Capital Watch

Contents

March 2019

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A Message from IPP

Wave of Momentum

The U.S. markets rode the momentum of recovery in February as the U.S. Federal Reserve tempered expectations for future interest rate hikes. The expectation of a trade deal between the U.S. and China also helped to push the market up on a recovery path. The benchmark S&P 500 Index rose +2.97% for the month, while the Dow climbed 3.67% and the NASDAQ moved up 3.44%. Over in Europe, the Euro Stoxx 50 climbed 4.39% and in Asia, MSCI AC Asia Ex. Japan Index rose 2.05%.

The bond markets enjoyed the positive momentum in the equity market as well. The equity-correlated Bloomberg Barclays Global High Yield Total Return Index rose 1.38%, while the lower risk investment grade index of Bloomberg Barclays Global IG Corporate rose 0.45%. Bloomberg US Treasury Bond Index fell correspondingly to -0.27% on better economic sentiments.

Undercurrent of Recovery

The story in February is very much the continuation of the narrative in January; the very factors that have caused the decline in equity markets in December were the same factors that sparked the recovery.

The Fed continues to assure the market that they will be patient with interest rate hikes, and this allays Wall Street concerns that the central bank may unwittingly suffocate the current strong US economic expansion. There is also the growing expectation of a positive trade deal to be concluded between U.S. and China in the near future and this has a positive bearing on the global markets. We need to bear in mind that the U.S. and China are the two largest economies in the world and the impact of a positive outcome does not come any larger.

> ***The U.S. markets continued to ride the momentum of recover in February 2019.***

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.

Further Upside?

Given the sharp rise in January and February of 2019, is there any more room for upside for the rest of 2019?

Our research tells us that we are likely to have seen the bottom of a market correction (-19% in Dow Jones Industrial Average) in December last year. Recovery to the previous high is next on the cards. Will we see a straight-line recovery towards our first milestone? Unlikely. Market moves in waves and ebbs. There is a likelihood of a gentle pullback before the market pushes towards its previous high.

Thereafter, the market will search for new highs again before encountering another dip in about three years' time. From this permutation, we are likely to have a honeymoon period of about two years of a gradual rise.

Tactical Navigation

We are locked on to our forward propulsion gear for 2019. Our allocation between equity and bonds leans towards equity. We are allocating 0-10% more to the equities, away from fixed income. For equities, we are overweight in the U.S. and Asia while under-weighting Europe.

For fixed income, we have returned to risk. We held positions in floating rate bonds in 2018; but now, as the Fed is more cautious with the raising of interest rates, we feel that it is appropriate to return to higher-risk fixed income instruments like investment grade and high-yield bonds.

Wave Bumps Ahead

Unfortunately, some worries that brought the markets down in December will remain with us throughout 2019. There is a risk that the Fed may be trigger happy and raise interest rates, over-calibrating their intent to counter rising inflation. Another major 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 turn nasty. The U.S. government will be paralysed and market confidence will fall.

Getting Onboard

It is not easy to ask someone to come on board to join the party today, especially when the market had risen so much in such a short time. However, if your investment time horizon is stretched, then you may want to consider a staggered entry, engaging some of your money now, while reserving the rest to top up when the market takes a breather. The big picture is that the global market moves on an upward slope. The recent dip is behind us and we are on an upward momentum, searching for our last highest levels.

Investment is not without risk. But the ride is exhilarating. Enjoy!

Soft economic data points to slowing global growth.

Potential Risks

Slowdown in Global Economic Growth and Macro Risks

Following the January 2019 rally in the equity markets, February 2019 was yet another month of rally, albeit at a slower pace. The rally in February 2019 was largely due to news flow which led to positive sentiments. Positive developments and optimism over the U.S.-China trade talks boosted risk sentiment; the week-long talks between representatives of the U.S. and China with signs of progress and President Trump delaying the 25% tariff deadline past 1st March 2019. Furthermore, the Fed reiterating its positive stance in the January 2019 minutes was a positive confirmation for the markets. However, risks of a global growth slowdown remain in the horizon. The soft economic data released in February 2019, such as lower than expected manufacturing Purchasing Managers' Index (PMI) figures and/or retail sales data from the three major regions, U.S., Europe and China, pointed to a slowdown in the economy. Macro and political risks remains as well; the ongoing U.S.-China trade spat, Brexit uncertainty and the potential trade conflict between the U.S. and Europe will remain issues in contention. 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. With the recent positive developments in the U.S.-China trade talks, the probability of a positive outcome has increased to more than 50%. The 25% tariff deadline has also been pushed back and thus the next turning point in the U.S. China trade talks is currently unknown. However, it should be noted that China has been getting the short end of the stick in this trade war, with their Purchasing Managers' Index (PMI) showing a contractionary manufacturing sector for three months in a row (<50.0). The risks of a full-blown trade war remains.

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 emerging markets as it tracked the global rally. 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 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 their published minutes.

Potential Risks

Overcorrection of Interest Rate Policy

The current Fed target rate is at 2.25 to 2.50 percent. Amid tightened financial conditions and muted inflation readings, the Fed confirmed its "patient" approach and removed references to further rate hikes in the Fed minutes releases in February 2019. Currently, two rates hikes are expected in 2019. Though the Fed is dovish 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.

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. 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. There are also signs of armed conflict between India and Pakistan, due to the suicide car bombing by Pakistan-based militants in Indian-controlled Kashmir, which killed at least 40 Indian paramilitary police on 14 February 2019. This led to airstrikes and ground based fire between both nuclear armed powers. The escalation in conflicts between India and Pakistan will be on our radar.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
USD Nonfarm Payrolls (Jan 19)	**304K**	165K
USD ISM Manufacturing PMI (Jan 19)	**56.5**	54.2
USD ISM Non-Manufacturing PMI (Jan 19)	**56.7**	57.2
USD Average Hourly Earnings (YoY) (Jan 19)	**3.2%**	3.2%
USD Consumer Price Index Ex Food & Energy (YoY) (Jan 19)	**2.2%**	2.1%
USD Retail Sales ex Autos (MoM) (Dec 18)	**-1.8%**	0.1%
USD Michigan Consumer Sentiment Index (Feb 19)	**95.5**	93.0
USD Gross Domestic Product Annualized (Q4'18)	**2.6%**	2.3%

Data source: FXStreet Economic Calendar

February 2019

U.S. markets rallied for the second consecutive month.

U.S. Treasury yields fell on the Fed's dovish stance.

U.S. dollar gained ground on global uncertainties.

	Feb	YTD
S&P 500	**2.97%**	**11.08%**
Dow Jones	**3.67%**	**11.10%**
NASDAQ	**3.44%**	**13.52%**

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 continued their rally from January 2019 into the month of February 2019. The rally was due largely to progress in U.S-China trade talks, as the market priced in optimism on a trade deal being made. News flow of week-long talks between representatives of U.S. and China and President Trump postponing the 1 March 2019 tariff deadline were positive drivers for the market. The Fed confirming their patient stance in the Fed minutes for January 2019 aided in the rally in February 2019. However, gains were pared on soft economic data globally, in particular weak retail sales data in December 2018 for the U.S.

U.S. Treasury yields rose in February 2019, together with the rise in the U.S. stock markets. However, the continuing dovish stance of the Fed, the uncertainty of the Fed's balance sheet runoff and soft economic data held yields down.

The U.S. Dollar Spot Index, which tracks the U.S. currency against 10 of its major peers, peaked to a three-month high before dipping in February 2019.Overall, for the month of February 2019, the dollar was up against 10 of its major peers. The dollar strengthened together with the rise in yields on signs of a global growth slowdown and soft economic data. One rate hike is still expected in 2019, which lend further support to the dollar. The index closed higher at 96.157. Global uncertainties remain – the U.S.-China trade war, Brexit, a possibility of the Eurozone being the next tariff target for the U.S., North Korea denuclearization and the recent India and Pakistan armed conflicts. These issues 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 Manufacturing PMI (Jan 19)	**50.5**	50.5
EUR Retail Sales (YoY) (Dec 19)	**0.8%**	0.5%
EUR Industrial Production s.a. (MoM) (Dec 18)	**-0.9%**	-0.4%
EUR ZEW Survey - Economic Sentiment (Feb 19)	**-16.6**	-18.2
EUR Consumer Price Index - Core (YoY) (Jan 19)	**1.1%**	1.1%
EUR Preliminary Gross Domestic Product s.a. (YoY) (Q4'18)	**1.2%**	1.2%
DEU Markit Manufacturing PMI (Feb 19)	**47.6**	49.7
GBP ILO Unemployment Rate (3M) (Dec'18)	**4%**	4%
GBP Consumer Price Index (YoY) (Jan 18)	**1.8%**	1.9%
Data source: FXStreet Economic Calendar		

February 2019

European stocks up on positive global sentiments.

German bunds flat.

Euro fell on soft economic data.

	Feb	YTD
FTSE 100	**1.52%**	**5.15%**
Euro Stoxx 50	**4.39%**	**9.89%**
DAX	**2.72%**	**9.06%**
CAC 40	**4.96%**	**10.78%**

Our Opinion on the UK & EMU

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

European markets were up in the month of February 2019. European markets were up on positive investors' sentiments; as news of U.S.-China trade developments and Trump delaying the tariff lifted global markets. Gains were pared in the European markets amid weaker than expected economic data, lower growth forecasts and Brexit uncertainty. Looking ahead, 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 as there are signs of potential tariffs on European automobiles already.

The 10-year German government bund yield stood at 0.148 percent at the end of February 2019, almost flat compared to January 2019's yield of 0.15 percent. The spread over the equivalent 10-year U.S. Treasury bond yield widened from minus 248 basis points from January 2019 to minus 258 basis points on February 2019 as Europe uncertainty remained.

The Euro fell in the month of January with the EUR/USD trading at 1.1448 at the start of February and closed at 1.1371 at month end. The Euro depreciated against the dollar as weaker than expected eurozone economic data, the delay of rising interest rates and Brexit weighed on the currency.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
CNY Caixin Manufacturing PMI (Jan'19)	**48.3**	49.5
CNY Caixin Services PMI (Jan'19)	**53.6**	53.3
CNY Trade Balance USD (Jan'19)	**39.16B**	33.50B
CNY Producer Price Index (YoY) (Jan'19)	**0.1%**	0.2%
CNY Consumer Price Index (YoY) (Jan'19)	**1.7%**	1.9%
CNY Non-Manufacturing PMI (Feb 19)	**54.3**	54.5
CNY NBS Manufacturing PMI (Feb 19)	**49.2**	49.5

Data source: FXStreet Economic Calendar

February 2019

Asian stocks were up on U.S.-China trade developments.

The Shanghai SE Composite outperformed.

	Feb	YTD
MSCI Asia Pacific ex Japan	**2.13%**	**9.48%**
MSCI Emerging Markets	**0.10%**	**8.82%**
Nikkei 225	**2.94%**	**6.85%**
Hang Seng	**2.47%**	**10.79%**
Shanghai SE Composite	**13.79%**	**17.93%**
India Sensex	**-1.07%**	**-0.56%**

Our Opinion on Asia & the Emerging Markets

Some progress has been seen in the trade talks but the outcome of the trade talks and how the market will behave remains unknown. We remain mindful of how China will navigate 2019 using its policy-driven approach.

Asian bourses were up for the month of February 2019. Positive developments in U.S-China trade talks as well as President Trump postponing the tariff deadline led Asian markets to rally, particularly China which hit multi-month highs, which was hit the most in 2018 due to the trade war. Soft economic data globally and uncertainty over whether this rally was sustainable pared some gains. Geopolitically, the conflict between India and Pakistan may potentially weigh on markets.

Bitcoin ended the month of February 2019 at US$3,841.43 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 February 2019 price within a span of about 1 year. Despite the up move in February 2019, it is still 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.