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Global Economic & Market Review

Fourth Quarter 2019

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Summary:

An easing of geopolitical tensions in the fourth quarter led to record highs for most global risk markets. At the forefront, an imminent trade deal between the U.S. and China boosted investor confidence around the world while the results of the U.K. election in December seemed to signal that a resolution to Brexit was on the horizon. In contrast, the global economy continued to struggle. While economic growth in the U.S. remained stable, Europe continued to grapple with near stagnant output and growth in China fell to a multi decade low. The IMF now expects the global economy to expand by 2.9% in 2019 and 3.3% in 2020, a downward revision of 0.1 percentage points for each year. Some stabilization is likely, but many headwinds remain.

CFAL Global Economic & Market Review Q4-2019

United States

U.S. equity markets saw spectacular growth during the fourth quarter as a stable economy, actions by the U.S. Federal Reserve and progress in trade negotiations boosted investor risk appetite and overshadowed political developments including the impeachment of U.S. President Donald Trump. The U.S. economy grew by 2.1% in the third quarter, slightly outpacing the previous quarter growth of 2.0%. The economy is expected to have expanded at a similar pace in the fourth quarter, as record low unemployment and strong consumer spending continued to support growth. Fears of a recession all but faded as the U.S. Federal Reserve made its third and final rate cut of 2019 during the quarter. In October, the Fed cut rates by another 25 basis points to a range of 1.5% to 1.75% and opted to maintain rates at this level in its final meeting of the year. The FOMC stated at its December meeting that rates were "appropriate" to support growth, jobs and inflation and indicated that they would wait and see how the economy performed before making another move.

In December, the U.S. and China made significant headway in trade negotiations, with both sides agreeing to a phase one trade deal to be signed in mid-January 2020. Investors celebrated the announcement, which signaled that planned new tariffs would not be introduced. Amidst this backdrop, the S&P500 rose to a record high in the final days of December and ended the quarter with a return of 8.53%. Year to date, the index soared 28.88%, its best annual gain since 2013. Meanwhile, the tech heavy Nasdaq index also saw its best annual performance in 6 years, up 12.17% for the quarter and 35.23% for the year. The Dow Jones Industrial Average also posted healthy returns, up 6.02% in the fourth quarter to end the year with an annual return of 22.34%. U.S. corporate bonds fared relatively well during the final three months of the year, up 1.15% for the quarter to increase its 2019 gain to 14.23%. However, U.S. Treasuries 1-10 years were flat in the fourth quarter and ended the year with a return of 5.15%.

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Europe

The European economy remained sluggish in the fourth quarter, as weakness in trade and manufacturing activity hampered growth in its largest economy. While domestically driven economies such as France and Spain remained mostly insulated from global trade conflicts, the export reliant German economy continued to struggle. The French economy grew by a better than expected 0.3% in the three months ending September while Spain's GDP rose by 0.4% in the same period. However, Germany narrowly avoided a recession in the third quarter, as falling global demand for capital goods and structural changes in the automotive industry contributed to the weakness in economic activity. GDP increased by 0.1% compared to a revised -0.2% in the second quarter. Overall, the Eurozone reported growth of 0.2% for the third quarter, unchanged from the previous period. The IMF predicts that real GDP growth for the euro area would slow to 1.2% in 2019 with a slight pickup to 1.3% in 2020. It remains to be seen if the package of stimulus measures introduced by the European Central Bank in September have had any meaningful effect on the economy. On November 1, Christine Lagarde took over as President of the ECB, with a promise to conduct a review of the bank's monetary policy strategy. During the quarter, the DJ Euro Stoxx Index performed fairly well, posting a gain of 4.92% for a year to date return of 24.78%. Euro government bonds were down -2.90% in the quarter, to close out the year with a return of 6.82%.

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In the U.K., the incumbent Conservative Party won the country's third national elections in four years by a landslide, setting the stage for a conclusion to Brexit. The Pound had one of its largest ever rallies following the results as investors expressed relief after years of confusion over the U.K.'s exit from the European Union. The historic victory allowed British Prime Minister Boris Johnson to easily pass the Brexit Withdrawal Agreement Bill in the House of Commons. The agreement outlines the terms of the U.K.'s exit from the E.U. and must also be passed by the House of Lords to allow for "first stage" exit from the E.U. on January 31, 2020. However, months of uncertainty preceding the election took a toll on the British economy. The economy grew by 0.3% in the third quarter, following a -0.2% contraction in the previous quarter. On an annual basis, GDP only rose by 1%, the lowest rate since the first quarter of 2010. In contrast to the struggling economy, U.K. equity markets gained in the fourth quarter, the FTSE 100 rose by 1.81% to end the year with a return of 12.10%.

Asia Pacific

The de-escalation of the U.S.-China trade war led to gains in Asian markets over the quarter. The Shanghai Composite Index advanced by 4.99% for the quarter or 22.30% year to date, while Japan's Nikkei 225 increased 8.74% over the quarter to end the year with a return of 18.20%. Under the phase one trade agreement, the U.S. will indefinitely suspend tariffs on approximately $160 billion of Chinese imports which were formerly scheduled to go into effect on December 15. Existing tariffs on $120 billion of Chinese imports will be reduced from 15% to 7.5%. In exchange, China will increase their purchases of U.S. agricultural goods. However, on the economic front, China experienced its slowest growth since the first quarter of 1992. Third quarter GDP figures showed that the economy grew by an annual rate of 6%, down from 6.2% in the previous quarter. Meanwhile, the semi-autonomous territory Hong Kong entered its first recession in a decade as political unrest continued for the sixth month. The protest violence increased over the quarter as two deaths occurred and several were critically injured. In the three months to September, Hong Kong's GDP fell 3.2%. It is expected that year over year GDP will contract 1.3%.

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Meanwhile in Japan, manufacturing activity fell to a 3-year low. The IHS Jibun Bank

Manufacturing Purchasing Manager's Index yielded a reading of 48.4 in October, down from 48.5 in September. October's reading was the lowest since June 2016 and the sixth straight month that the index came in below 50, a sign of contraction. Factory activity was also affected by an increase in Japan's sales tax from 8% to 10% on October 1. The IMF estimates that Japan's economic growth will decline to 0.7% in 2020 compared to the 2019 estimate of 1.0%. The Bank of Japan kept rates unchanged but hinted that it was willing to cut further in order to achieve an inflation target of 2%.

Emerging Markets

Emerging market equities posted strong gains over the quarter following the trade developments between the U.S. and China. The MSCI Emerging Market Index increased by 11.35% for the quarter, outperforming the MSCI World Index by 3.16 percentage points. Year to date, the index underperformed the MSCI World, adding 15.42% while the MSCI World realized gains of 25.19%. Economic growth for emerging market countries was mixed for the third quarter as some nations experienced country-specific shocks. The IMF adjusted its growth forecasts yet again, predicting growth of 3.7% for 2019, 4.4% for 2020 and 4.6% for 2021. India was a large contributor to this downward revision as the country's GDP growth slowed to a 6-year low of 4.5% for the quarter ending September. The country has faced several challenges including a crisis in the financial sector and weakness in corporate earnings. India's banking system has lost billions of dollars due to high levels of non-performing loans. Moody's downgraded India's outlook from "stable" to "negative" due to the country's economic slowdown. In response to the slowdown, India introduced fiscal stimulus in hopes of spurring economic growth.

In October, Brazilian President Jair Bolsonaro was victorious as Brazil's senate approved the much-anticipated pension reform bill. The bill focused on the creation of a retirement age of 65 for men and 62 for women. Additional revisions included a benefits calculation change and an increase in workers' pension contributions. These changes are expected to save the country 800 billion reais or 195 billion U.S. dollars, reducing the strain on Brazil's finances. Latin America's largest economy also experienced better than expected growth of 0.6% for the quarter ending September. Stocks rallied, and the Ibovespa Brazil ended the quarter up 10.4%. Elsewhere in South America, Chile's economy contracted 3.4% in October and the peso fell to a new low as mass protests shut down much of the country's capital, Santiago. This represented the largest monthly contraction since the 2009 financial crisis. The protests began on October 18 following an increase in subway fares. This led to other criticisms of the government from pension payments to the health care and school systems. The government reported that 14,800 businesses were damaged and 100,000 jobs were lost across the country in two months. The protests prompted Chilean President Sebastián Piñera to announce a $5.5 billion stimulus plan to rebuild infrastructure and assist small businesses affected by looting and vandalism.

"Chile's economy contracted 3.4% in October and the peso fell to a new low as mass protests shut down much of the country's capital, Santiago. This represented the largest monthly contraction since the 2009 financial crisis."

Conclusion

The final quarter of 2019 ended a decade which saw debt crises, trade wars, unprecedented central bank intervention and a continuation of one of the longest and most robust bull markets in history. Despite a fragile economic recovery and geopolitical shocks, markets were resilient and closed out the fourth quarter with a flourish. However, while progress has been made, as always, uncertainties remain. While the U.S. and China appear to have made some headway in a trade deal and Brexit is finally underway, increased political and social unrest around the world could threaten global growth and markets will remain vulnerable to any negative developments.

Market Returns Q4-2019

	As at 31 December 2019			
	MTD	**QTD**	**YTD**	**1 year**
Equity Indices *(% local currency)*				
S & P 500	2.86	8.53	28.88	28.88
Dow Jones Industrial Average	1.74	6.02	22.34	22.34
NASDAQ	3.54	12.17	35.23	35.23
S & P TSX	0.14	2.43	19.13	19.13
FTSE 100	2.67	1.81	12.10	12.10
DJ Euro Stoxx 50	1.12	4.92	24.78	24.78
Shanghai SE Composite	6.20	4.99	22.30	22.30
Nikkei 225	1.56	8.74	18.20	18.20
Ibovespa Brasil	6.85	10.41	31.58	31.58
MSCI Emerging Markets	7.17	11.35	15.42	15.42
MSCI World	2.89	8.19	25.19	25.19
ICE BofAML Bond Indices *(% local currency)*				
US Treasuries 0-3 months	0.14	0.44	2.21	2.21
US Treasuries 3-5 years	0.03	0.11	5.20	5.20
US Treasuries 1-10 years	-0.02	0.03	5.15	5.15
US Corporates	0.33	1.15	14.23	14.23
US High Yield	2.11	2.61	14.41	14.41
UK Gilts 1-10 yrs	-0.35	-1.27	2.33	2.33
Canada Government 1-10 yrs	-0.53	-0.58	2.11	2.11
Euro Government	-0.90	-2.90	6.82	6.82
Global High Yield & Emerging Markets	2.58	3.44	12.92	12.92
Global Broad Market Index	0.42	0.23	6.85	6.85
Currencies vs. USD				
British Pound	2.57	7.88	3.94	3.94
Euro	1.77	2.88	-2.22	-2.22
Canadian Dollar	-2.20	-1.90	-4.74	-4.74
Japanese Yen	-0.80	0.49	-0.98	-0.98
Australian Dollar	3.81	4.01	-0.40	-0.40
Swiss Franc	-3.36	-3.12	-1.58	-1.58
Commodities *(% USD)*				
Gold	3.64	3.04	18.31	18.31
Silver	4.83	5.04	15.21	15.21
Copper	5.09	8.01	5.49	5.49
WTI Crude Oil	10.74	14.52	25.59	25.59
Alternatives *(% USD)*				
HFRX Global Hedge Fund	1.22	2.57	8.62	8.62