Capital Watch

Contents

February 2019

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A Message from IPP

Decisive Rebound

The U.S. markets recorded its best January in 30 years with the Dow registering a massive +7.2% return while the broader S&P 500 index rose +7.9%. Tech-heavy NASDAQ climbed 9.7% over the same period. Over in Europe, Euro Stoxx 50 rose +5.3%, while in Asia, the MSCI Asia ex-Japan soared +7.3%. The impressive performance across all major equity markets is due largely to a rebound from the sharp decline in the preceding month of December, when the U.S., Europe and Asia markets fell -6.2%, -14.3% and -2.9% respectively.

Causes of Blowout in December

There were many factors that caused the December puncture; 1) The U.S. central bank, the Federal Reserve System, continued to raise interest rates and seemed oblivious of the waning confidence in the economic growth expectations of the U.S., 2) Trump's White House troubles with the resignation of Defense Secretary James Mattis, 3) The budget fight between Trump and the Democrats resulting in the shutting down of the U.S. government, 4) Ongoing trade war between U.S. and China resulting in economic slowdown in China, and 5) Brexit chaos and Europe economic weakness.

The sheer number of negative factors overwhelmed the positive news of a solid U.S. economy. In addition, many now believe that part of the sharp decline seen on Christmas Eve and the subsequent equally sharp rebound on Boxing Day was due to machine trading. So, what caused the rebound?

"The U.S. markets recorded its best January in 30 years.

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

Our research tells us that we are likely to have seen the bottom in December 2018. Recovery to the previous high is next on the cards.

What Caused It to go Down, Will Cause It to Come Up

We have mentioned many times before; the very factors that cause a decline in equity markets will be the same factors that will trigger a recovery.

On 5 Jan, U.S. Federal Reserve chairman Jerome Powell, at the American Economic Association's annual meeting in Atlanta, said that the U.S. Fed will be patient with any future interest-rate hikes, allaying Wall Street concerns that the central bank will suffocate the current strong US economic expansion. His statement brought cheers to the market and it has not looked backed since. In addition, hope seems to be arising for a positive outcome from the U.S. and China trade talks. Also, the shutting down of the government has been lifted. All this good news helped the world markets recover as we concluded the first month of 2019.

Is There Further Upside in 2019?

Given the sharp rise in January 2019, is there any more room for the upside for the rest of 2019? This is a very difficult question to answer – if you do not have a compass or a barometer for the market.

Our research tells us that we are likely to have seen the bottom (-19% in Dow Jones Industrial Average) in December last year. Recovery to the previous high is next on the cards. Thereafter, the market will search for new highs again before encountering another dip in about three years' time. As such, we are likely to have a honeymoon period of two years of a gradual rise.

Our Tactical Positioning

We are maintaining our risk-on position for 2019. Our allocation between equity and bonds is largely neutral with slight leaning towards equity. We are allocating 0-5% more to the equities from fixed income. For equities, we are overweight in the U.S. and Asia, under-weighting Europe.

For fixed income, we are returning to risk. We held positions in floating rate bonds in 2018 and now, as the Fed is more cautious with the raising of interest rates, we feel it is appropriate to return to normal bond funds

Risks Ahead

Unfortunately, the very worries that brought the markets down in December will remain with us throughout 2019. The Fed may be trigger happy and impatiently raise interest rates as it sees the stock market recovers. Another continuing risk that is not fully priced in the market is the hatred of Democrats towards President Trump. It will be very worrying should this fight be brought to its extreme; market confidence will fall, and the U.S. government will further shut down.

Stay the Course

The market has corrected and crossed the -15% that we use as a benchmark for a once-in-three-years' dip. What it means is that once every three years, the Dow will fall -15% and it happened in December 2018. Thereafter, the market is likely to recover and will return to its previous high. We mentioned this is our previous month's newsletter to you. If you had followed, you are happier now. Nonetheless, there is still some way to go - albeit more volatile. You can still put in more money now. Enjoy the ride!

On behalf of the management and the investment team at IPP, we like to take this opportunity to wish all our Chinese clients a happy and prosperous Year of the Pig! **新年快乐! 万事如意! 恭喜发财!**

We see signs of slowing global economic growth and macro risks in the horizon.

Potential Risks

Slowdown in Global Economic Growth and Macro Risks

After the historic selloff in the equity markets in December 2018, markets rallied back up in January 2019, making it one of the best Januarys in history. This rally was brought about by positive investors' sentiments, as positive news trickled into the market. The optimism in the trade spat between U.S. and China and the Fed reiterating multiple times that they would be patient in raising interest rates were catalysts for the rally. However, there are still risks in the horizon. The economic data released in January 2019 such as an unexpected drop in China's exports, the International Monetary Fund (IMF) lowering growth forecasts and some disappointing corporate earnings from U.S. companies such as Caterpillar and Nvidia pointed to slowing global economic growth. Macro and political risks remains as well; the ongoing U.S.-China trade spat, Brexit and the U.S. government shutdown (though a temporary deal for three weeks is currently in effect) are still unresolved issues. Therefore, 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". As of 1 October 2018, U.S. has already levied tariffs on $250 bn worth of Chinese goods while China's retaliatory tariffs sit at $110 bn worth of U.S. goods. Currently, the Chinese government has shown to be softening their stance in their retaliatory efforts as the Chinese markets are currently getting the short end of the stick and are more negatively impacted than the U.S. markets with China's Purchasing Managers' Index (PMI) showing a contractionary manufacturing sector for two months in a row (<50.0). All in all, the Sino-U.S. trade feud has seen tit-for-tat actions from both sides, setting up a volatile ground for the global stock markets while investors fear a full-blown trade war being played out. The outcome of the recent trade talks between U.S. and China at the end of January 2019 was inconclusive, and the only concession was that of China saying that it would purchase 5 million tons more of soybeans from the U.S. The closely watched upcoming 90-day trade truce, which deadline is set on March 1, 2019, will be a possible turning point for either the best or worst case scenarios to play out.

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' behavior 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. However, as observed in the market data, we do see some upwards momentum in some emerging markets like Brazil, which is recovering from this selloff. Emerging markets can take a slight breather as a slowing of the U.S. Fed rate hike will put less downward pressure on emerging market currencies, but will remain an issue 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 fulfillment 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 maintained their target rate of 2.25 to 2.50 percent.

Potential Risks

Overcorrection of Interest Rate Policy

As expected, during the January 2019 Federal Open Market Committee (FOMC) meeting, the Fed maintained the target rate at 2.25 to 2.50 percent. Amid tightened financial conditions and muted inflation readings, the Fed reaffirmed its "patient" approach and removed references to further rate hikes. Currently, two rates hikes are expected in 2019. Though the Fed signaled a more dovish stance as compared to December 2018, the risk remains that they will overcorrect as they stand by their data-dependent approach. Considering how interest rate changed can impact both 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.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
USD ISM Manufacturing PMI (Dec 18)	54.1	57.9
USD Nonfarm Payrolls (Dec 18)	312K	177K
USD Average Hourly Earnings (YoY) (Dec 18)	3.2%	3.0%
USD Consumer Price Index (YoY) (Dec 18)	1.9%	1.9%
USD Consumer Price Index Ex Food & Energy (YoY) (Dec 18)	2.2%	2.2%
USD Fed Interest Rate Decision	2.5%	2.5%
USD Unemployment Rate (Dec 18)	3.9%	3.5%
USD S&P/Case-Shiller Home Price Indices (YoY) (Nov 18)	4.7%	4.9%

Data source: FXStreet Economic Calendar

January 2019

U.S. markets went through a volatile month of December and ended in the red.

U.S. Treasury yields plunge as investors flock to safe-haven assets.

U.S. dollar lost some of its bull strength after the dovish December FOMC meeting.

	YTD
S&P 500	7.87%
Dow Jones	7.17%
NASDAQ	9.74%

Our Opinion on the U.S. markets

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

The three major U.S. market indices, the S&P 500, Dow Jones, and Nasdaq rallied in the month of January 2019 and clocked a solid start to the year 2019. January 2019 was also one of the best Januarys in history. This rally was brought on by positive investor sentiments as positive news kept trickling into the market; optimism over a trade deal between the U.S. and China, the Fed's reiterating it's "patient" and dovish stance, a temporary three-week deal to end the U.S. government shutdown and a mixed but overall positive corporate earnings releases. The rally was capped by signs of slowing global economic growth with weaker than expected economic data as well as lower than expected earnings from companies exposed to China.

U.S. Treasury yields fell in January 2019. Though the January rally in the equity markets added to positive investor sentiments and reduced demand for safe haven assets, the Fed's dovish stance plus weaker economic data signaled to investors that rates were not going up. Yields were affected by opposing factors in January and the jury is not yet out as to which factor will prevail.

The U.S. Dollar Spot Index, which tracks the U.S. currency against 10 of its major peers, had a choppy January in 2019. For the month of January 2019, the dollar lost ground against 10 of its major peers. Concerns about global growth sent the dollar up to a three week high mid-January, but it eventually lost ground amidst the rally and optimism in the equity markets and the dovish stance the Fed is signaling. The index closed lower at 95.578. The risks of a Brexit "no-deal", Emerging Market woes, the U.S.-China trade feud might provide support to the demand for USD, as investors seek out higher quality, higher yielding, and lower risk assets.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
EUR Markit PMI Composite (Dec 18)	51.1	51.3
EUR Business Climate (Jan 19)	0.69	0.75
ECB Interest Rate Decision	0%	0%
EUR Consumer Price Index – Core (YoY) (Dec 18)	1%	1%
EUR Unemployment Rate (Dec 18)	7.9%	7.9%
EUR Gross Domestic Product	1.2%	1.2%
EUR Industrial Production s.a. (MoM) (Nov 18)	-1.7%	-1.5%
GBP Gross Domestic Product (MoM) (Nov 18)	0.2%	0.1%
GBP Consumer Price Index (YoY) (Dec 18)	2.1%	2.1%

Data source: FXStreet Economic Calendar

January 2019

European stocks decline led by U.S. markets selloff.

European Central Bank (ECB) declares the start of Quantitative Tightening (QT) with only a reinvestment approach of existing monies.

Euro rose slightly amid dovish Fed policy.

	YTD
FTSE 100	3.58%
Euro Stoxx 50	5.26%
DAX	5.82%
CAC 40	5.54%

Our Opinion on the UK & EMU

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

European markets rallied in the month of January 2019. The rally was largely fueled by positive sentiments in the U.S.-China trade talks European markets shrugged off weak economic data and disappointing earnings and followed its U.S. counterparts in the rally. Uncertainties such as the outcome of Brexit and the trade talks will continue to weigh on sentiments. Also, as President Trump proceeds with his economic agenda, market watchers will be keeping a close eye on the U.S. and EU trade talk progress.

The 10-year German government bund yield stood at 0.15 percent at the end of January 2019, declining from the start of 2019 yield of 0.242 percent. The spread over the equivalent 10-year U.S. Treasury bond yield increased from minus 244 basis points from the start of 2019 to minus 248 basis points at the end of January as political uncertainty weighed in the market.

The Euro rose slightly in the month of January with the EUR/USD trading at 1.1467 at the start of January and closed at 1.1448 at month end. The uncertainty of Brexit weighed on the Euro during the middle of the month, but the depreciation was pared amid the weakening of the U.S. dollar, as the Fed signaled a dovish stance.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
CNY Gross Domestic Product (YoY) (Q4'18)	**6.4%**	6.4%
CNY Caixin Manufacturing PMI (Dec 18)	**49.7**	50.1
CNY Exports (YoY) (Dec 18)	**-4.4%**	3.0%
CNY Imports (YoY) (Dec 18)	**-7.6%**	5.0%
CNY Retail Sales (YoY) (Dec 18)	**8.2%**	8.2%
CNY Non-Manufacturing PMI (Jan 19)	**54.7**	53.9
CNY NBS Manufacturing PMI (Jan 19)	**49.5**	49.3

Data source: FXStreet Economic Calendar

January 2019

Asian stocks decline as trade tensions persist.

Majority of the Asian indices ended 2018 in the red; with the exception of India.

The Shanghai SE Composite posted one of its worst performances in 2018.

	YTD
MSCI Asia Pacific ex Japan	**7.20%**
MSCI Emerging Markets	**8.71%**
Nikkei 225	**3.79%**
Hang Seng	**8.11%**
Shanghai SE Composite	**3.64%**
India Sensex	**0.52%**

Our Opinion on Asia & the Emerging Markets

All eyes will be on the outcome of the trade talks and how the market will behave when the result is out. We remain mindful of how China will navigate 2019 using its policy-driven approach.

Asian bourses rallied in the month of January 2019. Optimism over a trade deal between the U.S. and China and signals from the China government to stimulate the Chinese economy stoked positive investor sentiment. Asian bourses also took the lead from Wall Street as it rallied on in January 2019. Despite the rally, it should be noted that there are signs of a slowdown in global growth, especially in China, where economic data has shown that the economy is slowing down. The ongoing U.S.-China trade conflict and the issue between Huawei's Chief Financial Officer Meng Wanzhou will continue to weigh on investor sentiment.

Bitcoin ended the month of January 2019 at US$3,415.02 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 80 percent to its current end of January 2019 price within a span of about 1 year. It is on track for the longest correction ever for the cryptocurrency. Declining volume of digital assets and the potential scenario of cryptocurrencies free falling without significant sell pressure from bears does not bode well for the cryptocurrency. It continues to remain an unpredictable asset class which correlates with the direction of global stock markets randomly. Currently, retail Bitcoin investors are hoping for institutional investors to join in to bump up trading volume and price.