CROSSINVEST
Wealth Management since 1985

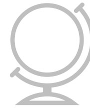
MACRO REVIEW

Equities were hit hard last month as sentiment soured after a rapid about-turn on a US-China trade deal that was expected to be close to completion. The US blamed it on a U-turn by the Chinese leadership that worried the deal, as it stood, might be seen as 'humiliating'. Unsurprisingly, Asia Pacific (APAC) markets were suffered with Hong Kong off almost 10%, MSCI Asia ex-Japan (AXJ) down 9% and Nikkei 225 down 7.5%. The exception was India after the BJP's landslide victory, which saw Sensex rise 1.75% for the month on the hope this will enable further reform progress. India was not alone in producing a positive election result as Australia, the EU, Indonesia, Philippines, South Africa and Thailand all exceeded expectations which helped equities and currencies. US markets were not spared with trade impacted Nasdaq off 7.9%, and S&P 500 off 6.6%. A further negative for US technology/social media is concern around antitrust actions by the regulators that affected Facebook, Google, Amazon and Apple.

Risk-off assets rallied with the US Treasury (UST) 10Y yield dropping to the lowest levels since September 2017, whilst 10Y German bunds, in part around worries over Italy's fiscal rectitude, rallied such that the yield fell into unchartered territory below the previous low at -20bps. US high yield (HY) fixed income (FI) belatedly saw spreads widen out by 70bps, led by weakness in CCCs that fell 2.2%. However, AXJ HY FI was resilient, gaining 8bps over May, helped by positive election results and a belief the key sub-sector, China's real estate developers, could gain from domestic reflation.

Other safe haven assets such as Gold and and JPY rallied later in May. Away from the JPY rally, the USD gained 2.5% against CNY which fell from 6.74 to end at 6.90 but tested key support at 6.96 during the month on the worsening trade news. Continued Brexit chaos helped sink GBP by over 3% towards YTD lows. Oil was the worst performing asset class of all, with Brent oil plunging over 11% to break support at $70/brl before testing the $60/brl. The fall was based on a combination of, rising US crude inventories (the US produced a record 12.5mn/bpd last month); forecasts of weaker global demand; and concern that Russia might seek to increase its production levels at the next OPEC meeting this month.

WEAKNESS IN MAY



MACRO OUTLOOK

Jerome Powell's apparent shift in 'language' on 4 June led markets to assume that the Fed is open to rate cuts, thus helping the biggest one-day rally on the S&P 500 YTD. There is a significant risk of a disconnect between the markets' expectations and the Federal Reserve's true willingness to act. It is interesting that only six months ago, there were many commentators calling for three or four rate rises in 2019 (we thought one or maybe two) and more in 2020, and yet now there are some expecting two or even three cuts in the coming year. Such a disconnect is worrying.

Frankly, economic data does not support a rate cut as although it is true that growth is slowing, it is still at above-trend levels. The calls for a so-called "insurance cut" in rates to protect against further weakness are mis-placed. It is critical for the long-term credibility of the Fed that it does not cave in to either political influence or to market worries. We do not know what Powell and his colleagues are going to do but care should be taken. There have been multiple comments which markets have interpreted as indicating a willingness to cuts rates, and soon. If the Fed believes that talk is cheap, and that there is no strong intention to cut rates, then we will see a sharper downside in equities.

We have positioned portfolios defensively through selling into strength this year and this has served us well during the recent market weakness. We remain comfortable holding more cash than we have typically done in the past few years, as markets come to terms with greater unpredictability.

It is clear to us that the US and China are engaged in a long-term conflict which goes far beyond mere trade numbers. Equity markets in particular were expecting a trade deal and used this expectation to justify reaching an all-time high in the US. We also expected a trade deal but have been suggesting for some time that it will be more face-saving than truly substantive. The US is pushing China, with tariffs; attacks on Chinese companies (e.g. Huawei); and potential arms deals with Taiwan. It is clear that Xi has his "red lines" and will not give in to perceived "bullying". Whilst we do not expect aggressive selling of US Treasuries by China, the implementation of the 'unreliable entities' blacklist; the imposition of retaliatory tariffs; and comments from some officials that breaking the 7 level on USDCNY may be possible; are all evidence of a hardening Chinese position. We are seeing trade damage on economies, adding to reasons why we will likely see further GDP downgrades (IMF lowered China's GDP forecast for 2019 and 2020 by 10bps each). A further worry is that company earnings might weaken more than what is being discounted by markets. Even if there is a renewed "bromance" between Trump and Xi at the G20 summit later this month, we believe it will be superficial and thus one should be careful about getting too bullish.

In the bigger picture, there is an argument that we will shift away from globalization to regional trade blocs, and that the US is serious about reducing its economic interdependence on China. This will place several countries – notably those in APAC, as well as commodity exporters like Australia and Brazil – in a conundrum as China is increasingly important to their economies, yet they rely on US's military shield. If countries are forced to 'choose', this could be highly disruptive to their economies and markets.

A long period of strategic confrontation between China and the USA; the possible end to globalization; and the continued disruption to established political parties by populism; all suggest increasing uncertainty in the world. This is bad news for risk assets, GDP growth, earnings and volatility, but could favour fixed income (FI) and non-traditional assets. It is potentially a future where emerging markets (EM), APAC especially, may suffer more.

Best Independent Wealth Manager Asia 2018 (Wealth Briefing Asia)
Best Independent Wealth Manager Asia 2017 (Wealth Briefing Asia)
Best Discretionary & Advisory Offering 2017 (Private Banker International)

At Crossinvest, we do not follow. We LEAD.
WWW.CROSSINVEST.COM.SG

DISCLAIMER: The securities and/or financial instruments recommendations and comments presented should not be considered as an offer or solicitation to buy or sell securities and/or financial instruments. These investments are subject to market risks and there is no assurance or guarantee that the objectives of the recommendations will be achieved. Crossinvest (Asia) Pte Ltd relies on a variety of data providers for economic and financial market information. The data used in this report are judged to be reliable, but Crossinvest disclaims any and all liability in the event any information, commentary, analysis, opinions, advice and/or recommendations prove to be inaccurate, incomplete or unreliable, or result in any investment or other losses.

cross-insight@crossinvest.com.sg

US Equities

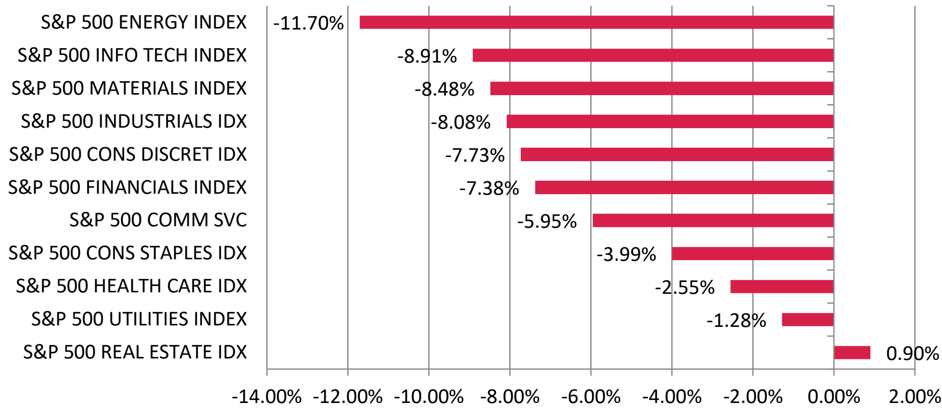


Fig 1. S&P 500 sector returns in May **Source: Bloomberg**

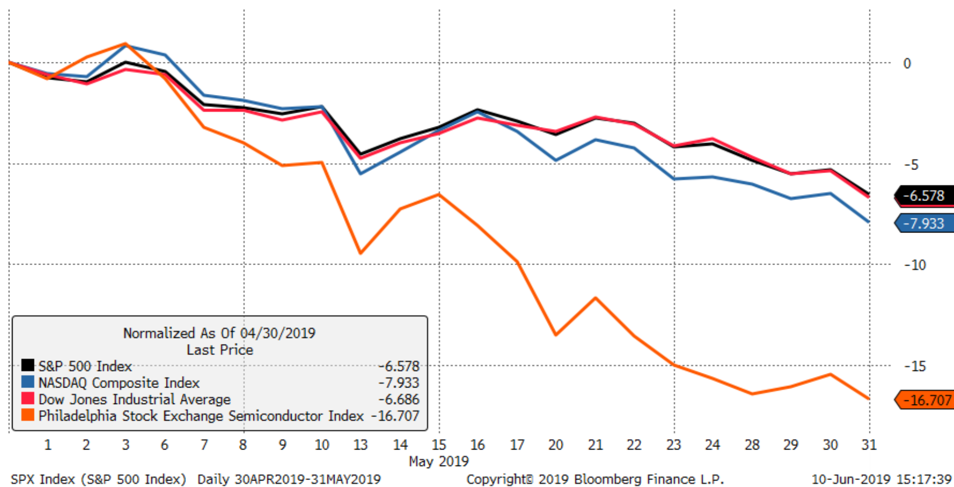


Fig 2. Relative performance of US indices **Source: Bloomberg**

Review

- All three major US indices fell significantly in May, breaking their respective 200DMA support lines. However there was some respite through a perceived Fed 'put', after FOMC comments were released in early June which saw equity markets make a broader rebound. Energy (-11.70% MoM) stocks were the biggest losers this month, led lower as oil prices fell, at least partially on the back of concerns over the impact of US tariffs on global growth (Figure 1).
- IT (-8.91% MoM) shares also saw a big fall, alongside the Nasdaq (-7.93% MoM) as growth stocks came off and investors fled into safe haven assets. Notably, a big contributor to weakness came from Semiconductor stocks, as the Philadelphia Semiconductor Index (-16.70% MoM) came off sharply from all-time highs after weaker guidance from Q1 earnings reports raised fears that an anticipated H2 2019 recovery in the industry could be delayed. This weakness extended over the past week, following antitrust concerns over the reach of Facebook and Amazon which fell 7.50% and 6.11% on the day the news broke (Figure 2)
- Data releases were somewhat mixed this month, with GDP revised lower to 3.1% YoY (vs exp. 3.0%), from 3.2% a month earlier. PPI also fell short of expectations, coming in at 2.2% YoY (vs exp. 2.3%) while industrial output fell unexpectedly by -0.5% MoM. ISM manufacturing was also disappointing, slowing for a second straight month to 52.1 (vs est. 53.0).
- Numbers from the consumer side were more supportive, with retail sales still gaining 0.2% MoM after March's blockbuster 1.7% reading, followed by consumer confidence coming back to a six-month high of 134.1 in May (vs exp. 130.0) with job expectations high and most survey respondents still seeing a strong US economy in the near-term.
- On the geopolitical front, headlines continued to be dominated by trade, first with the ramping up of tariffs on China, then subsequently an announcement on a 5% tariff for all Mexican exports effective 10 June, and for that amount to be raised by 5% every month to a cap of 25%. The latter threat, related to immigration, came from a tweet by Trump before he flew to Europe, and just a week later the threat has been removed as it seems an agreement between the two countries has been reached. If anyone doubts the unpredictability of current US behaviour, pause and consider the nonsensical nature of what is happening with Mexico.

US Equities

Outlook

- Trade and US politics will drive short term directionality in the S&P 500. We can imagine a test of the December lows although it is possible that near that level, either the Fed rescues sentiment, or Trump caves in with China and agrees a deal. It is quite possible that the US imposes 10% tariffs on the $325 billion of goods that have so far been left out of the trade war. Retaliation from China is likely. It is unpredictable and therein lies the market vulnerability.
- Whilst the Fed has talked more 'dovishly' of late we think the hurdle to cut rates is much higher than the FI markets predict at a 97.7% probability (and 82% for two cuts+) and this opens up a 'disconnect' for risk assets. We also note that, should the Fed actually cut rates this year, there is a risk that markets will worry more about perceived deeper problems that led to such action.
- Key to S&P 500 medium term will be GDP growth and earnings and we are becoming more cautious on both. We believe the trade war deterioration will have negative implications for private sector capex, discretionary consumption and weaker business and consumer sentiment thus lowering GDP activity from May onwards. It may also lift inflation. More tariffs will increase costs for S&P 500 companies and lower earnings – Goldman Sachs (GS) estimates that if a full 25% tariff across all Chinese imports was levied, S&P 500 EPS would fall by 6%, vs. the -1.5% so far. That would almost certainly result in an earnings contraction in FY19 relative to current consensus of +4% and, with a possible recession in 2020 on the cards, FY19 might be the start of a multi-year earnings cycle decline. Historically S&P 500 de-rates into an earnings decline.
- Sector action might be trickier. Historically this type of environment may have favoured growth, but the regulatory threats to big-tech (Facebook, Amazon, Google and Apple), which has a rare degree of bipartisan support in Congress, could complicate the past 'norms'. Value stocks also look cheap now.

EU Equities

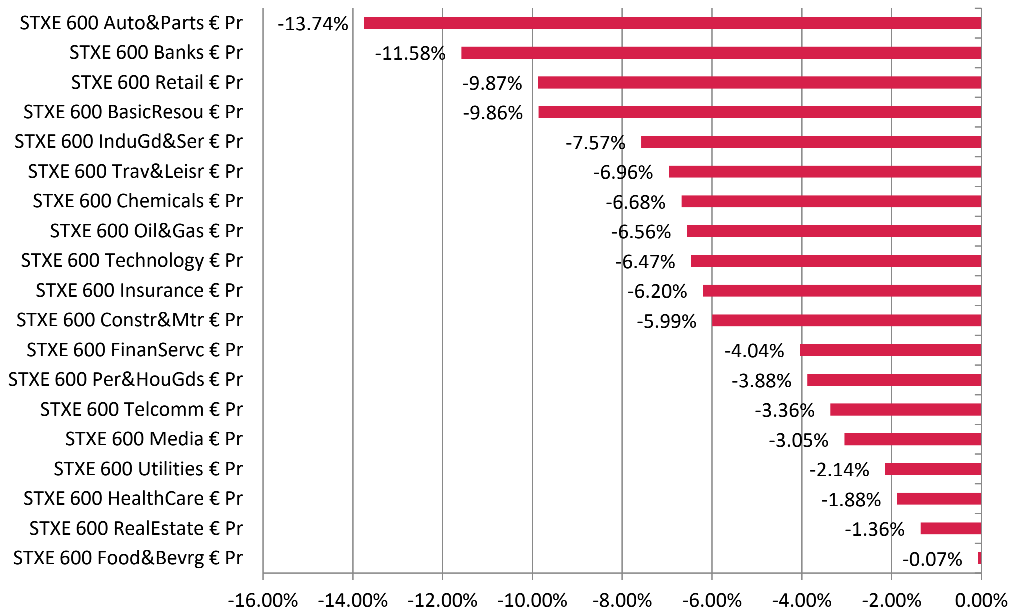


Fig 3. Stoxx 600 MoM sector performance **Source: Bloomberg**

Review

- European equities also came off, with the Stoxx 600 (-5.70% MoM) led lower by Autos (-13.74% MoM) and Bank (-11.58% MoM) stocks, followed closely behind by losses in the Basic Resources (-9.86% MoM) and Retail (-9.87% MoM) sectors. Unsurprisingly and much like their American counterparts, defensive sectors like F&B (-0.07% MoM) and Real Estate (-1.36% MoM) outperformed (Figure 3), alongside German shares in the DAX (-3.48% MoM) index which were noticeably resilient. The Stoxx Q1 EPS numbers have achieved their best result in two years, with Morgan Stanley (MS) even upgrading forecasts to +4% YoY in FY19 from a previously flat estimate.
- The region's key focus this month centred around the EU Parliament elections, which saw pro-EU parties largely staying in power. This helped alleviate concerns over a growing populist influence, although the results did seem to reflect a shift in a number of constituent nations. In Germany, there were reports that AKK was no longer viewed as heir apparent, raising concerns over Merkel's succession plans. To make matters worse, the leader of Germany's Social Democratic Party, Andrea Nahles, tendered a surprise resignation which added to fears given the key role she played in keeping the grand coalition together.
- Austria's Chancellor, Sebastian Kurz, was removed by a vote of no confidence, while Greece's Tsipras announced a general election after Syriza disappointment in EU elections. To top things off, the European Commission sent a letter to Italy's finance ministry, warning that it may take disciplinary action if Italy fails to justify its budget plans and sufficiently explain its deteriorating public debt and budget deficit. In a similar tone, the ECB also warned that trade tensions posed a key risk to growth, and a significant threat to the financial stability of the Eurozone especially if we saw a significant decline in asset prices which could trigger a second sovereign debt crisis.
- Brexit developments were not particularly supportive either, with Labour Party leader, Corbyn, calling off cross-party negotiations mid-month after six weeks of talks, calling May's offer a 'repackaged version of the same old deal'. PM May has resigned as leader of the Tory party (7 June) and will be replaced as Prime Minister once a new party leader is chosen.

EU Equities

Outlook

- Whilst the European election saw the EU ‘dodge’ a populist bullet, there is a growing risk that the battle over the appointments of senior positions in the key EU institutions, as the head of the European Commission and Draghi’s replacement at the ECB, will be contentious and may result in a weaker Franco-German relationship. Another worry is Italy’s shift towards growing support for The League, providing it with the desire to fight the EU over its higher than allowed fiscal deficit. The likelihood of the EU moving forward on further integration reforms necessary to address structural frailties in its undercapitalised banking system and fiscal system looks to be remote. Furthermore Germany looks unlikely to adopt a more reflationary fiscal approach despite its 8% trade surplus.
- Chaos continues over Brexit and a new Prime Minister is unlikely to be chosen before July. That, together with a summer parliamentary recess, and a looming 31 October deadline, means the chances of either a ‘no’ deal Brexit, or no Brexit, have risen, as have those of a second referendum. The incredibly divided nature of the debate and the lack of credible political leadership adds to uncertainty. The binary outcomes for both equities and the Pound means that these markets are being avoided.
- Whilst Q1FY19 Stoxx results were good, the outlook for earnings the rest of 2019 looks to be far more challenging as data suggests economic momentum is eroding despite positive metrics from rising wages and falling unemployment. For now, consensus is for +4% FY19E EPS growth but with Bunds yield below -20bps, and slowing loan demand, EU banks’ earnings look to be at.
- A key support for the much ‘unloved’ FTSE 100 has been its high dividend yield of over 4%, but this is now coming under severe strain as more companies are cutting these payments – in some cases by up to 50%. With GBP at near YTD-lows of 1.26 the risk is, on better Brexit news, GBP strengthens which impacts the 70%+ of earnings derived from abroad. One sector we see able to defend the dividend payouts is oil majors, and we remain positive on their outlook
- Whilst FTSE 100 might be a risky binary bet in the shorter term, should Brexit result in a major decline in GBP and domestic-demand related equities, that might be a ‘bargain basement’ time to buy.

APAC and EM Equities

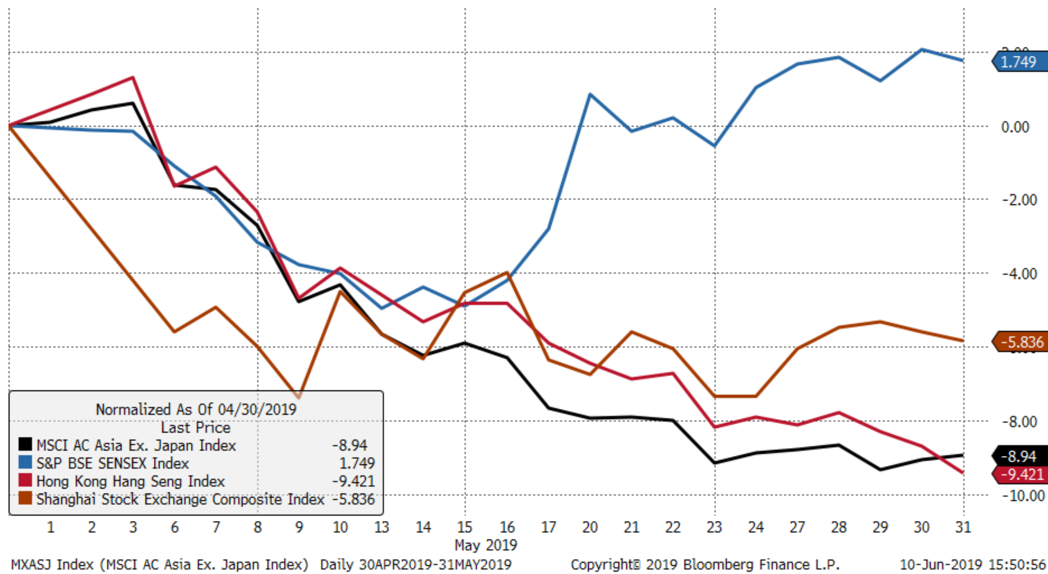


Fig 4. Sensex outperforms in the Asian region while Chinese equities weigh **Source: Bloomberg**

Review

- Shares in Asia were likewise depressed, with the broader MSCI Asia ex-Japan logging an 8.94% decline, led lower by the HSI (-9.42% MoM). However the Shanghai A-shares Index (-5.83% MoM) was relatively resilient possibly based on indications of PBOC support for the market and despite the re-escalation of trade tensions which undoubtedly weighed on China-focused stocks (Figure 4). MSCI ASEAN (-4.76% MoM) also fell, albeit from a lower base compared to the Q1 2019 rally we saw in Chinese stocks.
- Sensex (+1.75% MoM), however, outperformed the region, and pushed into all-time high territory following Modi's re-election. Investors took hope from continuity and the possibility of future land and labour reforms. Later in the month, swathe market shrugged off the news that Trump terminated India's designation as 'beneficiary developing country', disallowing duty-free allowances on some 2,000 products that were being exported to the US.
- In Indonesia, Jokowi won two-thirds of seats available in the parliament, which many viewed as a positive sign given that he now has a second term and the support needed to get reforms into law. The result announcement was marred by violence on the streets, but this was addressed fairly quickly. In Thailand, the incumbent Prayut was also elected as the country's prime minister and is now pending official endorsement from King Maha Vajiralongkorn.
- Economic data was mostly mixed, particularly as industrial output from China slowed to 5.4% YoY (vs exp. 6.6%), while profits in Chinese industrial companies fell 3.7% YoY, its quickest pace of decline since December 2015. Granted, this came off a high base of comparison last year, but slowing demand and lower manufacturing activity were flagged as concerning factors. The official manufacturing PMI also came in lower-than-expected and into contraction territory at 49.4 (vs exp. 50.1).
- There were several other GDP releases, with Japan's Q1 growth coming in better-than-expected at 2.1% YoY (vs exp. 0.2%), supported by a tick up in net exports, helped by a steep decline in imports. On the other hand, Thailand's Q1 GDP fell to four-year low of 2.8% YoY (vs est. 3.0%), while Singapore also lagged behind at 1.2% YoY (vs est. 1.5%). Both countries subsequently revised down their respective GDP forecasts.

APAC and EM Equities

Outlook

- The recent elections in India, Indonesia, Philippines and Thailand were equity market positive as the outcomes left incumbents in power with strengthened positions to undertake important economic reforms. Likewise, in South Africa, Cyril Ramaphosa lifted the ANC vote share relative to 2016 local elections with the hope he has a stronger mandate to accelerate the critical reforms required and to clean up the corruption within the ANC left over from Zuma's failed presidency. Not all was rosy around political action in EM. In Brazil, Bolsonaro's bizarre behaviour, and those of his sons, is reducing the prospect of getting meaningful fiscal reforms through the notoriously irresponsible Congress. An election in the state of Cordoba, in Argentina, saw the Peronist party regain power from Macri's coalition fanning fears a populist might win the October Presidential election. Lastly, Erdogan succeed in overturning the Istanbul city election result with a rerun later this month, so delaying the possible start of much needed economic reforms at a time Turkey is on the edge of a full-blown currency crisis.
- India's election result was the first time in over 50 years that a single, incumbent party has retained a majority in the Lower House, (it last happened in the 1970s when Indira Ghandi was in power) and this has reaffirmed Modi's position as India's reformer in chief. Arguably the more important development might be if, as seems likely, the BJP gains control of the Upper House by late 2020 that might see it then undertake the vital reforms of labour markets and in land acquisitions. With the US-China trade war redefining global supply chains, should India pass these key legislations, along with its positive demographic outlook, it could become a major beneficiary in a new world order.
- Indonesia's election not only saw Jokowi win by a larger majority than in his first election, but his coalition won a two-third majority in the Parliament. This will give him the ability to accelerate economic reforms, particularly in labour markets, which are critical to lifting Indonesia's GDP growth rate and enabling it to be more competitive at a time China is losing ground. Indonesia, like India, is less exposed to the dangers of a protracted trade war and strategic confrontation between PRC and USA. This contrasts with North Asian countries such as Japan, South Korea, and Taiwan, and more open trade economies such as Vietnam, Singapore, Malaysia and Thailand all of which could be badly damaged by the 'giants' if forced to choose sides.
- Vietnam may be put on the watch list to be upgraded to MSCI EM status this month which would put it on the fast track to index inclusion as early as 2020 or, more likely, 2021. Vietnam could well repeat its position as the fastest growing APAC economy this year and remains in a strong position to benefit from global supply chains shifting out from China, not least by Chinese companies seeking to diversify away from trade risks and costly labour.
- A-shares outperformed Hong Kong last month helped by higher weighting in MSCI EM and likely buying support from Chinese government backed funds. Our base case is the greater the trade related damage to the economy, the more intense the fiscal and monetary policy reflation into the domestic economy. As such we remain constructive on Chinese equities, including Banks, Insurance, Autos and Property that offer value, as wells as in consumer related plays like Alibaba and Tencent.

Fixed Income

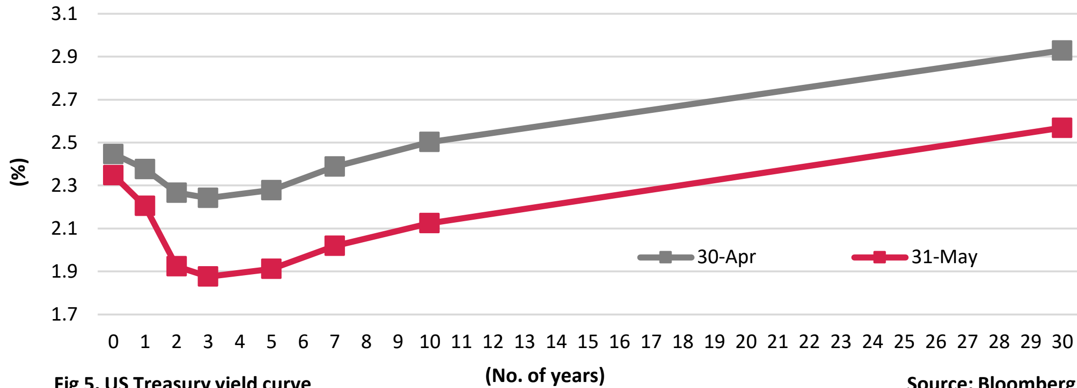


Fig 5. US Treasury yield curve **Source: Bloomberg**

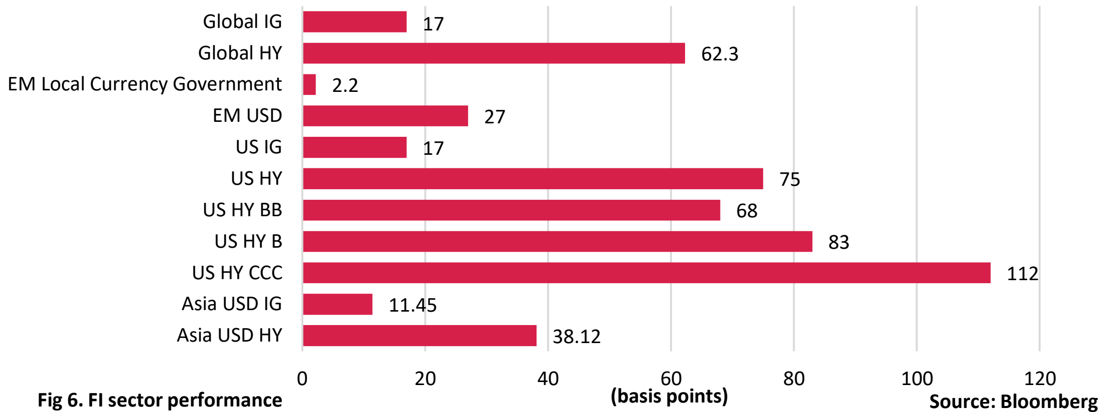


Fig 6. FI sector performance **Source: Bloomberg**

Review

- Sovereign yields fell sharply in May amid worsening trade environments between US and two of its biggest trade partners - Mexico and China. The UST yield curve saw a parallel shift downwards, with 2Y yields and longer falling by more than 30bps. The 3M/10Y spread turned negative again in the last week of May and remained below zero through the first week of June (Figure 5). The 2Y and 10Y ended the month at 1.9221% and 2.1246%, falling 34.40bps and 37.72bps MoM. These are the largest MoM falls seen in 4.5 years and 10.5 years respectively.
- Powell's statement on Tuesday (4 June) implied that the Fed is now open to cutting rates if necessary. Recent comments from Bullard and other voting members of the Fed seem to echo Powell's statement, raising expectations that rates will be cut this year.
- Inflation data have not been supportive, with the US core PCE YoY remaining persistently below the Fed's 2% target. The same has been apparent in Europe, with the core CPI YoY fluctuating around 1% in recent months. The May Eurozone core CPI fell sharply to 0.8% from 1.3%, leading German 10Y bunds yield to fall 21.5bps and further below zero to -0.202% – a new all-time low.
- UST volatility has also increased significantly in May. Merrill Lynch's MOVE index, which tracks volatility of USTs, rose significantly from 49.47 to end the month at 72.68, a 2Y high. It continued to rise to 77.64 as at 5 June, a level not seen since January 2017.
- Recent developments also saw JP Morgan cutting its yield forecasts to reflect two rate cuts this year – one in September and one in December. However, this view is in contrast with those of UBS and GS, both of which believe a cut in September is highly improbable.
- Performance in credit markets was mixed, but the risk-off mood in May saw a rotation into safer bonds. While spreads widened across all sectors (Figure 6), the rally in USTs was able to offset the slightly smaller spread widening of investment grade (IG) bonds. As measured by the Bloomberg Barclays indices, global and US IG bonds returned 0.68% and 1.43%, significantly outperforming their high yield (HY) counterparts (Global HY: -1.04%; US HY: -1.19%). In fact, May was US HY's first MoM loss and its worst month since the rout in December last year. Unsurprisingly, the CCC performed the worst with total returns of -2.73% and spreads widening 112bps.
- Lipper Fund Flows data also reflected the same sentiments, with UST funds seeing the highest cumulative inflow in May. IG funds were seeing significant inflows up till the last week with IG funds seeing the largest WoW outflow since December 2015 (Figure 7 on next page).
- Asian USD debt and EM hard currency debt also managed to close the month higher while EM local currency debt was flat. Of notable concern was S&P's decision to upgrade Indonesia's sovereign credit rating by one notch to BBB after the re-election of Jokowi, citing prudent fiscal policy and strong growth prospects relative to its peers with similar income levels.

Fixed Income

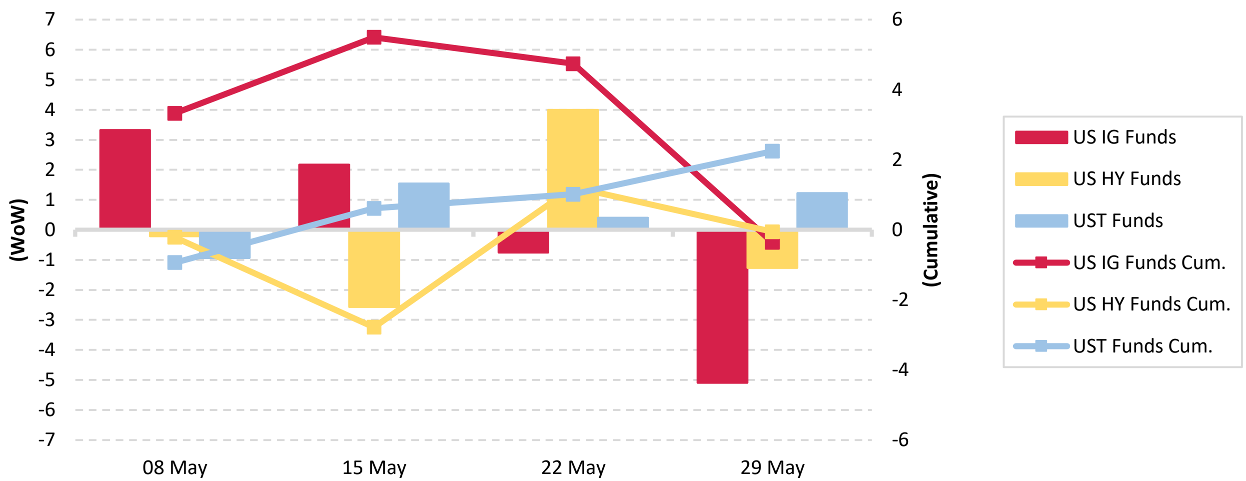
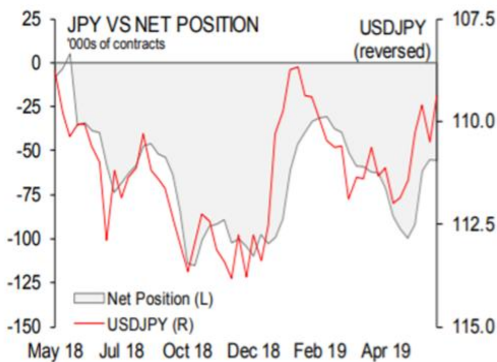


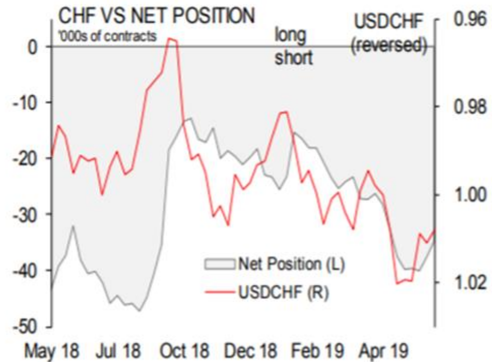
Fig 7. FI fund flows in May **Source: Bloomberg**

Outlook

- We think USTs have been overbought and agree with houses like UBS and GS that the market's reaction is likely overdone. The Fed has historically been all about rhetoric and has seldom acted on its words, and it is likely Powell will continue doing this. To reiterate earlier comments, the US economy is not all that bad, with recent economic data coming in mixed. On the other hand, while we think Bunds are a structural short at these levels, we think that this negative yield could well remain in the short-term.
- We also do not think US HY debt will continue the trend it saw in May and see no reason to avoid it. Fundamentals of the sector remain positive, especially with Q1 earnings still strong. However, more consideration will have to be given to adding to US HY FI. With the sector still up 8+% YTD, this modest pull-back does not offer much upside.
- Asian credits should continue to see strength in the short-term. Election positives from the results in the region should help support economic growth in the region and should be credit positive, especially for countries like Indonesia and India. In addition, a huge part of Asian credit, especially in the HY space, is made up of debt from Chinese real estate developers, which are seen to be less affected by trade concerns. The sector might even benefit should the Chinese government decide to reflate the economy.

FX





JPY — NON-COMMERCIAL POSITIONING

	($MM)	Position - Contracts of 12.5MM JPY				
Date	Net	Long	Short	Net	Net w/w	Open Int.
28-May	-6,351	25,803	81,380	-55,577	-385	169,790
21-May	-6,243	27,540	82,732	-55,192	6,388	170,834
14-May	-7,023	35,915	97,495	-61,580	30,137	180,573
7-May	-10,398	25,869	117,586	-91,717	7,882	201,462

CHF — NON-COMMERCIAL POSITIONING

	($MM)	Position - Contracts of 125,000 CHF				
Date	Net	Long	Short	Net	Net w/w	Open Int.
28-May	-4,301	4,644	39,319	-34,675	2,820	85,660
21-May	-4,635	5,270	42,765	-37,495	2,515	88,283
14-May	-4,958	7,646	47,656	-40,010	-431	93,782
7-May	-4,852	12,383	51,962	-39,579	167	101,595

Fig 8. Non-commercial positioning of haven currencies

Source: Scotiabank FX Strategy, Bloomberg & CFTC

Review

- Since April, volatility in the G7 pairs recovered further in May mainly due to developments in the trade war. Aside from the escalation between China and the US, Trump began to shift the narrative towards the EU and Japan, as well as Mexico. Concerns around global growth grew further and markets have started to price in up to two Federal rate cuts by the end of 2019.
- The dollar weakened and conventional safe havens, such as JPY and CHF, gained significantly. Concerns around the slowdown of growth contributed to the weakness in equities, which in turn strengthened the havens. Housing data, durable goods orders, ISM production as well as retail sales all reported lower and further weighed on the dollar. CFTC reports show both CHF and JPY shorts unwinding with JPY shorts reporting -117k to -81k and CHF shorts from -52k to -40k (Figure 8).
- The Australian dollar dipped from 0.7090 to 0.6901 in May. Weighed down by what was seen as an unlikely win by the conservative party, we now believe the 0.70 support will become a resistance between Q3 and Q4. The RBA cut rates by 25bps to 1.50%. This had already been priced in by markets and a further cut is expected.
- Sterling continued its descent and experienced a very depressing month of trading. As we have noted in our previous reviews, Brexit continues to steer the pound. Theresa May's resignation and what remains of the political leadership have all but confirmed that uncertainty in the pound will continue.
- The Thai Baht stood out in terms of strength and finished 1.78% stronger against the dollar. A mix of electoral results and a downgrade of the Thai economy's growth from 4% to 3.8% caused initial weakness before being supported by local bond purchases as well as relatively small equity outflows. Q1 GDP growth reported 2.8% vs. Q4 2018's 3.6% on account of a sharp fall in exports.
- Aside from the Thai Baht, the INR also came in close behind in terms of strength. With electoral clarity, Modi's single party victory received strong support from foreign investors. This caused the INR to quickly strength beyond 70.53, the monthly low in May.

Outlook

- We remain of the view that the dollar remains the least bad currency amongst all developing markets FX. The US economy remains robust and we expect the rebound in yields to be supportive for USD. In addition, we expect the real yield differential between US and EU to widen, providing greater support to the DXY, which is made up largely by EUR. Despite DXY's fall below its 97.50 support, we think it is too early to call the end of the USD strength, notwithstanding various FOMC members' best attempts to talk it down with 'dovishness'.
- GBP will likely continue to trade in a range given the lack of clarity in Brexit. The Brexit chaos is unlikely to be sorted out till end September and the news flow there will continue to direct the currency.
- With AUD currently trading around the 0.7 level, we think it is not pricing in the current weakness in the economy – economic momentum is slowing while the country experiencing a collapse in its housing market and risks from the US-China trade war. As mentioned, we see 0.7 as a new resistance level.
- AXJ FX finished relatively flat against the wandering dollar bar the Chinese Yuan, which weakened -2.53% against the dollar amidst the re-escalation of the trade war. Markets must watch closely for signs that the 7 level may be allowed to slip.

Commodities

Review

- Oil prices ignored physical market data (for the most part) despite OPEC+'s further co-operation and output cut extensions. Iranian tensions caused exports to plummet, despite the change in sales towards China. Data suggests that Iranian exports fell to 500k/bpd in May, more than half of what was seen in April.
- We believe oil reacted more towards the build-up of US inventories. As we have noted in April's review – Brent's failure to break past $75 caused it to return to its familiar support around the $70 region. Concerns around global growth slowing caused traders to lower their net long positions, causing oil to end the month of May at $63. Inventory reports came out mixed) however all data releases failed to be in line with negative forecasts.
- Gold had a quiet start in May before ending $50 higher. The surge was in part due to its safe haven status as equities sold off amidst the trade war escalation as well as a weaker dollar. On technicals, we expect to see a reversal in Gold's stellar jump. Since 2017 to 2018, Gold has failed to break above 1360 and so it remains a significant and well-tested resistance level. In 2019, Gold has failed to trade at and break above 1350.

Outlook

- Oil bounced off a key support at $60/brl Brent this week and this proved to be a major support previously – next down is $55/brl. We think much of the fall is technical related to gross long positions being unwound beyond simply some fundamental negatives. We do not believe the weak oil price will persist given the tensions in the Middle East, OPEC's clear commitment to production quotas – especially, Saudi Arabia – even if Russia seeks a release in the June meeting and supply side reductions regarding troubles in Libya, Venezuela, Algeria etc. and US sanctions on Iran. The extraordinary ability of US shale oil to increase production to a record 12.5mn/bpd will cap the upside but, to a degree, limit the downside as producers are very quick to respond to price movement. At the year-end environmental requirements will force ships to burn lower sulphur bunker oil that will increase demand for middle distillates by 2-3mn/bpd and that is meaningful. This might be an opportune time to add to Oil majors.
- Gold may well advance to test a multi-month high above $1,340/Oz and conditions are in place for this to go higher should we be closer to the USD peak at a time UST yields offer limited compensation and less capital upside. Speculative selling much for of this year has removed a source of downward pressure and might become a source of demand alongside steady EM central bank buying. As we enter a riskier global outlook gold's insurance attributes and as a portfolio diversifier will boost its appeal.