisation for Economic Co-operation and Development (OECD) cut global growth forecasts from 3.3 per cent to 3.2 per cent and urged governments to "resolve trade disputes through increased international cooperation while fixing the international rules-based system". Macro and political risks on the table: the ongoing U.S.-China escalating trade spat, Brexit uncertainty (Prime Minister May will resign on June 7 2019) and the potential trade conflict between the U.S. and Europe will remain issues in contention. We remain disciplined and stick to our global approach when deciding our investment asset allocation to brace for the ups and the downs. 2019 will continue to have bouts of volatility, but we continue to advocate staying invested as we still see opportunities for the market to rally in 2019.

#### Risks of Full-Blown Global Trade War

The rise in economic nationalism in the U.S. through threats and actual implementation of trade tariffs against other major economic powerhouses may risk spurring a global trade war. These tariffs are allowed by Section 232 of the U.S. law to safeguard "National Security Interest". Currently, U.S. has levied tariffs on \$250 bn worth of Chinese goods while China's retaliatory tariffs sits at \$110 bn worth of U.S. goods. In an unexpected move of escalation in the U.S.-China trade war, President Trump has fired his "first" salvo by increasing tariff rates from 10 per cent to 25 per cent on US\$200 billion worth of imports, and threatened to impose tariffs on another US\$326 billion worth of goods. China has retaliated by saying that it would increase tariffs on US\$60 billion worth of goods on June 1 2019. Also, the U.S. has escalated its crackdown on Huawei by placing it on the U.S. government blacklist, an indirect jab to China. China's responded by threatening their exports of rare earth, a critical material for U.S. defense, energy, electronics and automobile sectors.

#### Emerging Markets Woes

The irrational emerging market slump and selloff which started in August 2018 seem to be starting to recover from the rampant selloff scenario. Initially, the irrational investors' behaviour came about ever since the huge fall in Turkey's Lira; triggering the mental lumping of all emerging markets into one representative basket with no consideration given to each market's fundamental strengths. When developed markets fall, emerging markets are hit harder as evidenced by the recent bout of volatility in May 2019. Emerging markets will continue to be a challenging market as investors shift to U.S. higher-quality and higher-yielding assets in times of market uncertainty. A strong U.S. dollar will put pressure on the credit fulfilment ability of Emerging Markets with a large amount of U.S. denominated debt. Valuations and yields from EM markets remain very attractive; however, we continue to remain objective that "Cheap" may not be "Good".



## *The Fed confirmed their patient approach in May.*

### Potential Risks

#### Overcorrection of Interest Rate Policy

The current Fed target rate is at 2.25 to 2.50 percent. In the latest Federal Open Market Committee (FOMC) minutes, the Fed maintained their patient approach to interest-rates. It would be appropriate "for some time," and many sided with Chairman Jerome Powell's view that the recent dip in inflation was probably temporary. The Fed has not indicated any intention to cut rates in 2019, despite market participants expecting them to do so. The risks are now of the Fed either over loosening or tightening monetary policy. Considering how interest rate changes can impact the bonds and equity markets, the FOMC and interest rate schedule will be on our radar as we trek cautiously in the ever-changing market conditions.

#### Escalation in armed conflicts

U.S. President Trump and North Korea's Kim Jong Un held their second summit at Vietnam, Hanoi, from 27 to 28 February 2019. The meeting concluded with no significant progress or agreement, as President Trump was not agreeable to Kim's demand to remove sanctions entirely. In Kim's recent visit to Russia on 25 April 2019, Kim commented that the U.S. acted in "bad faith", heralding a possible reversion to the "old North Korea way". Though there has been historic progress in relations between the U.S. and North Korea, the risks remain that there would be a fallout, especially when both sides are unable to agree on when to denuclearize or even to denuclearize.

With China's threat of restricting rare earth exports, this may escalate into a military issue as rare earth is a critical component in the U.S. defense sector.





KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED	June 2019												
USD ISM Manufacturing PMI (Apr'19)	<b>52.8</b>	55.0	U.S. markets tanked as trade tensions flared.  U.S. Treasury yields dipped as risk-off sentiment prevailed.  U.S. dollar was steady.												
USD Fed Interest Rate Decision	<b>2.5%</b>	2.5%													
USD Nonfarm Payrolls (Apr'19)	<b>263K</b>	185K													
USD Consumer Price Index ex Food & Energy (YoY) (Apr'19)	<b>2.1%</b>	2.1%													
USD Retail Sales Control Group (Apr'19)	<b>0.0%</b>	0.4%													
USD Nondefense Capital Goods Orders ex Aircraft (Apr'19)	<b>-0.9%</b>	-0.3%													
USD Michigan Consumer Sentiment Index (Apr'19)	<b>102.4</b>	97.5													
USD Gross Domestic Product Annualized (Q1'19)	<b>3.1%</b>	3.1%													
Data source: FXStreet Economic Calendar			<table border="1"> <thead> <tr> <th></th> <th>Jun</th> <th>YTD</th> </tr> </thead> <tbody> <tr> <td>S&amp;P 500</td> <td><b>-6.58%</b></td> <td><b>9.78%</b></td> </tr> <tr> <td>Dow Jones</td> <td><b>-6.69%</b></td> <td><b>6.38%</b></td> </tr> <tr> <td>NASDAQ</td> <td><b>-7.93%</b></td> <td><b>12.33%</b></td> </tr> </tbody> </table>		Jun	YTD	S&P 500	<b>-6.58%</b>	<b>9.78%</b>	Dow Jones	<b>-6.69%</b>	<b>6.38%</b>	NASDAQ	<b>-7.93%</b>	<b>12.33%</b>
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## Our Opinion on the U.S. markets

**The U.S. economy will continue to be one of the strongest drivers of global growth.**

After a strong rally in the first four months of 2019, the three major U.S. market indices, the S&P 500, Dow Jones, and Nasdaq pulled back meaningfully in May 2019. One geopolitical issue was on the mind of all market participants – the U.S.-China trade war. In an unexpected turn of events, President Trump escalated the trade war by increasing the tariffs to 25 per cent on US\$200 billion worth of goods. Beijing retaliated by increasing tariffs on U\$60 billion worth of goods. Washington has also placed Huawei on their blacklist, restricting their business activities in the U.S, while China has threatened their exports of rare earth. Markets were spooked as they were already pricing a done deal between the U.S. and China. Risk-off sentiment prevailed as equity markets sold off globally and went into safe haven assets. At this point of time, there is no evidence of a deal to be made in the near future. The latest U.S. manufacturing PMI numbers also weighed on sentiments, as it fell to its lowest in a decade. Investors are worried about the direction of global growth and the impact of the trade war.

As the equity markets tanked and risk-off sentiment prevailed, investors flocked to safe haven assets as they were caught off foot. Treasury yields fell dramatically to its lowest since 2017 in May 2019 as investors digested the escalation of the trade war and a return of volatility. Yields were also pressured by soft U.S. economic data. With the fall in yields, the yield curve has once again inverted.

The U.S. Dollar Spot Index, which tracks the U.S. currency against 10 of its major peers, traded choppy in the May 2019 and closed the month slightly up. The dollar index hit a two-year high in May 2019 amidst escalating trade tensions and political uncertainty, but gave ground on soft U.S. economic data, fuelling expectations of a rate cut. The fall in yields pressured the dollar as well.



KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED	June 2019		
EUR Consumer Price Index - Core (YoY) (Apr'19)	1.2%	1.0%	European markets fell on trade tensions.		
EUR Industrial Production s.a. (MoM) (Mar'19)	-0.3%	-0.3%	German bund yields fell.		
EUR Markit PMI Composite (May'19)	51.6	51.7	Euro fell slightly against the dollar.		
EUR Gross Domestic Product s.a. (YoY) (Q1'19)	1.2%	1.2%			
EUR ZEW Survey - Economic Sentiment (Apr'19)	-1.6	1.0			
EUR Business Climate	0.30	0.40			
EUR Markit Manufacturing PMI (May'19)	47.7	48.1			
EUR Retail Sales (YoY) (Mar'19)	1.9%	1.8%			
Germany Harmonized Index of Consumer Prices (YoY) (May'19)	1.3%	1.4%			
Data source: FXStreet Economic Calendar					
			Jun	YTD	
			FTSE 100	-3.46%	6.44%
			Euro Stoxx 50	-6.66%	9.3%
			DAX	-5.00%	11.06%
			CAC 40	-6.78%	10.08%

## Our Opinion on the UK & EMU

**Euro markets valuations remain attractive and will remain in our watchlist for opportunities to enter.**

European markets, together with global markets, pulled back in May 2019. As a trade-sensitive market, European markets were rattled by the escalation of trade tensions between U.S. and China, when trade deal was already priced in before the escalation. Other factors also contributed to the dip in European markets – growth worries when forecasts were cut and political uncertainty in regards to Brexit. Some losses were pared on President Trump delaying auto tariff on U.S. imports for up to six months and as the EU Parliament election showed Europhile parties still performing reasonably well despite a rise in support for nationalists.

The 10-year German government bund yield stood at -0.205 percent at the end of May 2019, falling from April 2019's yield of 0.012 percent. The spread over the equivalent 10-year U.S. Treasury bond yield tightened slightly from minus 250 basis points in April 2019 to minus 235 basis points in May 2019.

The Euro trade choppily in the month of May. The EUR/USD trading at 1.1215 at the start of May and closed at 1.1169 at month end. The Euro fell slightly against the dollar. The Euro hit a multi-year low against the dollar in May 2019 amidst trade tensions, but pared losses as soft U.S. economic data was released.





KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED	June 2019		
CNY Consumer Price Index (YoY) (Apr'19)	<b>2.5%</b>	2.5%	Asian stocks tanked as the trade war escalated.		
CNY Exports (YoY) (Apr'19)	<b>-2.7%</b>	2.3%			
CNY Trade Balance USD (Apr'19)	<b>13.84B</b>	35.00B			
CNY Industrial Production (YoY) (Apr'19)	<b>5.4%</b>	6.5%			
CNY Caixin Services PMI (Apr'19)	<b>54.5</b>	52.8			
CNY Retail Sales (YoY) (Apr'19)	<b>7.2%</b>	8.6%			
CNY NBS Manufacturing PMI (May'19)	<b>49.4</b>	49.9			
Data source: FXStreet Economic Calendar			Jun	YTD	
			MSCI Asia Pacific ex Japan	-7.41%	4.48%
			MSCI Emerging Markets	-7.53%	3.34%
			Nikkei 225	-7.45%	2.93%
			Hang Seng	-9.42%	4.08%
			Shanghai SE Composite	-5.84%	16.23%
			India Sensex	1.75%	10.11%

## Our Opinion on Asia & the Emerging Markets

**Significant progress has been made in trade talks but a deal has not been signed and Asia still has not recovered from 2018. We remain mindful of how China will navigate 2019 using its policy-driven approach.**

Asian bourses dipped in the May 2019. The escalation of the trade war between U.S. and China weighed on risk sentiments. With no upcoming deal in sight, market participants went risk-off and flocked to safe haven assets. As a beneficiary of trade, Asian markets tend to be sensitive to trade issues, and this unexpected escalation took its toll. India bucked the trend and hit a record high before pulling back and was up for the month. The landslide victory of Prime Minister Narendra Modi's Janata Party in the elections was positive news to investors.

Bitcoin ended the month of May 2019 at US\$8,349.68 per coin. Bitcoin price reached the record high of US\$19,783.21 on 17 December 2017 last year and has since fallen by more than 60 percent to its current end of May 2019 price within a span of about a year. Bitcoin rallied in May as there has been an increase in major companies experimenting or bringing out cryptocurrency-related products. Taiwanese phone maker HTC released a phone focused on helping people store their digital coins, while Facebook is reportedly working on its own cryptocurrency. Fidelity, meanwhile, launched a new company to help institutional investors trade bitcoin. Investors are also preparing for the halvening event in May 2020 and are starting to hoard Bitcoin. Technically, Bitcoin has been showing strong bullish signals as well. However, it continues to remain an unpredictable asset class which correlates with the direction of global stock markets randomly.

