SIGNIA TALKING POINTS

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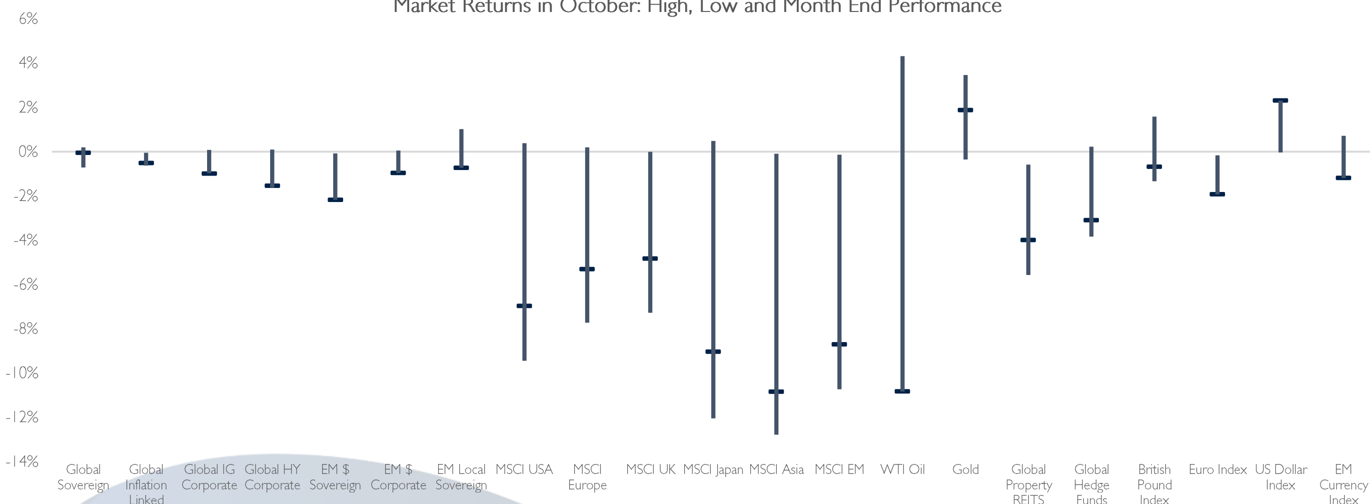
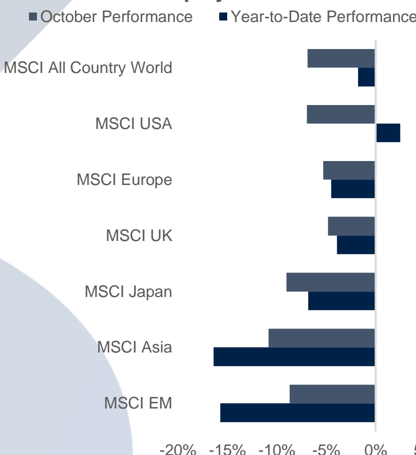
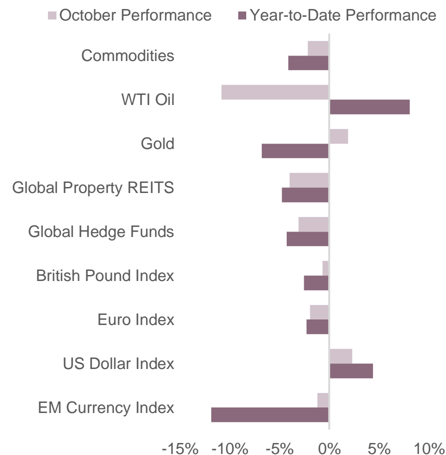
A Spooky Month for Markets

The practices of Halloween are widely believed to originate from Celtic paganism in the British Isles, where their feast of Samhain marked the end of the harvest season and the beginning of winter or the 'darker half' of the year. They believed it was the time when ghosts and spirits came out to haunt, and the Celts would appease the spirits by giving them treats. Unfortunately for investors there were no treats this Halloween, which saw market volatility return in a particularly spooky fashion in October. Across the 21 key global markets only 2 posted a positive return – Gold and the U.S. Dollar. Despite a two-day rally into month end of +2.7% U.S. equities suffered their largest monthly decline since September 2011, ending the month down -7.0%. Furthermore, the U.S. S&P 500 equity index fluctuated by more than 1% in a single day on ten occasions during the month – two more times than in the whole of 2017! Fixed income markets were also negatively affected, with global investment grade corporate bonds and emerging market dollar sovereign bonds declining -1.0% and -2.2%, respectively. Whilst WTI oil prices suffered the greatest volatility, posting an intra-month high of +4.3% but ending the month at their low, down -10.8%.

What is more curious is that there was no clear catalyst for these movements in broader asset markets. Economic growth slowed slightly from its cyclical highs but remained healthy, G10 inflation levels continued growing in their sweet spot near central bank targets, and employment globally stayed strong. Third-quarter earnings season got off to a good start, particularly in the U.S., where over 85% of companies that reported in October beat earnings expectations. So why were markets spooked? In short, a culmination of non-fundamental factors seem to take the blame: (i) overstretched equity market valuations with the S&P 500 index hitting an all-time record high on 3rd October, (ii) rising bond yields which moved up sharply also on 3rd October following strong U.S. economic data, (iii) U.S.-China trade war attrition starting to weigh more heavily on investors' minds, and (iv) escalating Italian-EU budget standoff. Whilst each of these factors can be deemed some cause for concern, we are not spooked by them, and instead remain cautiously optimistic on risk assets going into the darker half of the year.







Source: Bloomberg, Signia Wealth. Data as at 31/10/2018.

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: MSCI 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

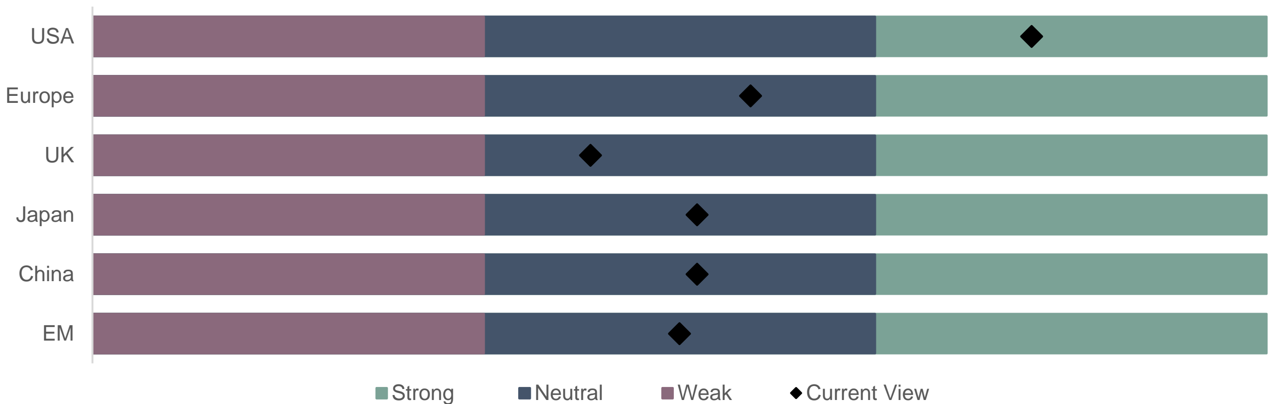
- Global rates sold off this month with US and European sovereign bonds both ending the month in the red. Strong growth in the US raised fears of the U.S. Federal Reserve tightening faster than expected and political turmoil in Italy contributed to the selloff
- In the credit space, both global investment grade and global high yield had a negative month with the latter suffering the most off the back of market volatility and despite strong technical support provided by low issuance
- In the EM space, dollar sovereigns suffered the most as the upward move in US treasury yields affected the asset class in particular

Equities

- US equities fell sharply in October, as rising yields, Italian political risk, and worsening corporate outlooks turned sentiment bearish
- UK and European equities fared relatively better, though both recorded negative absolute returns
- Asian and emerging market equities were the worst performers, as concerns surrounding trade tariffs, and their economic impact, intensified
- Japanese bourses also performed poorly, as Yen strengthened and weaker Chinese growth occupied investors

Alternatives & FX

- Commodity weakness was driven by the sharp fall in oil prices as risk off sentiment and news of U.S. waivers for Iranian oil imports to eight countries took hold
- The rise in yields continued to put pressure on REITs and the liquidation of crowded stock positioning in the equity long-short space hurt hedge funds
- The US dollar resumed it's rise against most major currencies except the Japanese Yen, which benefited from a safe haven bid



- **USA**: Tailwinds from tax cuts, fiscal easing and deregulation continue to support consumer and business sentiment in what is the second longest U.S. economic expansion in history (113 months), now in the latter stages of its cycle but still running strong. An escalating trade war with China is a concern but so far the strength of the US dollar has largely cancelled out any meaningful trade impact. Despite tightening financial conditions a recession in 2019 remains unlikely.

- **Europe**: Economic momentum continues to struggle against several key headwinds: a less accommodative ECB due to finish its asset purchase programme in December, an Italian budget standoff with the EU, Brexit uncertainty, and populist uprisings across the continent. Declining industrial production and real money growth is a concern for future economic growth, however, the labour market, inflation and wage growth are all in healthy shape.

- **UK**: Stubbornly sticky consumer price inflation above the Bank of England's 2% target prompted the bank to hike this year to the highest level since February 2009 at a time when the economy remains in a delicate state – at least one hike in 2019 remains likely. Profit growth is declining and risks remain to the downside as intensifying Brexit uncertainty weighs significantly on business investment and the British Pound.

- **Japan**: The policy mix in Japan is changing. Fiscal stimulus is increasing to help the Bank of Japan in its monetary fight against structurally low consumer price inflation, which continues to defy rising wages and a tight labour market. Foreign workers continue to drive the replacement of the shrinking domestic labour force as immigration policies are relaxed. Corporate profit margins are at all-time highs.

- **China**: Beijing is to end winter curbs on coal power and steel production designed to tackle air pollution. Whilst a major environmental negative, this should boost economic growth alongside recent income tax breaks in an attempt to head off an escalating trade war with the USA. The People's Bank of China is also stimulating the economy to counter this alongside other major existential threats of declining credit growth and infrastructure spending.

- **Emerging Markets**: Brazil has elected a market friendly president, Mexico has signed a new trade agreement with the USA, and Turkey has released a politically sensitive U.S. citizen. Overall growth is slowing but stable commodity prices and continued above-trend global economic growth remain a fillip to the broader EM complex. Most countries are now tightening monetary policy, whilst the path for U.S. policy and the U.S. Dollar remain key market drivers.

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