CROSSMONTHLY

February 2020

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REVIEW

Markets were risk on at the start of January on the back of optimism around the successful signing of the US-China phase one deal and the easing of US-Iran tensions. However, that was quickly forgotten and reversed following the coronavirus outbreak, which led to an extended holiday in China and the cancellation of several inbound flights to China by multiple airlines. Fears around the virus eventually impacted the tourism and retail sectors, and weighed on sentiments around global growth, leading to selloffs in the later part of the month.

Fears around a slowdown in global growth directly impacted oil prices, with the Brent oil price erasing its December 2019 gains while it heads lower towards a near term support of $50. Inversely, Gold climbed further to reach highs of $1,611 per ounce before stabilising between $1,580 and $1,550 amid risk-off sentiments

Global equities fell, ultimately dragged lower by Asian equities which bore the brunt of the coronavirus selloff. In fact, the month ended with most major equity indices in the red year to date (YTD), with only Nasdaq remaining positive. However, the tapering of concerns around the virus in the first week of February saw US equities continue to outperform other regions and eventually went back on track to notch fresh all-time highs.

The risk-off sentiment throughout January also helped support Fixed Income (FI) as demand for sovereign debt, notably US Treasuries (UST), increased. This led to the UST 10Y yield falling to a key support of c. 1.50% at the end of the month before rebounding in the first week of February. Fund flows into higher quality bond ETFs also dominated this month as markets took risk off amid concerns that the virus will impact corporate earnings.

The risk-off sentiment also led to increased volatility in the FX market and saw the USD strengthen considerably, with the DXY climbing to 98.50 in the year to 6th Feb – its highest in four months. On top of concerns around the coronavirus, GBP also weakened last week amid potential UK-EU trade complications after Johnson and Barnier clashed over rules around post-Brexit trade arrangements.

OUTLOOK

How the markets react on the back of the corona virus that seems to have captured everyone's attention is any ones guess. One thing is certain though – Xi, the Communist Party of China (CCP)and the China model, have suffered an enormous blow to their pride.

One of the ways, and perhaps the only way, Xi and CCP, can respond is to throw everything they can at containing this virus and to more aggressively reflate the Chinese economy. China’s unilateral decision to halve trade tariffs is clearly positive, especially if Trump responds graciously, which he is likely to.

There is no doubt the virus is Xi Jinping's biggest challenge since taking over in 2012. The Communist Party of China (CCP), and XI, have suffered an enormous blow to their prestige and the China 'model‘ as a result of this virus. By jettisoning trade tariffs, Xi is putting the economy ahead of principle. This is positive for the economy and for equities and reduces risk.

There are three likely scenarios:

- Infection rates rise aggressively and continues to worsen until well into Q2 which is likely to have greater impact on GDP growth in China, Asia ex-Japan and even globally;
- Markets have already priced in the impacts of the virus based on where we are now, i.e. nasty but not likely to cause any long term damage;
- The infection rates peak in February and then stabilise prompting a further risk rally.

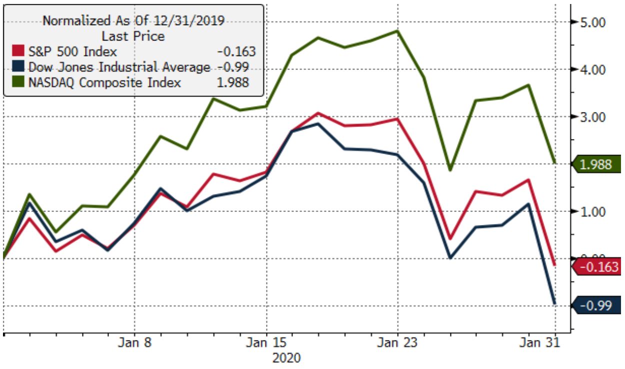
We continue to closely monitor the developments and are ready, from an investment perspective at least, to manage the underlying investment opportunities and risks.

Elsewhere, S&P 500 companies’ earnings reports in Q4 are beating consensus forecasts handily whilst recent macroeconomic data in US is positive, as is a robust ADP report. These are fundamentally important for risk assets. Whilst we should be cautious in the short-term now equities have rebounded strongly with US equities at fresh all-time highs, the medium- to long-term case that there is no alternative (TINA) to equities remains in place.

Equities

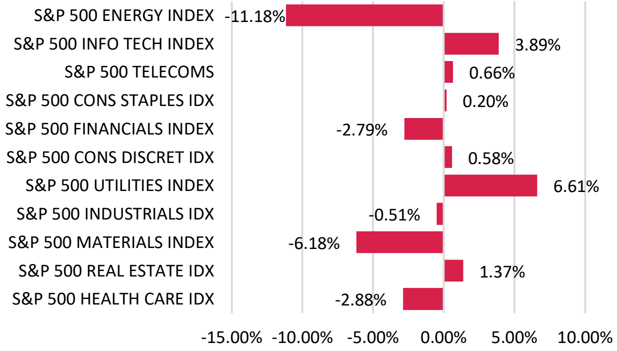
The S&P 500 (-0.16%) lost most of its mid-month gains to close the month mostly flat (Figure 1), while DJIA (-0.99%) performed likewise, weighed lower by a steep decline in Boeing. Nasdaq (+1.99%) managed to hold on to some gains, with tech stocks again outperforming on the back of several earnings beats from the likes of big hitters such as IBM and Facebook.

Figure 1: US indices returns



Source: Bloomberg

Figure 2: S&P 500 sector returns



Source: Bloomberg

The risk-off appetite from investors saw moves out of Materials, Financials and Healthcare, while Utilities outperformed alongside IT, which remained surprisingly resilient despite the run-up it had already seen. Energy underperformed significantly, though understandably so as oil prices likewise came sharply off January highs (Figure 2).

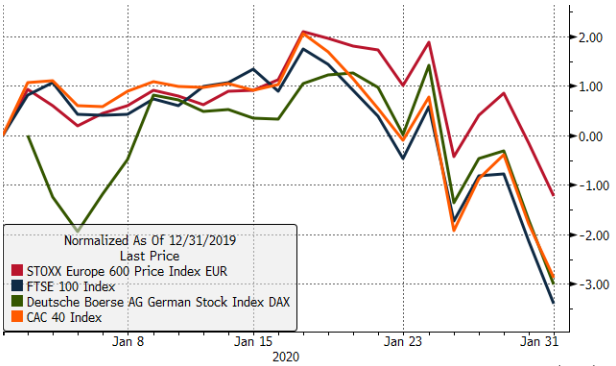
Macroeconomic data was generally supportive in Dec, with ISM Manufacturing PMI rebounding sharply in January to 50.9 (vs est. 48.5), while CPI rose 2.3% year on year (YoY) (vs est. 2.4%) in December. Housing starts rose 16.9% month on month (MoM) (vs est. 1.1%) to a 13Y high as lower mortgage rates, along with higher wages and low unemployment helped buoy demand. Overall, GDP grew at an annualized 2.1% on 4Q19 (vs est. 2.0%), the same as the prior period although consumer spending moderated, and business investment continued to deteriorate. Notably, NFP also fell short of expectations, rising +145k in December (vs. est. +160k) although this came after a strong print in November.

Earnings season is also ongoing, with close to half of all S&P 500 companies having reported as of 31st Jan. Of the 45% that did, 69% reported a positive EPS surprise, while close to two-thirds reported a positive revenue surprise. The current estimated earnings decline in 4Q19 sits at roughly -0.3%, while estimates sit closer to -1.6%.

Equities

Shares in Europe were likewise down across the board, with shares in the UK leading losses, while the French CAC 40 trailed behind. In terms of data, German manufacturing PMI in January rose to 45.2 (vs est. 44.5), while the overall Eurozone figure came in at 47.9 (vs est. 47.8) compared to 46.3 a month earlier. The move, despite it still being a contraction, is its strongest reading since April 2019. Separately, ECB's chief economist expressed his view that rising labour costs would eventually re-ignite inflation in the region, expressing confidence that the ECB was on track toward its inflation goals.

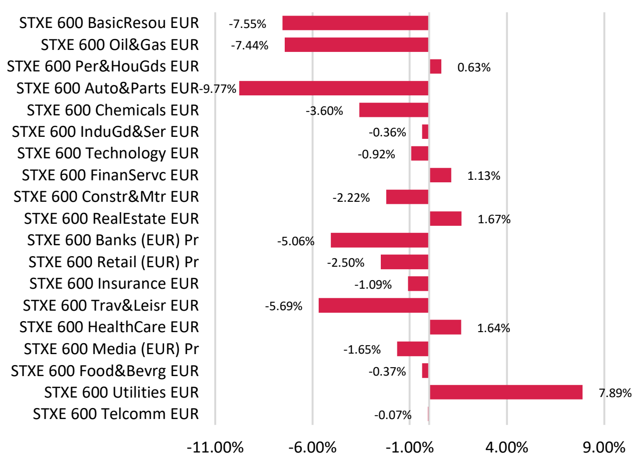
Figure 3: European regional indices total returns



Source: Bloomberg

Utilities outperformed significantly, no doubt a result of a risk-off move into defensives, while Basic Resources and Oil & Gas were key laggards. Autos underperformed significantly amidst renewed fears that Trump would impose stricter tariffs on European carmakers (Figure 4).

Figure 4: Stoxx 600 sector returns in December



In Asia, equity markets were undoubtedly alleviated earlier in January by the news over trade – China understandably one of the top gainers in the region. HSI also rallied, in part off the back of this news, but also as tension on the streets appeared to have tapered off toward the holiday season. MSCI Asia ex-Japan gained, while Japan and Sensex lagged the broader region. This was however quickly erased following the outbreak of the coronavirus.

Asian markets bore the brunt of the selloff sparked by the outbreak of the coronavirus, with the MSCI Asia ex-Japan Index (-4.45%) logging steep declines for January, while the SHASHR (-2.41%) and HSI (-6.66%) were still on their Chinese New Year holiday when the month ended. Nikkei (-1.91%) also closed lower, while MSCI ASEAN (-5.16%) underperformed the broader region.

New data also showed China's GDP grew +6.1% in 2019, down from +6.6% a year earlier to its slowest pace in 29Y. The results were however, largely in-line with economists' expectations and the government's target of 6% to 6.5%. Industrial output grew 6.9% in 2019 (vs est. 5.9%) while FAI picked up for the first time since June to grow 5.4% in 2019 (vs est. 5.2%), signalling a firmer recovery could be underway.

Source: Bloomberg

Fixed Income

Fixed income markets were risk off as well as we saw rotation into higher quality debt. Flows moved back into sovereign debt, with USTs outperforming all other sectors in the asset class (Figure 5). Prices rose and yields fell across the UST curve, with the 10Y yield falling to a support at c. 1.50%. This led to duration spreads flattening (Figure 6), with the 3m/10y inverting momentarily towards the end of January, reviving memories of growth fears seen last year.

The FOMC also had its first meeting of the year and kept its key interest rate unchanged while indicating that monetary policy will stay on hold. Markets expected this and had little reaction to the news. However, the FOMC raised the IOER and overnight repo rates by 5bps each to 1.6% and 1.5% respectively and said it would continue expanding its balance sheet into 2Q20. It also tweaked its language to say that current monetary policy is appropriate to support inflation "returning" to the 2% target, from saying prices were "near" the goal. Powell clarified in his post-meeting comments that the new language was meant to clarify that the central bank is "not comfortable with inflation running persistently below" the 2% goal.

Looking at other parts of the world, JP Morgan estimates that the net supply of euro-area sovereign bonds this year will amount to EUR 188bn, the lowest since 2008. This comes against a backdrop of lower borrowing costs and is lower than the EUR 240bn ECB pledged to buy under its bond-buying program. The expected slowdown in issuance of sovereign debt in the region saw auctions in Spain and Italy during the month draw record demand.

Global credit spreads all widened too, though a fall in sovereign yields helped cushion the impact. US HY spreads widened the most to reverse the narrowing seen in Dec (Figure 7) as concerns around the coronavirus, and its potential impact on the economy and corporate earnings, led investors to pull funds out of the sector. UBS noted that the concerns around the virus led to $2.2bn worth of outflows from bond funds since 24th January. Global HY issuance was also strong up till the last week of the month. Data from Dealogic showed that global HY bond issuance in Jan amounted to $73.6bn, exceeding any other monthly total over the past 25 years.

Figure 5: FI sector returns in December and 2019

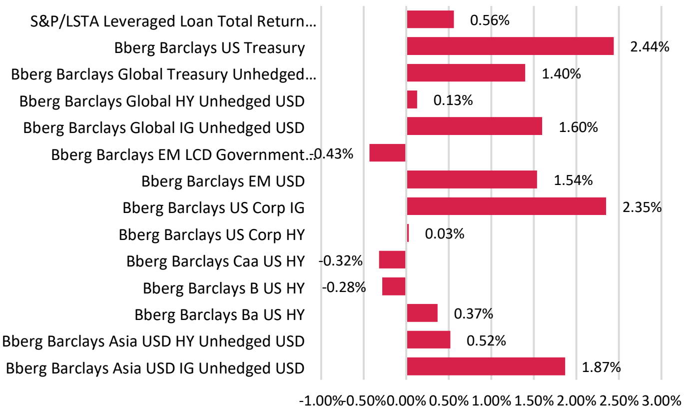


Figure 6: UST yield curve comparison between Dec 2019 and Jan 2020

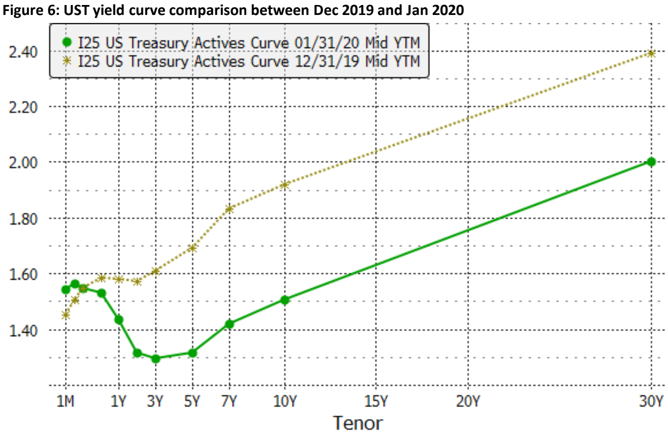
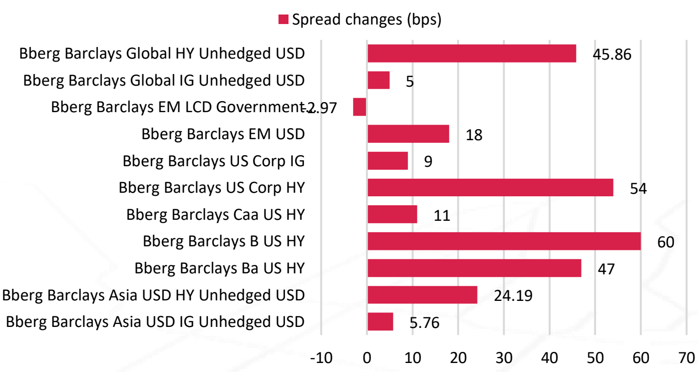


Figure 7: Credit spreads widen to reverse December's tightening



Source: Bloomberg

Elsewhere, JP Morgan credit analysts have lowered forecasts for US HY returns, spreads and yields for 2020 following a strong rally for the debt in December. It slashed its return outlook to 6% from 7.5% initially seen in late November. YE20 yield forecast was also cut to 6% from 6.25%, and spreads to 425 basis points over Treasuries from 440bps. This does not change our preference for riskier debt over IG as valuations in the latter remain rich. However, given the late cycle environment we are in, we continue to advise investors to remain cautious when dealing with the risker end of the credit quality curve.

Concerns around the virus also affected primary issuances in AxJ. Prior to the escalation of the illness, sales of Asia dollar bonds rose to $42.5bn in January – a record for issuance levels in any January. However, the virus, coupled with the Lunar New Year holidays, saw issuance come to a standstill in the last two weeks of the month. Despite this, we remain positive on AxJ FI. On top of the reasons highlighted last month – reflation in Asian economies; positive technicals – we remain of the view that central banks in Asia have the willingness, and the ability, to cut rates still. Apart from wanting to support their economies amid the viral outbreak, central banks will undoubtedly move to cut rates to prevent their currencies from strengthening too much as the hunt for yield brings fund flows into the region.

FX

Concerns around the coronavirus saw USDCNH break above 7 again momentarily and caused a spike in volatility in the rest of the world. As for the rest of Asia, investors began to assume the worst; tourist and export-based economies such as Australia (AUD -3.74%), Thailand (THB -3.69%), S. Korea (KRW -2.86%) and Singapore (SGD -2.86%) were affected the most YTD (6th February).

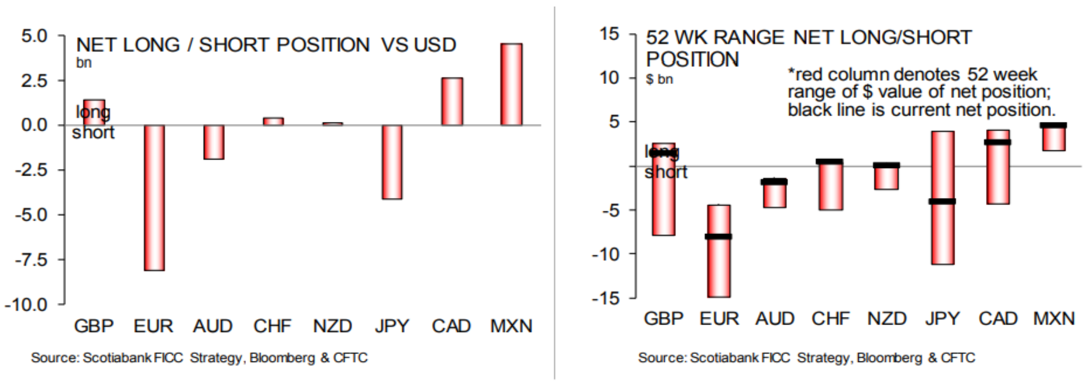
The relative outperformers YTD in Asian FX were IDR (+1.67%), INR (+0.26%), PHP (-0.24%) and VND (-0.20%) as investors favoured higher yielding FX and as oil prices fell. In the G7 space, JPY experienced a healthy bout of volatility as traders rode the 107 to 110 range as shown by positions as uncertainty rocked markets (Figure 8).

The remainder of the G7 currencies also weakened as the ultimate haven, the dollar, supported by the resilient consumer, once again led the charge. The DXY climbed from 96.40 to 98.50 YTD (6th February). GBP and EUR also led losses (aside from AUD) as traders unwound longs (GBP) and remained bearish (EUR).

In the coming months, aside from an overall slowdown/weakness in FX, we continue to see further weakness in the AUD, THB, KRW, and SGD as the economic damage from the coronavirus seeps its way into trade related data and of course, tourism.

However, the damage is reparable. Countries affected by the coronavirus have reacted much quicker to contain, mitigate and attempt to treat the virus. Although we understand the asymptomatic attribute may drive fear, we do not believe this fear will last forever. China, much different than it was in 2003, is much more capable in stabilizing and stimulating its economy using state-owned entities. Like we have seen for the second time on 31st Dec, the Reserve Requirement Ratio was cut once again and as we write this, China has ordered state-owned funds, lenders as well as brokerages to pump liquidity to virally affected parts of its economy.

Figure 8: Long/Short positions against USD



Source: Bloomberg

Commodities

The Brent oil price experienced a tumultuous start to the year as it fell from its high of $71/bbl (from Iran-US tensions from the death of Iranian General Soleimani and the signing of Phase One of the trade deal) before ultimately falling amid fears of a global slowdown from the coronavirus. This prompted a rapid unwinding of long positions that caused Brent to reverse all its gains from December 2019 (Figure 9).

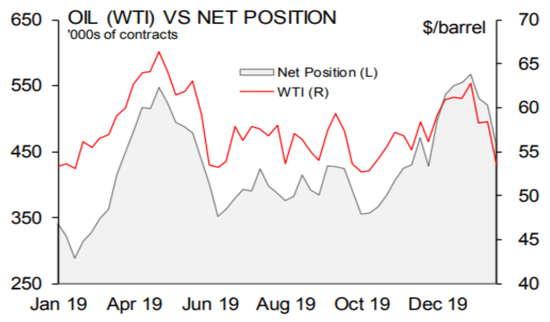
Inversely, Gold climbed further to reach highs of $1,611 per ounce before stabilising between $1,580 and $1,550.

We believe that the virus will continue to take center stage for commodities and metals as the demand for energy falls, particularly due to the slowdown of auto-manufacturing economies in Asia. This will in turn lead to a build-up in inventories as we believe demand growth will slow for the better part of 2020.

We see further room for Brent to fall before finding support at the $50 region due to three reasons – a recent OPEC+ emergency meeting was called for (OPEC+ officials recommended 600kbpd of additional cuts in output, but Saudi Arabia and Russia are at odds around this decision); positioning still places investors net-long and therefore more room for a sell-off; the coronavirus' pressure on China might hamper its growth in the short-term and affect near-term demand (some Chinese commodity companies are reportedly claiming force majeure on some of their contracts).

Although concerns of the coronavirus infection rate will continue to weigh down on oil, we believe OPEC+ policy revisions and a slowdown in fears (as markets tend to do) will place a floor on the oil price within the coming month.

Figure 9:WTI Oil vs Net Position



Source: Scotiabank FICC Strategy, Bloomberg & CFTC

NYMEX Crude — NON-COMMERCIAL POSITIONING

Date	($MM) Net	Position - Contracts of 1000 barrels Long	Short	Net	Net w/w	Open Int.
28-Jan	24,695	588,255	126,493	461,762	-58,806	2,172,019
21-Jan	30,370	599,228	78,660	520,568	-9,744	2,146,832
14-Jan	30,880	610,444	80,132	530,312	-36,960	2,215,893
7-Jan	35,568	639,009	71,737	567,272	12,415	2,244,930

Markets

Name	31.01.2020	31.12.2019	MTD	YTD	Total Return MTD	Total Return YTD
Equities						
MSCI ACWI Index	558.62	565.24	-1.17%	-1.17%	-1.08%	-1.08%
S&P 500	3225.52	3230.78	-0.16%	-0.16%	-0.05%	-0.05%
DJIA	28256.03	28538.44	-0.99%	-0.99%	-0.89%	-0.89%
NASDAQ	9150.94	8972.60	1.99%	1.99%	2.03%	2.03%
RUSSELL 2000	1614.06	1668.47	-3.26%	-3.26%	-3.21%	-3.21%
Russell Top 200	778.25	775.87	0.31%	0.31%	0.44%	0.44%
STOXX 600	410.71	415.84	-1.23%	-1.23%	-1.17%	-1.17%
Euro Stoxx 50	3640.91	3745.15	-2.78%	-2.78%	-2.63%	-2.63%
FTSE 100	7286.01	7542.44	-3.40%	-3.40%	-3.36%	-3.36%
MSCI AXJ	657.52	688.27	-4.47%	-4.47%	-4.45%	-4.45%
Stock Exchange of Thailand	1514.14	1579.84	-4.16%	-4.16%	-4.11%	-4.11%
Jakarta Composite	5940.05	6299.54	-5.71%	-5.71%	-5.68%	-5.68%
Philippines Stock Exchange	7200.79	7815.26	-7.86%	-7.86%	-7.87%	-7.87%
NIKKEI 225	23205.18	23656.62	-1.91%	-1.91%	-1.91%	-1.91%
KOSPI Index	2119.01	2197.67	-3.58%	-3.58%	-3.58%	-3.58%
Nifty 50	11962.10	12168.45	-1.70%	-1.70%	-1.68%	-1.68%
S&P BSE SENSEX 30	40723.49	41253.74	-1.29%	-1.29%	-1.27%	-1.27%
Straits Times Index	3153.73	3222.83	-2.14%	-2.14%	-2.05%	-2.05%
Hang Seng Index	26312.63	28189.75	-6.66%	-6.66%	-6.66%	-6.66%
Shanghai Comp	2976.53	3050.12	-2.41%	-2.41%	-2.42%	-2.42%
SHANGHAI A SHARE	3118.92	3195.98	-2.41%	-2.41%	-2.42%	-2.42%
S&P/ASX 200	7017.22	6684.08	4.98%	4.98%	4.99%	4.99%
MSCI AC ASEAN Index	758.00	799.24	-5.16%	-5.16%	-5.10%	-5.10%
MSCI EM Ex. Asia Index	1388.08	1464.50	-5.22%	-5.22%	-5.14%	-5.14%
MSCI EM Asia Index	540.61	566.11	-4.50%	-4.50%	-4.49%	-4.49%
MSCI EM Index	1062.34	1114.66	-4.69%	-4.69%	-4.66%	-4.66%
Fixed Income					**MTD bps**	**YTD bps**
US10YT Yield	1.5068	1.9175	-21.42%	-21.42%	-41.07	-41.07
US2YT Yield	1.3132	1.5691	-16.31%	-16.31%	-25.59	-25.59
Bunds 10Y Yield	-0.4340	-0.1850	-	-	-24.90	-24.90
Global Investment Grade	518.20	511.67	1.28%	1.28%		
Global High Yield	1416.37	1414.56	0.13%	0.13%		
Forex						
EUR	1.1093	1.1213	-1.07%	-1.07%		
JPY	108.3500	108.6100	-0.24%	-0.24%		
SGD	1.3648	1.3459	1.40%	1.40%		
GBP	1.3206	1.3257	-0.38%	-0.38%		
AUD	0.6692	0.7021	-4.69%	-4.69%		
US Dollar Index	97.3900	96.3890	1.04%	1.04%		
China RMB Spot Currency	6.9426	6.9632	-0.30%	0.93%		
Offshore Deliverable CNY	6.9984	6.9617	0.53%	0.53%		
Gold/Oil						
Brent Crude	58.16	66.00	-11.88%	-11.88%		
Generic 1st Crude Oil, WTI	51.56	61.06	-15.56%	-15.56%		
Gold Spot Price	1589.16	1517.27	4.74%	4.74%		