Monthly Market Review

FINALIZED OCTOBER 14TH, 2019

- Market expectations for earnings growth remain too high!
- Back to quantitative easing
- Commodities are losers again
- Draghi's stimulus seems to be no cure for Europe's Japanification
- How good is artificial intelligence at managing money?
- The bank of Japan steps back from longer-term bond purchases

Dear investor,

- **If global growth concerns is not really gaining traction among equity investors – the MSCI World index is up a healthy 13% this year (in local currencies) –, it is probably because many of the traditional drivers of downturns seem to missing in action**: inflation isn't high and rising, central banks aren't raising interest rates, stock prices are elevated, but arguably not in bubble territory given the low level of rates, and households are not over-leveraged.
- **Even if the U.S. and China may reach some very limited mini-deal, that it however is unlikely to reverse the slowdown in economy anytime soon**. The world gross domestic product has slowed dramatically from its late 2017 peak (4.7%) to post its first three quarters of sub-2.5% expansion since the 2009 recession, according to Bloomberg's global tracker.
- **The inability of the global economy and the earnings growth to bounce back with so much easy money sloshing around is hardly the up arrow for riskier assets** such as equities with high-beta and high yield corporate debt.

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Thierry Masset, Chief Investment Officer ING Belgium

EQUITIES

Market expectations for earnings growth remain too high!


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Don't expect companies to deliver a magic bullet for stocks when they start reporting. Analysts are projecting U.S. corporates to say that profits fell 3.6% in the third-quarter from a year earlier. This is troubling because they were expected to be showing earnings growth by now, with forecasts for a 5.3% gain this quarter at the start of the year. Even if the U.S. and China may reach some very limited mini-deal, that won't fix the growth slowdowns that all are seeing.

The paths of global stocks and economic trends, usually in sync, have grown apart recently. The MSCI World All-Country index is still near the highest in more than a year, even as the ISM Manufacturing purchasing managers' index, a key indicator of U.S. growth, declined to its lowest level since 2009, below even the level that it fell to when earnings growth stalled between late 2014 and mid-2016. Perhaps more troubling, the ISM's gauge of activity in the services sector, by far the largest part of the economy, tumbled to its lowest since 2016. If global growth concerns is not really gaining traction among equity investors, it is probably because many of the traditional drivers of downturns are missing in action: inflation isn't high and rising, central banks aren't raising interest rates, stock prices are elevated, but arguably not in bubble territory given the low level of rates and households are not over-leveraged. But what could make investors nervous about a recession is a global, geopolitical shock to business sentiment that could prompt companies to curb spending.
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- **The concern is the contagion effect into the services economy.**
- **Big-Cap stocks are among the best-performing equities.**

BONDS

The oasis of government debt

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Investors are piling into safety trades, such as investment grade bonds (sovereign and corporate), with risks growing for world growth heading into 2020 and as monetary policy seems increasingly to be a weak tool.

The world's government debt markets are sending a clear signal that global economic growth is stalling and inflation expectations are fading fast. 10-year yields are still close to the lowest since 2017 in the U.S. (1.70%) and near all-time lows in Germany (-0.50%) and in Japan (-0.20%). The theme of "Japanification" - a mix of low growth and inflation -, was reinforced last month as the same forces that continue to hammer away at U.S. manufacturing appear to be gathering a bigger foothold in the service industry, which makes up the majority of the economy and accounts for the biggest share of the labor force. The risk seems real that the contraction of the manufacturing sector is spreading to the rest of the economy. Especially in a context where geopolitical headwinds abound, with an impeachment probe into Donald Trump, the Turkish offensive in Syria, marches in Hong Kong, the Argentinian fiscal crisis, the U.K.'s Brexit or the U.S.-China skirmish. Even another likely Federal Reserve (Fed) rate cut is seen as no panacea. So in the global bond market, it seems that for the foreseeable future all roads will lead to the oasis of safest government and corporate debt which has earned 6% (in euro) this year.
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- **Japanese investors get a taste of what happens when central banks step back.**
- **Credit quality is deteriorating.**

OTHER ASSET CLASSES

Commodities are losers again


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Investors pile into precious metals for the same reason they are shunning most industrial metals and are having second thoughts on their outlook for risk assets: the dimming global growth outlook and a combustible Middle East.

The U.S.-China trade war and geopolitical concerns have hit commodities worse than any other market. The Bloomberg Commodity index excluding precious metals fell last month (-1.3% in euro). Since the end of 2017, the benchmark is in the process of recording its twelfth quarterly decline and a fall of 15% in USD (-7% in euro) over that time, versus a gain of 13% for gold, 5% for world bonds and 1.5% for world stocks. There is a big downside to the drop in commodities prices beyond the negative impact they have on producers, and that is they weigh on the already low levels of global inflation. Low rates of inflation are generally believed to put a drag on economic growth by delaying corporate investment and spending decisions. In other words, if company executives believe they can get something for less at a later date, there is no incentive to buy or spend now. That is why it is notable that break-even rates on 10-year U.S. Treasury notes, which are a measure of what traders expect the pace of inflation to be over the life of the securities, are falling again, back near the lowest since 2016 (1.50%) after a brief increase in the first half of September.
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- **Investors are turning to gold with a consistency not seen in a decade.**
- **Are Russia and Saudi Arabia still pumping too much oil?**

IN THE NEWS

Draghi's stimulus seems to be no cure for Europe's Japanification


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The monetary stimulus conducted by the European Central Bank President (ECB) Mario Draghi won't be enough on its own to prevent an extended period of low economic growth and feeble inflation. That is the view of analysts in Japan, a nation with long experience of entrenched weakness where the central bank has also dived into a combination of negative interest rates and quantitative easing.

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How good is artificial intelligence at managing money?

To judge by the recent performance of some artificial intelligence (AI)-driven strategies, it doesn't look like the robots are going to take over from the humans anytime soon. Swings in investor sentiment are apparently hard for machines to navigate!

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The bank of Japan steps back from longer-term bond purchases

The Bank of Japan has been one of the primary offenders of zero-interest-rate policies, but it decided last month to try another approach. It indicated that it would try to steepen its yield curve by not buying debt with maturities of more than 25 years.

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If you have any questions or wish to discuss this further, please contact your private banker.

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