SIGNIA TALKING POINTS

March 2019

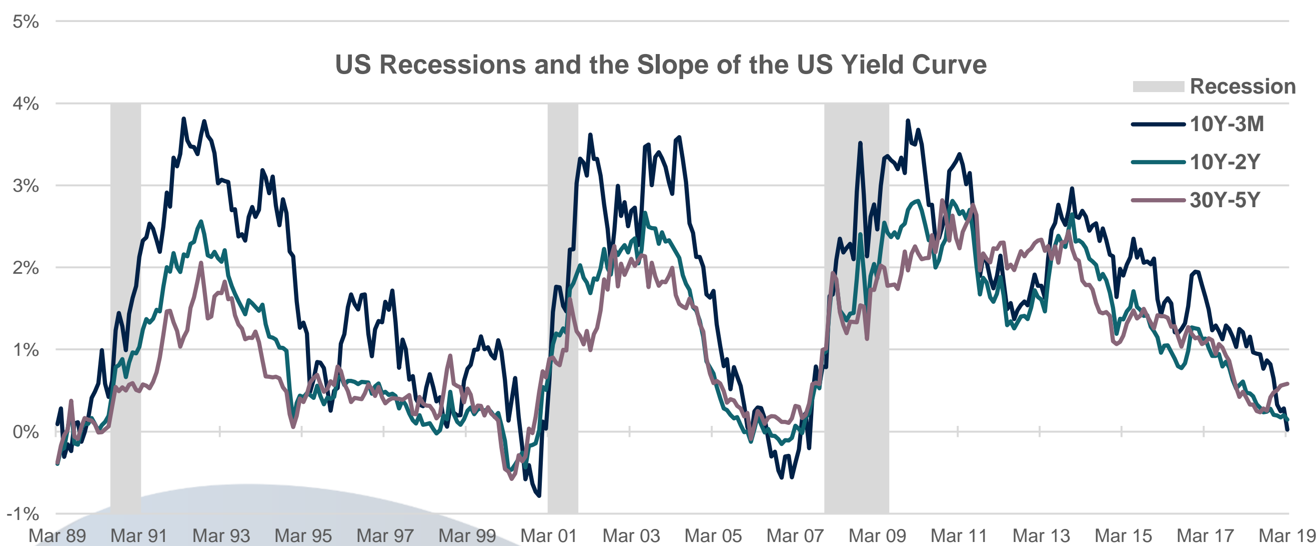
SIGNIA

Investigating Inversions

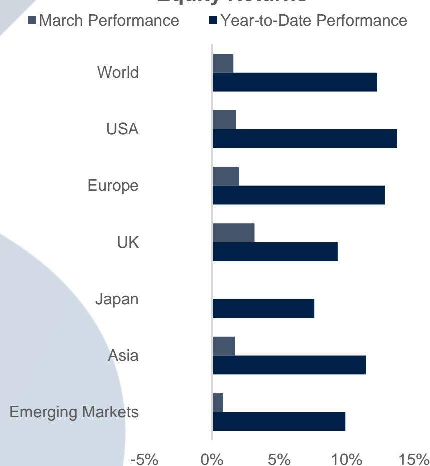
Where there's smoke there's fire, or so the saying goes. This was the hot topic for the shape of the US yield curve in March when the yield on three-month Treasury bills rose above the yield on ten-year Treasury bonds for the first time since 2007. The yield curve describes the yield of varying maturities of a bond over time and is typically upward sloping to compensate investors for taking time risk. When expectations for future central bank rate cuts to support a waning economy outweigh this, long-term yields decline significantly, resulting in a "curve inversion".

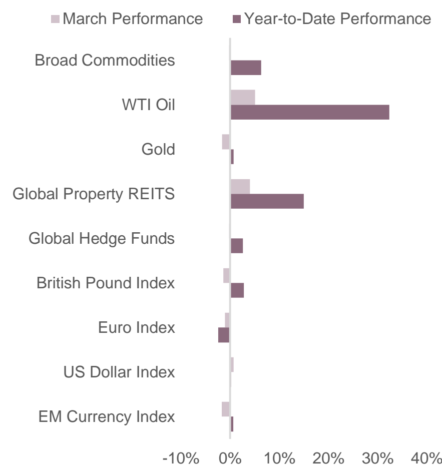
In March, this prompted warnings from prognosticators of an impending recession for the US economy, as historically inversions have tended to precede major economic slowdowns by about 12-18 months. Yet, equity markets were undeterred with the S&P 500 index rising to within 3% of its all-time high, and in complete contradiction to bond markets. The yield curve is signally smoke, but is there really a fire?

Unlike the global economy which is suffering on multiple fronts from slowing global trade and Chinese growth, increasing geopolitical uncertainties, and greater fragmentation and polarization, the US economy is in rude health and still growing above-trend. Job creation remains well above its late cycle norms, whilst wages are rising and attracting disgruntled workers back into the labour force. Moreover, we are living in a world of low inflation and greater central bank intervention, both of which are powerful suppressants on long-term interest rates. Ultimately, if consumers and businesses believe history is repeating itself, and postpone spending and investment, then it most likely will. Only time will tell.



Source: Bloomberg, Signia Wealth. Data as at 29/03/2019.





Source: Bloomberg, Signia Wealth. Data as at 29/03/2019.

Global Agg: Bloomberg Global Aggregate TR Hedged GBP; Global Sovereign: Bloomberg Global Treasury TR Hedged GBP; Global IL: Bloomberg World Govt Inflation Linked Bonds 1-10Y TR Hedged GBP; Global IG: Bloomberg Global Corporate TR Hedged GBP; Global HY: Bloomberg Global High Yield TR Hedged GBP; EM$ Sov: Bloomberg Emerging Markets Sovereigns TR Hedged GBP; EM$ Corp: Bloomberg EM USD Corporate 10% Cap Hedged GBP; EM Local Sov: Bloomberg EM Local Currency Govt TR Unhedged USD; Equities: Equity indices reflect net total returns in local currency, except Asia and EM in USD; Commodities: Bloomberg Commodity TR Index; Global Property REITS: FTSE EPRA/NAREIT Global Index; Global Hedge Fund: HFRX Global Hedge Fund Index; British Pound: Bloomberg British Pound Index; Euro: Bloomberg Euro Index; US Dollar: Bloomberg US Dollar Index; EM Currency: JP Morgan Emerging Market Currency Index.

Fixed Income

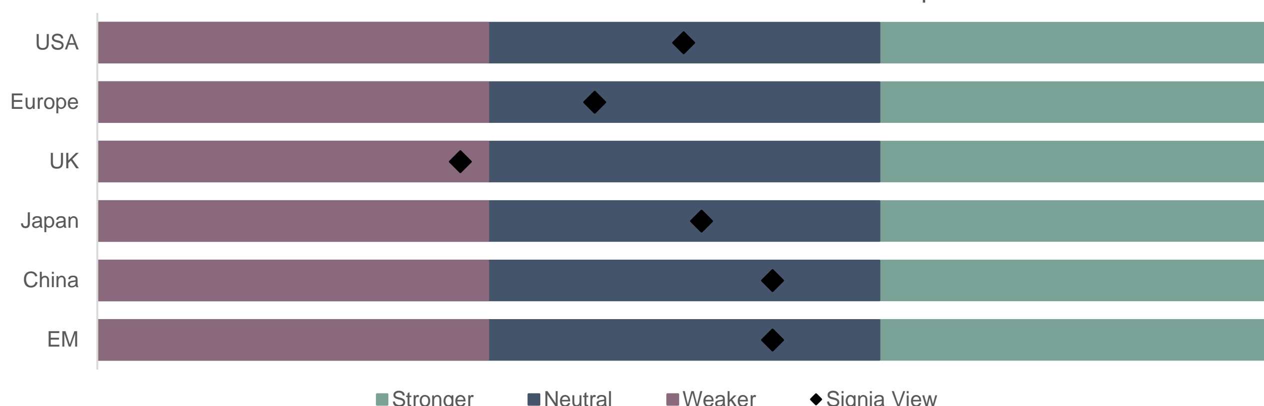
- It was a good month for fixed income markets as the US Federal Reserve turned more dovish in their rate outlook by announcing they would not be hiking interest rates this year. Ten-year US and German government yields were down -31bps and -25bps, respectively.
- Global investment grade corporate bonds outperformed, whereas it was a more divided picture within the high yield space with European high yield credit outperforming US high yield credit following the release of slowing US growth data.
- Finally, emerging market USD-denominated sovereign and corporate debt outperformed emerging market local currency debt after Turkey's attempt to stabilise its currency backfired, sending EM currencies broadly lower.

Equities

- UK equities outperformed during March despite the ongoing Brexit stalemate, with energy companies driving the market higher.
- Europe witnessed the next best gains despite growing evidence of slowing economic growth and the continued Brexit uncertainty.
- Japanese equities lagged their wider Asian counterparts, as the latter was driven by Chinese economic stimulus and the potential for a positive trade war outcome with the United States.

Alternatives & FX

- The broad commodity complex was largely unchanged despite another strong rise in Oil (+5% MTD / +32% YTD).
- Weaker economic data and downward revisions to growth from the major central banks, led to a rise in the US Dollar. This was most noticeable against the Turkish Lira (-4.2%), which was also impacted by a large spike in their overnight swap rates. In addition, the Brazilian Real (-4.2%) and the British Pound (-1.7%) were also weak, with the latter affected by further parliamentary deadlock on Brexit.
- Global REITs enjoyed good performance, benefiting from falling developed market bond yields.



Source: Signia, Bloomberg. Market Expectations are represented by the Bloomberg Contributor Composite. Data as at 29.03.19.

- USA: Slowing economic growth from a four-year peak in mid-2018 continues but is supported by rising wages, rising productivity growth, and a very buoyant domestic consumer. A trade war truce with China still holds with both sides working towards a more permanent agreement. Despite tighter financial conditions and a partially inverted yield curve, a recession in 2019 remains unlikely. The Fed has now paused its rate hike cycle.

- Europe: Economic growth indicators have weakened following the end of the ECB's asset purchase programme in December and Germany narrowly avoiding a technical recession in the fourth quarter. Economic expectations remain low but with employment and wage growth in healthy shape, and the ECB announcing plans for a third series of cheap long-term loans for banks, economic growth could stabilise later in the year. European parliament elections are due in May.

- UK: The economy remains in a delicate state, despite a strong jobs market, with monetary policy tied to a Brexit outcome. Profit growth is declining and risks remain to the downside as intensifying Brexit uncertainty weighs heavily on business confidence and the British Pound. The Brexit deadline was extended to April 12th to allow lawmakers time to find a solution and decide whether to hold European Parliament elections.

- Japan: Fiscal stimulus from the government is increasing to help the Bank of Japan in its monetary fight against structurally low economic growth but also consumer price inflation which is showing tentative signs of picking up in the midst of a very tight labour market. Labour shortages are driving an increase in capital expenditure. Foreign workers continue to drive the replacement of a shrinking domestic labour force as immigration policies are relaxed.

- China: President Xi Jinping's government has relaxed both corporate and personal taxes in an attempt to stimulate its economy, whilst the People's Bank of China is also in easing mode. The government is succeeding in its crack down on the unregulated shadow banking sector but this comes at the expense of credit growth and infrastructure spending. Policymakers are now targeting GDP growth of 6%-6.5% in 2019 versus last year's goal of approximately 6.5%.

- Emerging Markets: After slowing in 2018 due to tighter financial conditions and a stronger US Dollar, broad economic growth seems to have stabilised, helped by early signs of a Chinese economic recovery and thawing of US-China trade tensions. Moreover, a newly adopted circumspect stance from the US Federal Reserve, benign US Dollar, and anchored US bond yields should provide a fillip for emerging market economies in 2019.

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