Colina Financial Advisors Ltd.
308 East Bay Street, 3rd Floor
P.O. Box CB-12407 | Nassau, Bahamas
Tel: 242.502.7010 | Fax: 242.393.4639
info@cfal.com

Global Economic & Market Review

Second Quarter 2019

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Summary:

In its most recent World Economic Outlook, the International Monetary Fund (IMF) highlighted that growth in the global economy remains subdued and revised downwards its forecasts for global economic growth for 2019 and 2020. The IMF now expects worldwide GDP growth of 3.2 percent in 2019 and 3.5 percent in 2020. Both figures reflect a 0.1 percentage point downgrade from the previous estimate. The primary detractors to global growth include trade and technology tensions, particularly between the United States and China, the world's two largest economies. The increasing trade tensions have led to weaker trade volumes globally, which have caused a decline in business investment. Brexit uncertainty, low inflation and financial vulnerabilities resulting from a protracted period of low interest rates were also identified as key risks to the global economy. Amidst this backdrop, heightened expectations of looser monetary policy by developed market central banks led to positive gains in the second quarter for most developed equity markets despite a sharp pullback in May. On the other hand, safe haven assets also performed well in the second quarter revealing an unlikely "twin rally" as signs of a global slowdown persisted.

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United States

Major US equity indices ended the second quarter with gains despite a large drop in May. May's market sell-off followed heightened trade tensions between the US and two of its major trading partners. The US increased tariffs from 10 percent to 25 percent on $200 billion worth of Chinese exports, prompting China to retaliate with a promise to raise tariffs on $60 billion of US goods. The US also threatened to levy 5 percent tariffs on Mexican goods in the absence of proper cross-border migration controls but weeks later, the two countries struck an immigration deal leading to President Trump's "indefinite suspension" of the tariffs. The US and China also made progress in trade negotiations, which helped to buoy the stock market rally in the final month of the quarter. For the quarter, the benchmark S&P 500 Index was up 3.79 percent. Year to date the index rose 17.35 percent.

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The markets were also boosted by the US Federal Reserve, who hinted at a possible cut in interest rates. Following its June meeting, the Fed announced that it would keep its benchmark interest rate unchanged between a range of 2.25 – 2.50 percent. However, in its guidance statement, the central bank indicated that a rate cut could be possible should economic conditions worsen. This statement led many investors to believe rate cuts may be on the horizon in the second half of the year and resulted in a record closing high of 2,954.18 points for the S&P 500 on June 20, the second record closing high for the quarter. The widely watched US 10-year Treasury yield also fell to 2% during the month of June, the lowest level since late 2016. The Fed has not cut interest rates since the beginning of the 2008 global financial crisis, however, policymakers stated that they were prepared to "act as appropriate to sustain the expansion" of the US economy. The US economy grew at an annual rate of 3.1 percent in the first quarter, however, economic data reported in the second quarter pointed to slowdown in growth and an inverted US Treasury yield curve predicts a recession. Even with the unemployment rate at a multi-decade low of 3.1%, slowing GDP growth, stagnant inflation, trade uncertainties and weakening consumer and business confidence present headwinds for the world's largest economy.

Europe

Brexit developments dominated the headlines in Europe during the second quarter, as UK Prime Minister Theresa May tried and failed to garner sufficient parliamentary support for her Brexit divorce deal, which was rejected by the UK parliament three times. This ultimately led to the British Prime Minister announcing her resignation from the Conservative Party in late May, paving the way for a new leader to oversee the Brexit process. In April, EU leaders agreed to set a new Brexit deadline of October

31, a six-month extension from the original March 29 deadline. While the EU continually stated that it would not renegotiate the Brexit Withdrawal agreement, some UK leaders refused to agree to the terms of the deal with the issue of the Irish backstop remaining a point of contention for many. Despite the uncertainty surrounding Brexit, UK equities showed some resiliency during the quarter, with the FTSE 100 index rising 2.01 percent to boost its year to date return to 10.37 percent. However, economists predict that the UK economy likely contracted in the second quarter after accelerating by a better than expected 0.5 percent in the previous quarter.

Elsewhere in Europe, the Eurozone economy still showed signs or persistent weakness in the second quarter. While the economy rebounded in the first quarter with growth of 0.4 percent, disappointing negative economic data in the second quarter showed that economic growth remains subdued. Consumer and business confidence also weakened across the bloc. Germany, the EU's largest economy and global industrial powerhouse, experienced weaker growth due to lower exports from a global economic slowdown. In particular, the country's automobile manufacturing sector was hard hit by global trade conflicts as well as planned changes to auto emissions standards. The continued slowdown in the region will likely prompt the European Central Bank to further ease its monetary policies. Since early 2016, the ECB has maintained its main policy rate at -0.4% but the central bank has failed to realize its inflation target. Similar to their developed market counterparts, EU stocks saw positive gains for the quarter, with the Euro Stoxx 50 index up 3.6 percent for the three months ending in June. The EU also held its parliamentary elections in May, which saw a larger than usual turnout. While the share of populist and nationalist candidates increased, EU supporters still maintained a majority of the seats.

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Asia Pacific

Global trade tensions resulted in a lackluster performance for most Asian markets during the quarter, as China's trade war with the US had negative impact on other countries in the region. Even though eventual progress was made in trade negotiations near the end of the quarter, the lack of a firm trade deal resulted in growing investor unease. Notably in May, the US government placed Chinese telecom giant Huawei Technologies on its Entity List, a trade blacklist that barred the company from buying parts and other components from US based companies without US government approval. Despite economic stimulus measures by the Chinese government, the economy still demonstrated signs of a slowdown amid escalating trade tensions, reporting lower exports and a reduction in manufacturing activity. Other Asian countries including South Korea and Taiwan also saw a retreat in manufacturing activity as demand from China fell.

Meanwhile, Japan continued to underperform its developed market peers, as the Nikkei 225 index was relatively flat for the quarter, gaining only 0.33 percent. While data showed that the Japanese economy unexpectedly grew by an annualized rate of 2.1 percent in the first quarter, analysts warned of underlying weakness in the economy as the growth was mainly driven by imports falling faster than exports. Japan is expected to face additional headwinds from lower global trade volumes and a planned consumption tax hike in October 2019 which many analysts fear will have a disastrous effect on economic growth.

Emerging Markets

The slowdown in China proved to be a setback for other emerging markets in the quarter. The MSCI Emerging Market Index posted a slight loss of -0.31 percent in Q2 despite a 5.22 percent jump in June. Year to date, the index returned 9.22 percent, but still lagged most developed market indices. The IMF predicts that the emerging market and developing economies group will grow 4.1 percent in 2019 and 4.7 percent in 2020. This is down from previous forecasts of 4.4 percent and 4.8 percent respectively. Signs of lower growth was seen in Brazil, the largest economy in South America. In June, Brazil's national statistics agency reported that the economy contracted by 0.2 percent in the first quarter for the first time since 2016. The economy suffered after a deadly mine disaster in January reduced mining output. Brazil's extractive industry, which includes mining, declined by 6.3 percent in the first three months of the year. However, Brazilian equities exhibited some strength; the Ibovespa Index was up 5.82 percent for the quarter. In contrast, Turkey reported growth of 1.3 percent in the first quarter, after posting three consecutive quarters of negative growth. The growth was mainly attributed to an increase in fiscal spending. Elsewhere in the group, India's Prime Minister Narendra Modi secured another five-year term following a landslide election victory in May. The win is expected to allow Mr. Modi to continue his plans to reform India.

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Conclusion

Until there is some concrete resolution to the global trade war, the global economy is unlikely to experience any significant growth. Trade uncertainty will continue be a significant headwind for global risk assets, as investor unease will result in a flight to safety. While a loosening of central bank policy may result in a short-term boost for markets and economies, until trade disputes are significantly resolved, the global economy will remain on unstable footing.

Market Returns Q2-2019

	MTD	QTD	YTD	1 year
Equity Indices *(% local currency)*				
S & P 500	6.89	3.79	17.35	8.22
Dow Jones Industrial Average	7.19	2.59	14.03	9.59
NASDAQ	7.42	3.58	20.66	6.60
S & P TSX	2.15	1.74	14.38	0.64
FTSE 100	3.69	2.01	10.37	-2.77
DJ Euro Stoxx 50	5.89	3.64	15.73	2.30
Shanghai SE Composite	2.77	-3.62	19.45	4.62
Nikkei 225	3.28	0.33	6.30	-4.61
Ibovespa Brasil	4.06	5.82	14.88	38.76
MSCI Emerging Markets	5.70	-0.31	9.22	-1.37
MSCI World	6.46	3.35	15.63	4.26
ICE BofAML Bond Indices *(% local currency)*				
US Treasuries 0-3 months	0.20	0.62	1.22	2.28
US Treasuries 3-5 years	0.85	2.42	4.02	6.33
US Treasuries 1-10 years	0.81	2.32	3.91	6.08
US Corporates	2.28	4.33	9.55	10.55
US High Yield	2.42	2.55	10.12	7.56
UK Gilts 1-10 yrs	0.14	0.68	1.86	2.82
Canada Government 1-10 yrs	0.03	0.78	2.35	4.03
Euro Government	2.29	3.39	6.00	6.49
Global High Yield & Emerging Markets	3.22	3.08	9.67	8.09
Global Broad Market Index	2.10	3.36	5.67	5.97
Currencies vs. USD				
British Pound	0.53	-2.60	-0.45	-3.87
Euro	1.83	1.38	-0.82	-2.66
Canadian Dollar	-3.11	-1.90	-3.97	-0.29
Japanese Yen	-0.41	-2.72	-1.68	-2.63
Australian Dollar	1.18	-1.07	-0.41	-5.20
Swiss Franc	-2.43	-1.90	-0.59	-1.44
Commodities *(% USD)*				
Gold	7.96	9.07	9.91	12.53
Silver	4.94	1.30	-1.16	-4.98
Copper	2.75	-7.92	2.61	-10.77
WTI Crude Oil	9.00	-3.34	22.84	-10.24
Alternatives *(% USD)*				
HFRX Global Hedge Fund	1.61	1.58	4.22	-1.95