



## Monthly Market Commentary May 2019

### **ECONOMY: Trade Tensions Impacting Global Growth**

#### **UNCERTAINTY GROWS**

Despite posting its best start to the year in over four years, the U.S. economy has started to show signs of vulnerability. The rising prospects of a prolonged and more pronounced trade war appear to be having an impact on the domestic economy. A more defiant stance from the Trump administration towards China and the threat of new tariffs directed against Mexico are fueling the pessimism and uncertainty.

#### **SIGNS OF WEAKNESS IN THE JOBS REPORT**

Hiring was weak in May as employers added only 75,000 jobs, while economists expected 178,000 job gains. Adding to the concerns were the downward revisions to gains from March and April. March's additions were revised from 189,000 to 153,000, and April's, from 263,000 to 224,000. The unemployment rate was unchanged at a 50-year low of 3.6%.

#### **FED WATCH: CUTS ON THE HORIZON?**

Federal Reserve Chairman Jerome Powell said the central bank is watching current economic developments and will do what it must to keep the current economic expansion intact. Powell reiterated that the Fed remains data dependent, and indicated that the central bank is taking a patient stance toward policy changes as conditions evolve. The futures market has already priced in at least one rate cut in 2019.

#### **MANUFACTURING & SERVICES DIVERGE**

The ISM Manufacturing survey fell 0.7% to a 31-month low of 52.1%. Respondents expressed concern with the escalation in the U.S.-China trade standoff, but overall sentiment remained positive. U.S. manufacturing continues to reflect a slowing expansion. The ISM Non-Manufacturing survey rose 1.4% to 56.9%, which represents continued growth in the non-manufacturing sector at a slightly faster rate. Respondents were mostly optimistic about overall business conditions, but concerns remain about tariffs, employment resources, and a leveling off of economic activity. Overall, there was a divergence between the manufacturing and the much larger service sector in May.

#### **EUROPEAN RATES ON HOLD**

The European Central Bank (ECB), held its policy rates steady in May while noting that rates would likely remain at present levels at least through the first half of 2020. Previously, the ECB hinted that rates would be on hold through 2019. The Bank of England (BoE) also voted to keep rates steady at 0.75%, while also raising its growth forecast for the year to 1.6%.

#### **RACE TO REPLACE MAY**

In Britain the candidates seeking to succeed Theresa May as U.K. Prime Minister were discussing alternate Brexit strategies, trying to avoid a no-deal Brexit by the October 31st deadline.

#### **ITALY'S DEBT ISSUE**

The European Commission released a report that recommended disciplinary proceedings against Italy, over its failure to follow European Union (EU) debt rules. The Commission concluded that an excessive debt procedure (EDP) is warranted and the report marked the first step in the EDP. According to EU rules, no country should have a government deficit larger than 3% of GDP or government debt exceeding 60% of GDP.

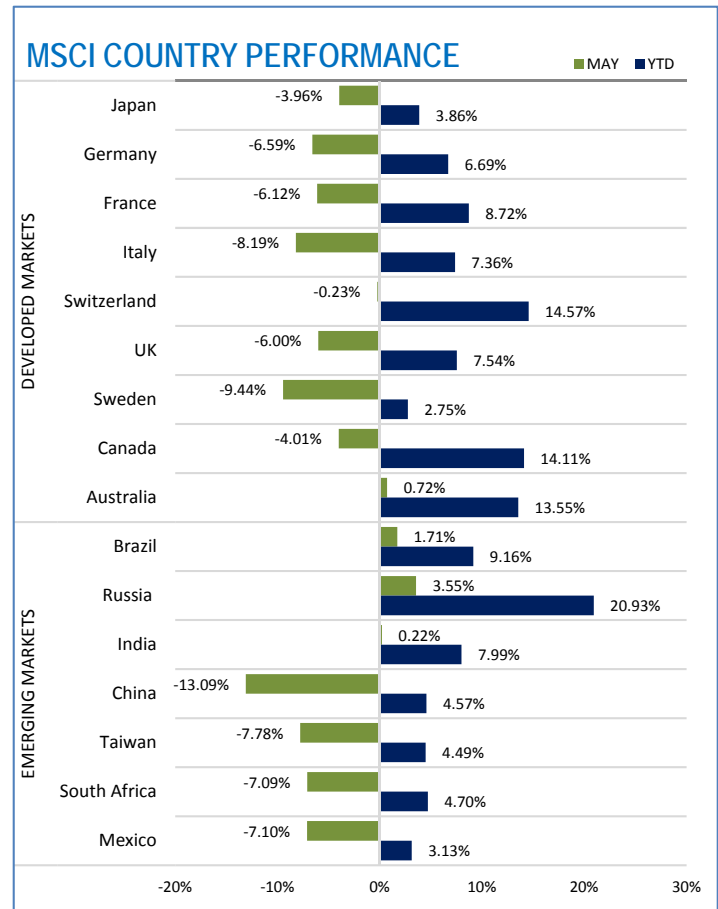
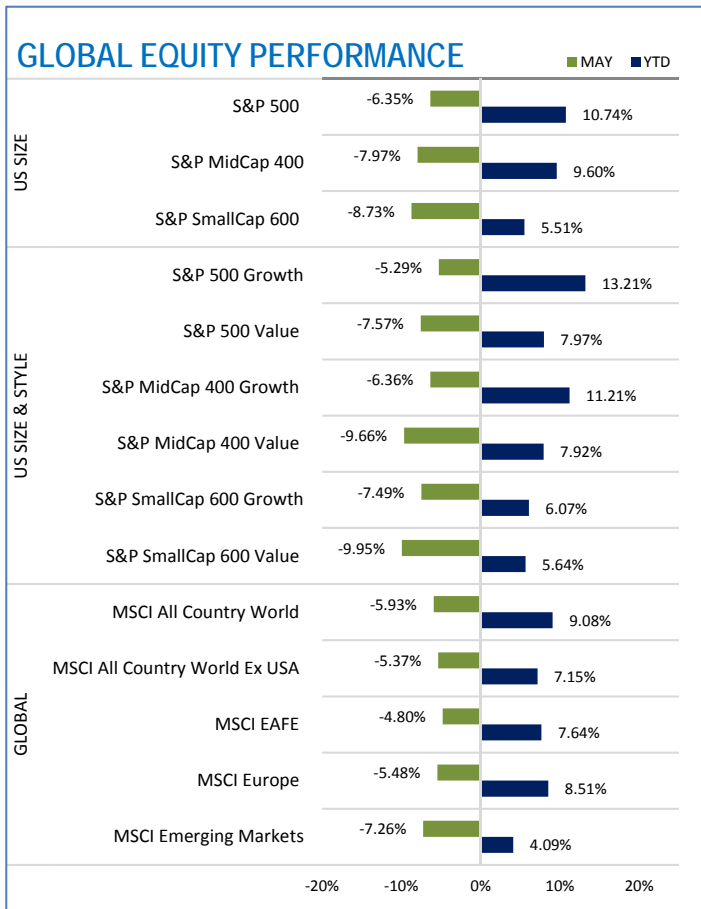
#### **CHINA'S GROWTH ESTIMATES LOWER**

Heightened trade tensions with the U.S. are beginning to impact Chinese growth. The International Monetary Fund (IMF) lowered its 2019 economic growth forecast for China from 6.3% to 6.2%. The IMF expects China's growth to slow to 6% next year, and to 5.5% by 2024. Likewise, Morgan Stanley economists also lowered their growth forecasts for China, down to 6.4% from a previous forecast of 6.5%.

#### **JAPAN GROWTH BETTER THAN EXPECTED**

Japan's economy grew slightly faster than initially thought in Q1, due partly to better-than-expected corporate investment. The world's third-biggest economy grew 0.6%, up from the preliminary estimate of 0.5%. The Japanese government remains flexible should any economic risks materialize.

# GLOBAL EQUITIES: Trade & Growth Concerns Hit Equities



## SELL IN MAY & GO AWAY?

In April, the S&P 500 ended the month with a closing high. May was quite a different story, as the index posted four consecutive weekly losses, something not seen since October 2014. By month's end, the S&P 500 index was down 6.35%, marking the worst May since 2010. Market sentiment soured as the U.S.-China trade tensions escalated further and Donald Trump threatened higher tariffs on Mexican goods. Almost no sector was spared – real estate being the only one to book a small gain. Small and Mid cap equities also saw significant losses, down 8.73% and 7.97% respectively.

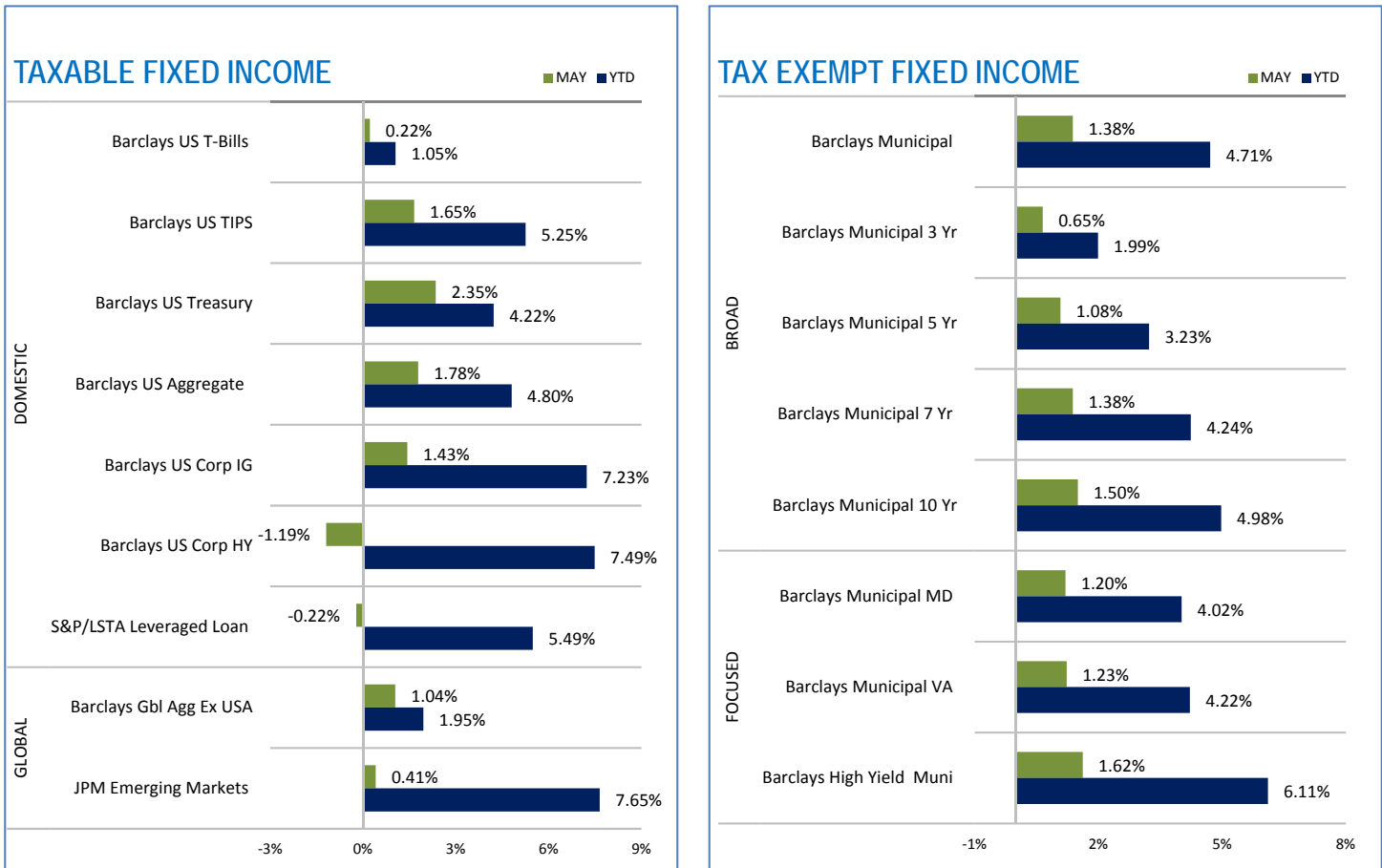
## ALL RED IN EUROPE

European equities did not fare any better in the month of May. The MSCI Europe Index fell 5.45%, as every country in the index fell. Switzerland was the region's best performer, falling only 0.23%, while Austria was the worst, falling 10.84%. Weakening economic data, global trade tensions and Italian elections spooked investors.

## WIDE DISPARITY WITHIN EM

As a whole, emerging markets also participated in the global equity sell-off, as the MSCI Emerging Market Index fell 7.26% for the month. However, there was a wide disparity in country performance. Given their higher sensitivity to global trade, equity markets in Asia, led by China, Korea and Taiwan, fell sharply. Mexico, a new target for potential trade sanctions, fell 7.10%. Conversely, India and Brazil both registered gains on the back of positive election results. Russia and Greece led the gains for the month as the MSCI Emerging Europe Index gained 1.33% in May.

# FIXED INCOME: Yield Curve Flattens & Inverts



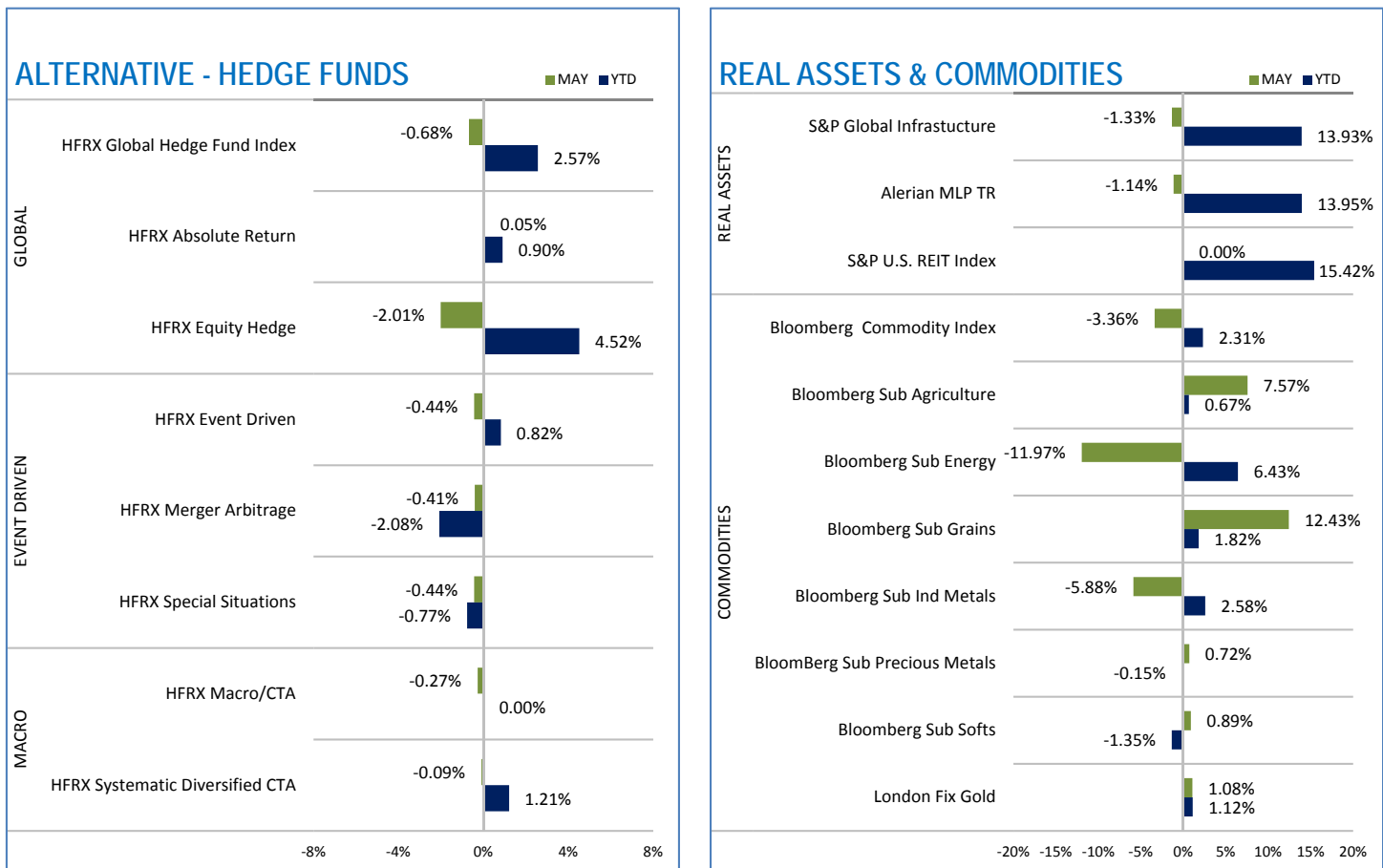
## INVESTORS SEEK SAFE HAVEN TREASURIES

Rising global trade tensions and signs of slowing economic growth pushed interest rates lower across the U.S. Treasury yield curve in May as investors sought safe haven assets. The U.S. yield curve inverted at various points, with the 10-Yr Treasury yield falling 0.37% to end the month at 2.14%. The Treasury heavy Barclays U.S. Aggregate Bond Index gained 1.78% in May. Not surprisingly, credit sensitive sectors such as high yield bonds and leveraged loans sold off slightly as the equity markets declined.

## MUNI RISK PAYS OFF

Despite trailing the U.S. Treasury market, the Barclays Municipal Bond Index gained 1.38% in May. The municipal yield curve also flattened significantly in May as supply and demand imbalances continued. Risk-seeking strategies were rewarded as longer maturities outperformed intermediate and short-term debt and lower quality credits outperformed investment grade credits.

# ALTERNATIVES: Hedge Funds Hold Up As Oil Retreats



## HEDGE FUNDS REDUCE RISK

Hedge funds followed the declines in the global equity markets in May due to continued investor concern over trade and tariff negotiations. While they held up substantially better than equity markets during the month, the HFRX Global Hedge Fund Index still fell 0.68%. Global Macro strategies held up well despite a large declines in oil prices and interest rates, while the HFRX Absolute Return Index eked out a 0.05% gain for the month.

## OIL TRENDS REVERSE

The world's most significant commodity and, until recently, a top performer this year, crude oil pushed the broader commodity markets lower. Oil prices have tumbled more than 20% since late April, while the Bloomberg Energy Sub Index fell 11.97% in May. Investors continue to fear that the ongoing trade wars will negatively impact global growth and the demand for oil. This is a significant change from analysts expectations for higher prices as the Trump administration had recently tightened sanctions on Iran and Venezuela, two major oil producers.