Capital Watch

October 2019

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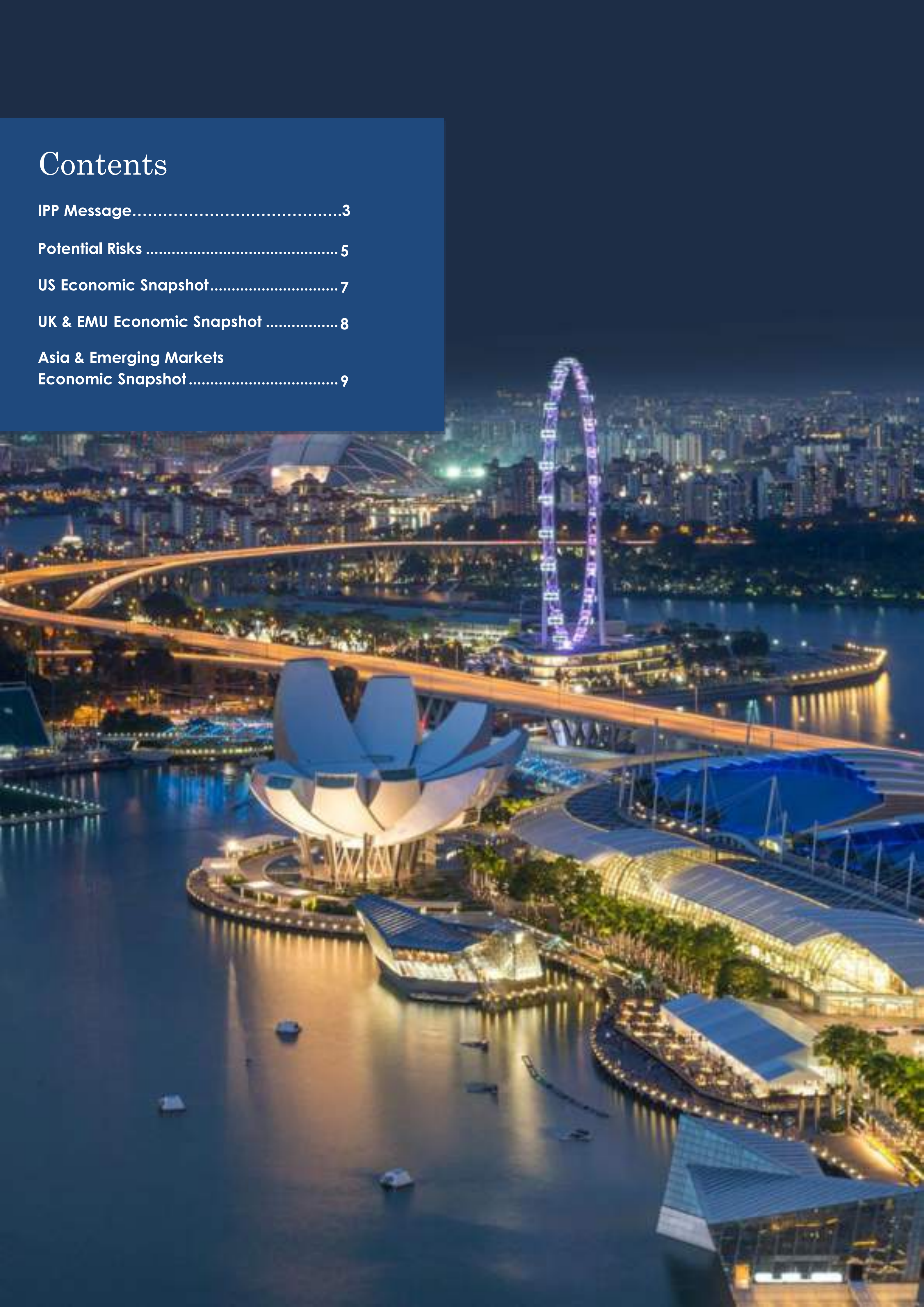

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A Message from IPP

Impeachment

On 24 Sep, the U.S. House Speaker, Nancy Pelosi, announced the start of an impeachment process against President Trump. The alleged misconduct details a whistle-blower complaining that the President had abused his power by soliciting a foreign government (Ukraine) to investigate a matter concerning his political rival, thereby giving him an advantage in the upcoming elections in 2020. For a successful impeachment of a sitting President, the House of Representatives must first submit articles of impeachment to the Senate. It takes a simple majority (218 votes) to do that. Currently, the Democrats hold 235 seats in the House and to impeach Trump in the House is easily achievable. However, the Senate is controlled by Republicans and it requires 2/3 (or 67 votes of 100) to convict Trump and remove him from office. Republicans now controls 53 seats in the Senate. The impeachment process is likely to be scuttled there.

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

Ironically, the impeachment proceedings may be a blessing in disguise for the US-China trade talks.

Impact

The market's reaction to the news of impeachment proceedings was mildly negative. The market must have figured out the math of getting President Trump impeached at the Senate and hence the subdued reaction. In addition, the negative news of impeachment proceedings was buffeted by the hope of a possible successful US-China trade talks in this month of October. The S&P 500 index ended the month of September up 1.7% at 2976.74, while Euro Stoxx 50 climbed 4.2% on the European Central Bank (ECB) responding to the weaker economic outlook by cutting interest rates to a record low of -0.5% from -0.4%, restarting quantitative easing and committing to continue with asset purchases until it achieves its inflation target. In Asia, MSCI AC Asia Ex. Japan rose 1.4% on renewed hopes of an amiable outcome to US-China trade talks.

Implications

Ironically, the impeachment proceedings may be a blessing in disguise for the US-China trade talks. With pressure piling on Trump on the domestic front, Trump may be motivated to produce a win in the external trade talks with China. In addition, should the market see more signs of weaknesses, the U.S. Fed may intervene with another round of interest rate cut, not unlike of that seen with ECB in September. If this bullish scenario plays out, then the stock markets will be in for a positive swing in the next few months.

That said, the economies of the world are struggling, except for the U.S. Asia is suffering from the impact of the trade war while Europe has its own internal problems, not least exacerbated by the lack of demand from Asia. Europe had resorted to cut interest rates further into negative territory to cope with their tepid economy. The messy Brexit is also not doing the European markets any favour. The worsening global economy must surely hit the resilient U.S. economy.

Implementation

Oscillating between positive sentiments of a possible U.S.-China trade deal, and the negative feeling of a worsening global growth, it is understandable that one finds it difficult to figure out whether to stay in the market or stay on the side lines. For us, we are more sanguine about the current situation. We believe the market at current levels tells us a great deal about what is going on. Despite all the troubles, the U.S. market is about 5% from its record high. That says a lot. It tells us that the underlying economic and monetary conditions of the U.S. economy and indeed the U.S. companies' earnings are incredibly resilient.

As such, we are returning to neutral asset allocation from a slightly defensive posture. We will ride the market movement in this quarter and into the new year. Yes, 2020 is on the horizon and 2019 is almost done! Our portfolios have returned, year-to-date, between 9 – 15%, depending on your risk profile. It is a credible performance. The month of October will certainly be another interesting ride. Hang in there! If you are unsure of the market, get in with Eagle Eye and enjoy the ride! Have a great October!

The Fed cut rates to 1.75 to 2.00 percent.

Potential Risks

Slowdown in Global Economic Growth and Macro Risks

Global growth has yet to bottom out. Citing that "the trade war between the United States and China has plunged global growth to its lowest levels in a decade", the Organization for Economic Cooperation and Development (OECD) cut global growth forecasts to 2.9% (from 3.2%) for 2019 and 3.0% (from 3.4%) in 2020. The Eurozone's purchasing managers index also hit a seven year low, with Germany likely entering into a technical recession. China's economic data also displayed a slowdown, while the U.S. remains a bright spot with robust economic numbers.

Macro and political risks on the table: (i) the U.S.-China trade, technology and currency war; (ii) Brexit uncertainty with hardliner Prime Minister Boris Johnson; (iii) tensions in Hong Kong that have dragged on for four months; (iv) Saudi-Arabia-Iran tensions as a drone strike, allegedly sponsored by Iran, was conducted on two Saudi oil fields; and (v) President Trump's impeachment proceedings by the Democrats as he spoke on the phone with the Ukrainian president, requesting them to investigate Joe Biden and his son. 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". U.S.-China trade tensions thawed in September'19 as both parties extended olive branches to each other. U.S. delayed their increase of tariffs from 25% to 30% of US$250 billion worth of goods from October 1 2019 to October 15 2019, while China exempted some U.S. goods from their tariff list. Middle level executives from China have also made a trip to the U.S. to set the ground for fresh trade talks to be scheduled from October 10 – 11 2019. President Trump commented that a trade deal might come "sooner than expected".

U.S. existing and proposed tariffs: up to 30% on US$550 billion worth of Chinese goods; and

China existing and proposed tariffs: up to 10% on US$185 billion worth of U.S. goods.

Mismanagement of Interest Rate Policy

As expected, the Fed cut rates in September'19, bring it down to 1.75 to 2.00 percent. The Fed commented that "if the economy does turn down, then a more extensive series of rate cuts could be appropriate", but they "don't see or expect that". The Fed also ruled out the possibility of negative rates. With only two more meetings in 2019, seven of the 17 Fed officials now see the possibility of at least one more rate cut, potentially totaling three for the year. Five officials would prefer to halt any additional easing for the remainder of 2019, sending mixed signals of where exactly the Fed may go next. With the pace of monetary easing, the Fed runs the risk of over loosening monetary policy and may have to play catch up when inflation heats up. 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.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
USD ISM Manufacturing PMI (Aug'19)	**49.1**	51.0
USD Average Hourly Earnings (YoY) (Aug'19)	**3.2%**	3.1%
USD Nonfarm Payrolls (Aug'19)	**130K**	158K
USD Consumer Price Index ex Food & Energy (YoY) (Aug'19)	**2.4%**	2.3%
USD Retail Sales Control Group (Aug'19)	**0.3%**	0.3%
USD Nondefense Capital Goods Orders ex Aircraft (Aug'19)	**-0.2%**	0.0%
USD Michigan Consumer Sentiment Index (Sep'19)	**92.0**	90.9
USD Gross Domestic Product Annualized (Q2'19)	**2.0%**	2.0%

Data source: FXStreet Economic Calendar

September 2019

U.S. markets rebounded on receding trade tensions.

U.S. Treasury yields soared as risk appetite returned.

U.S. dollar lost ground.

	Sep	YTD
S&P 500	1.72%	18.74%
Dow Jones	1.95%	15.39%
NASDAQ	0.46%	20.56%

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 rebounded in September'19. U.S. markets rebounded as U.S.-China trade tensions receded, with olive branches being extended by both parties. The U.S. delayed their increase of tariffs from 25% to 30% of US$250 billion worth of goods from October 1 2019 to October 15 2019, while China exempted some U.S. goods from their tariff list. Middle level executives from China have also made a trip to the U.S. to set the ground for fresh trade talks to be scheduled from October 10 – 11 2019. President Trump commented that a trade deal would come "sooner than you think". The stimulus package unveiled by the European Central Bank (ECB) and the Fed cutting interest rates by 25 basis points as expected supported risk sentiment. Some gains were pared on geopolitical tensions as drone strikes were conducted on two oilfields in Saudi Arabia and Democrats stating their intention to impeach President Trump.

Treasury yields appears to have found a bottom and rebounded in September'19, as risk appetite came back into markets, with ebbing U.S.-China trade tensions and stimulus packages from Europe and China. The Fed less dovish than expected tone after they cut rates also supported the rise in yields. However, the rise in yields were capped by geopolitical tensions in Saudi Arabia. The yield curve remains inverted on the 1 month, 2 month, 3 month, 6 month and 1 year end, but 2 year rates have now fallen back below the 10 year rates.

The U.S. Dollar Spot Index, which tracks the U.S. currency against 10 of its major peers, appreciated in September'19 as yields rose and on the uncertain political and geopolitical climate.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
EUR Consumer Price Index - Core (YoY) (Aug'19)	**0.9%**	0.9%
EUR Industrial Production s.a. (MoM) (Jul'19)	**-0.4%**	-0.1%
EUR Markit PMI Composite (Sep'19)	**50.4**	51.9
EUR Gross Domestic Product s.a. (YoY) (Q2'19)	**1.2%**	1.1%
EUR ZEW Survey - Economic Sentiment (Sep'19)	**-22.4**	-32.2
EUR Unemployment Rate (Aug'19)	**7.4%**	**7.5%**
EUR Markit Manufacturing PMI (Sep'19)	**45.6**	47.3
Germany Markit Manufacturing PMI (Sep'19)	**41.4**	44.0
Germany Harmonized Index of Consumer Prices (YoY) (Sep'19)	**0.9%**	1%

Data source: FXStreet Economic Calendar

September 2019

European markets rose.

German bund yields rose.

Euro depreciated against the USD.

	Sep	YTD
FTSE 100	2.79%	10.11%
Euro Stoxx 50	4.16%	18.93%
DAX	4.09%	17.70%
CAC 40	3.60%	20.02%

Our Opinion on the UK & EMU

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

European markets closed the month of September'19 up. European markets rose as U.S.-China trade tensions abated and on the back of ECB and People's Bank of China (PBoC) announced monetary stimulus. Brexit uncertainty also diminished as a "no-deal" Brexit was blocked by the UK parliament and the deadline is likely to be delayed to January 2020 if no deal can be achieved before the current deadline of October 31 2019. Some gains were pared on weak Eurozone economic data, Middle East geopolitical tensions and U.S. political tensions.

The 10-year German government bund yield stood at –0.576 percent at the end of September 2019, rising from August 2019's yield of -0.704 percent. The spread over the equivalent 10-year U.S. Treasury bond yield widened from minus 220 basis points in August 2019 to minus 226 basis points in September 2019.

The Euro depreciated against the dollar in the month of September. The EUR/USD traded at 1.0982 at the start of September and closed at 1.0899 at month end. The Euro depreciated against the U.S as global uncertainty saw the dollar appreciating as a safe haven.

KEY ECONOMIC DATA POINTS	ACTUAL	EXPECTED
CNY Consumer Price Index (YoY) (Aug'19)	**2.8%**	2.6%
CNY Exports (YoY) (Aug'19)	**-1.0%**	-2.0%
CNY Trade Balance USD (Aug'19)	**34.84B**	43.00B
CNY Industrial Production (YoY) (Aug'19)	**4.4%**	5.2%
CNY FDI - Foreign Direct Investment (YTD) (YoY) (Aug'19)	**6.9%**	-
CNY Non-Manufacturing PMI (Sep'19)	**53.7**	54.2
CNY NBS Manufacturing PMI (Sep'19)	**49.8**	49.7

Data source: FXStreet Economic Calendar

September 2019

Asian stocks rose on waning trade tensions.

	Sep	YTD
MSCI Asia Pacific ex Japan	1.44%	3.55%
MSCI Emerging Markets	1,69%	3.65%
Nikkei 225	5.08%	8.70%
Hang Seng	1.43%	0.95%
Shanghai SE Composite	0.66%	16.49%
India Sensex	3.57%	7.21%

Our Opinion on Asia & the Emerging Markets

Trade tensions remain a headline event. We remain mindful of how China will navigate 2019 using its policy-driven approach.

Asian bourses rose in September'19. Asian markets rose as U.S.-China trade tensions waned, monetary stimulus packages were announced by the PBoC and ECB and as the Fed cut interest rates. Gains were partially pared by Middle East geopolitical tensions, continuing protests in Hong Kong, weaker than expected Chinese economic data and U.S. political tensions.

Bitcoin ended the month of August 2019 at US$8,240.90 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 50 percent to its current end of September 2019 price within a span of about a year. Bitcoin was flat for most of the month but tanked during the latter part for no clear reason, though one theory investors pointed to was a lackluster debut of a new bitcoin futures product, Bakkt. It continues to remain an unpredictable asset class which correlates with the direction of global stock markets randomly.