

August 2019

## Global Investment Commentary

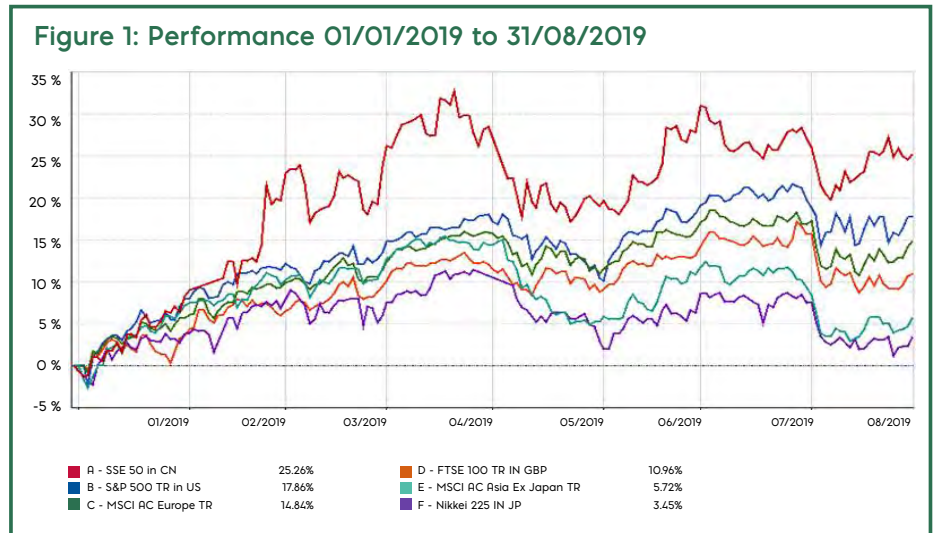
### SUMMARY

August's headlines continued to be dominated by familiar issues throughout, with the US-China trade war, increased gold price, talk of US recessionary signals, weakening German economic data and, of course, Brexit. Additionally, 2 and 10 year bond yields in both the UK and US inverted and US 30-year Treasury yields set a record low, falling below 2% for the first time. This led to higher relative volatility for the month and a continued search for safe-haven assets.

### Trade wars by Twitter

After the US and China seemingly agreed a ceasefire in their trade dispute at the G20 in May, the market was taken by surprise on the first day of the month by a tweet from US president Donald Trump, announcing an intention to impose a 10% tariff on the remaining \$300 billion of Chinese imports that were not yet subject to tariffs. The announcement of new tariffs resulted in retaliatory measures from China, which announced three weeks later that it would also increase tariffs on roughly \$75 billion of US imports, including agricultural goods, crude oil and cars. This led the US president to again tweet that the existing and planned tariff rates will both rise by 5%.

Although the damage to business and investor sentiment had already been done, a slightly more conciliatory tone from both countries started to come through at the end of the month. Triggered by the renewed escalation of trade tensions and the growing economic consequences, August saw profit-taking in global equity markets with developed market equities outperforming their emerging market (EM) peers.



Source: FE 2019

### Global bond yields continued to decrease

Safe havens were sought by investors and global bond yields continued to decrease, bringing the total market value of negative yielding debt in the Bloomberg Barclays Global Aggregate Index to over \$16 trillion. Fixed income segments with positive real yields rallied, including 30-year US Treasuries, whose yields dropped below 2% for the first time, and global investment grade corporate credit, which delivered just short of 2% over the month.

10-year UK Gilt yields also continued to rally through August on the back of growing Brexit uncertainties, ending the month

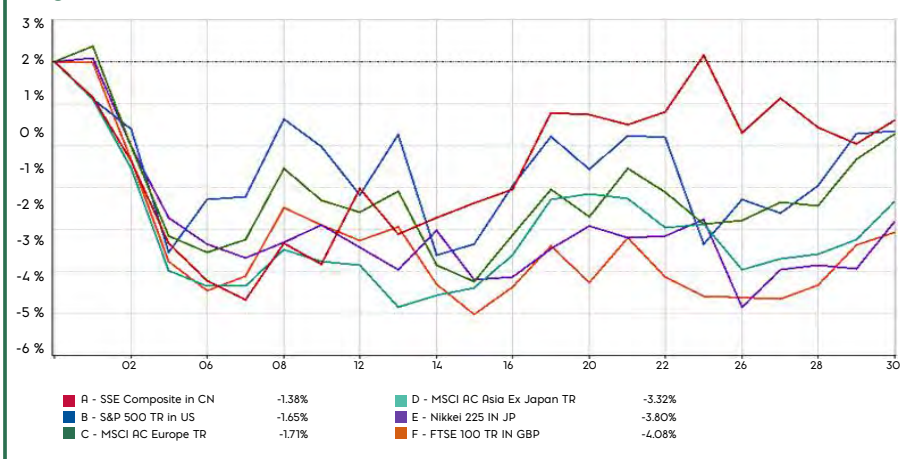
at 0.48%. In foreign exchange markets, while the US dollar remained generally stable, it rallied versus most EM currencies, gaining most against the Chinese renminbi and the Indian rupee.

### Will expected US rate cuts be enough to avoid a stall?

In the US, after the Federal Reserve (the Fed) cut rates by 25 basis points at the end of July, the August headlines were once again dominated by trade tensions but also increasingly by the risk of an economic downturn.

Indeed, most recent economic data releases have shown that the US economy is not immune

Figure 2: Performance 01/08/2019 to 31/08/2019



Source: FE 2019

to global trade tensions. The manufacturing part of the economy remains the weak spot as shown by the drop in the August US manufacturing purchasing managers' index (PMI), which showed its lowest reading since September 2009. There are also increasing signs that the manufacturing weakness is spreading to other areas of the economy.

The drop in consumer confidence has probably been driven to a large extent by the extensive media commentary on the increased risk of a recession, following the inversion of the US yield curve, which first occurred in mid-August.

However, domestic demand has so far remained relatively resilient, with retail sales figures for July increasing, showing that the strength of the labour market and rising wages continue to outweigh trade and recession concerns.

In this respect, it appears that the US economy is slowing, but not stalling. Jerome Powell's recent speech was largely in line with expectations and paves the way for the Fed to make another 25 basis point rate cut in September followed perhaps by one more rate cut at either their October or December meeting.

This move should be welcomed by US corporates as it will lower their

financing costs at a time when margins are under pressure from lower top-line revenue growth and higher wage costs. The second-quarter earnings season showed that US earnings-per-share growth was below 5% on average, broadly in line with sales growth, with next to no margin expansion.

Nonetheless, it could be argued that companies can still grind out positive earnings growth in the quarters ahead. However, consensus expectations for US earnings growth in 2020 appear too high and these expectations will likely be reduced by the end of the year.

### Is the final curtain about to drop or are we to endure another Brexit encore?

Meanwhile, in the UK, prime minister Boris Johnson has not so far managed to solve the Brexit impasse. Brexit is already weighing on the UK economy, with second-quarter GDP shrinking by 0.2%. In the final week of August, PM Johnson had a request to suspend parliament between 10th September to 14th October approved by the Queen.

The threat of a 'no deal' outcome is seen as a bargaining chip in the latest standoff with the EU, however, opposition parties have reacted with anger to the suspension, stating that the duration of the closure is an insult

to democracy and a deliberate attempt to stop Parliament having their say on the Brexit deal.

### European slow down and reminder of political volatility

In Europe, the August headlines were dominated by weak economic data, especially in Germany, and by increasing political uncertainties.

On the economic front, the second-quarter GDP releases confirmed the economic slowdown in Europe, when compared to the prior quarter.

At country level, the detail showed that Germany is now on the verge of a recession, as its economy contracted in the second quarter, while the Bundesbank expects the downturn in orders for cars and industrial equipment to continue in the third quarter. This economic slowdown has fuelled stimulus hopes and the German finance minister has left the door open to a possible fiscal package if the situation deteriorates further.

Overall though, the latest release for the eurozone indicated that growth stabilised in August, which suggests that Europe's economy is slowing but not quite yet approaching a recession, with the service sector continuing to grow.

Nevertheless, it's not a time for complacency. The recent political shifts in Italy remind investors of the regular political volatility experienced in Europe but borrowing costs remain low, helped by the fact that the European Central Bank (ECB) is expected to unveil new stimulus measures in September. On top of the measures already announced, the ECB is expected to further lower interest rates and could restart quantitative easing.

## China labelled a currency manipulator

All eyes have been on China since the beginning of the year and the country has taken several measures to counterbalance the effects of the trade war on its economy. However, even though Chinese authorities have this time delivered both fiscal and monetary stimulus, the results have so far been mixed as July data, including retail sales, came in short of expectations.

In this context and without the prospect of a trade deal in the near term, the Chinese authorities were obliged to take additional stimulus measures in August. The People's Bank

of China announced a lending rate reform to lower financing costs and let the renminbi break the psychological barrier of seven versus the US dollar. The currency move triggered official condemnation by the US, which labelled China a currency manipulator.

## Further afield

Elsewhere in emerging markets, Argentina experienced major difficulties in August with the peso weakening 26% vs the dollar and the Merval equity index dropping over 40% after the national primary election results showed that the current government could lose power in October.

## Portfolio Impact

In the coming months, new monetary and fiscal stimulus should support the global economy but these measures may not be able to fully offset the negative effects of the trade war and hence the economic slowdown could continue. We continue to think that these downside risks warrant an element of caution while maintaining portfolio agility in order to take advantage of upside opportunities as they present themselves.

## Economic Projections (30/08/2019)

### Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2019	2020	2021
UK	1.3	1.2	1.7
USA	2.3	1.8	1.8
Eurozone	1.1	1.1	1.2
Germany	0.6	1.0	1.4
France	1.3	1.3	1.4
Japan	1.0	0.4	0.9
China	6.2	6.0	5.8
India	6.7	6.7	7.0
Asia	5.5	5.5	5.5
Emerging Markets	4.6	4.8	4.9

Source: Bloomberg

### Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2019	2020	2021
UK	0.75	0.80	0.90
USA	1.95	1.85	2.00
Eurozone	0.00	0.00	0.05
Japan	-0.10	0.00	0.00
China	4.25	4.15	3.95
India	5.10	5.05	5.20

Source: Bloomberg

## Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2019	2020	2021
GBP/USD	1.23	1.32	1.34
EUR/GBP	0.91	0.89	0.88
EUR/USD	1.12	1.17	1.20
USD/JPY	105.00	103.00	105.00
EUR/JPY	117.00	120.00	125.00
USD/CNY	7.14	7.10	6.80
USD/INR	71.50	70.88	69.10

Source: Bloomberg

### Risk Warnings

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