



SEMINARS **Majoring on the Macro**

Macro economic update, June 2019

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June 2019



Learning objectives

- **Discuss:** the current global macro-economic environment
- **Describe:** the possible effect on asset prices
- **Understand:** which economic conditions are more fundamental and longer term in nature; and which are less fundamental but likely to cause shorter term noise and asset price volatility
- **Provide:** you with a narrative of current events to assist with client conversations

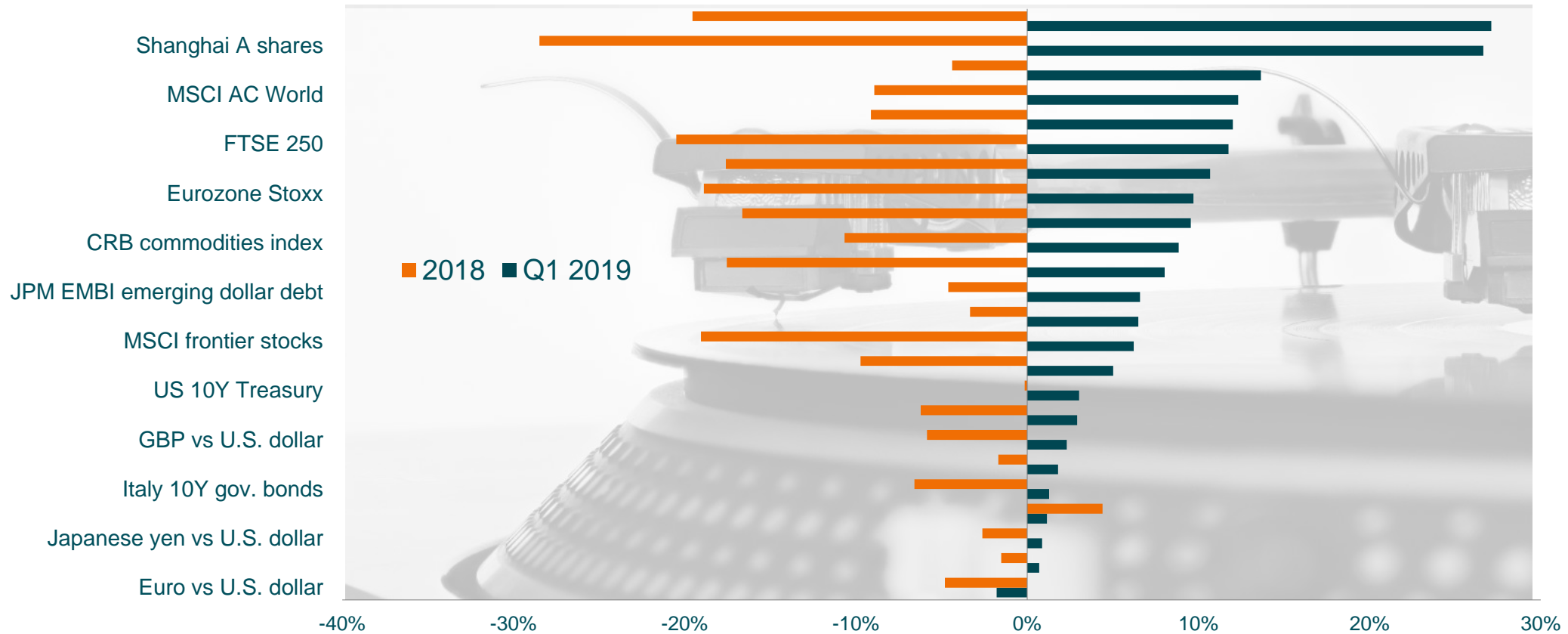
A top-down view of a vinyl record on a turntable. The record is black with a yellow and green label in the center. A tonearm with a red stylus is positioned over the record. The turntable is silver and has a black dust cover partially visible. The text "Feels like a stuck record?" is overlaid in white, bold font across the center of the record.

Feels like a stuck record?

The needle has shifted

Mirror image: Fed pivot has supported risk assets in 2019

Asset class performance (USD)



An unwinding of exaggerated risk aversion in 2018

A constant state of 'surprise'

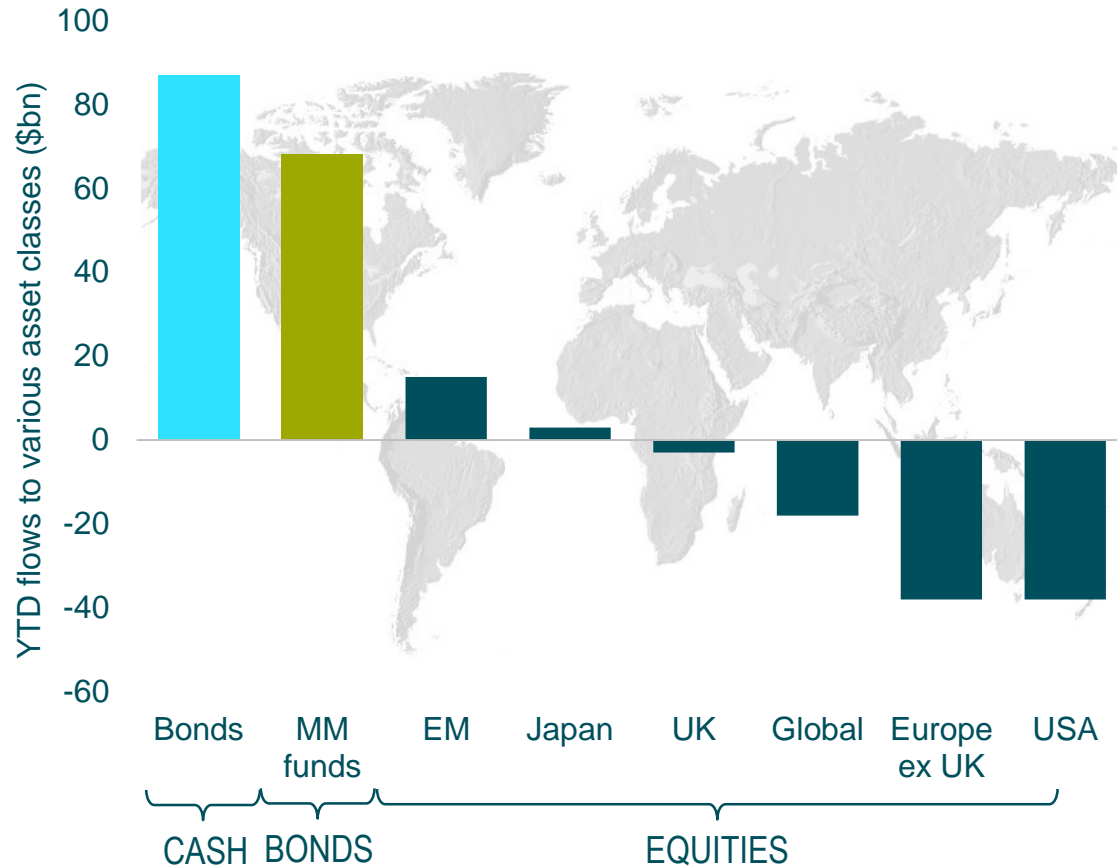
Asset recovery despite softer macro data



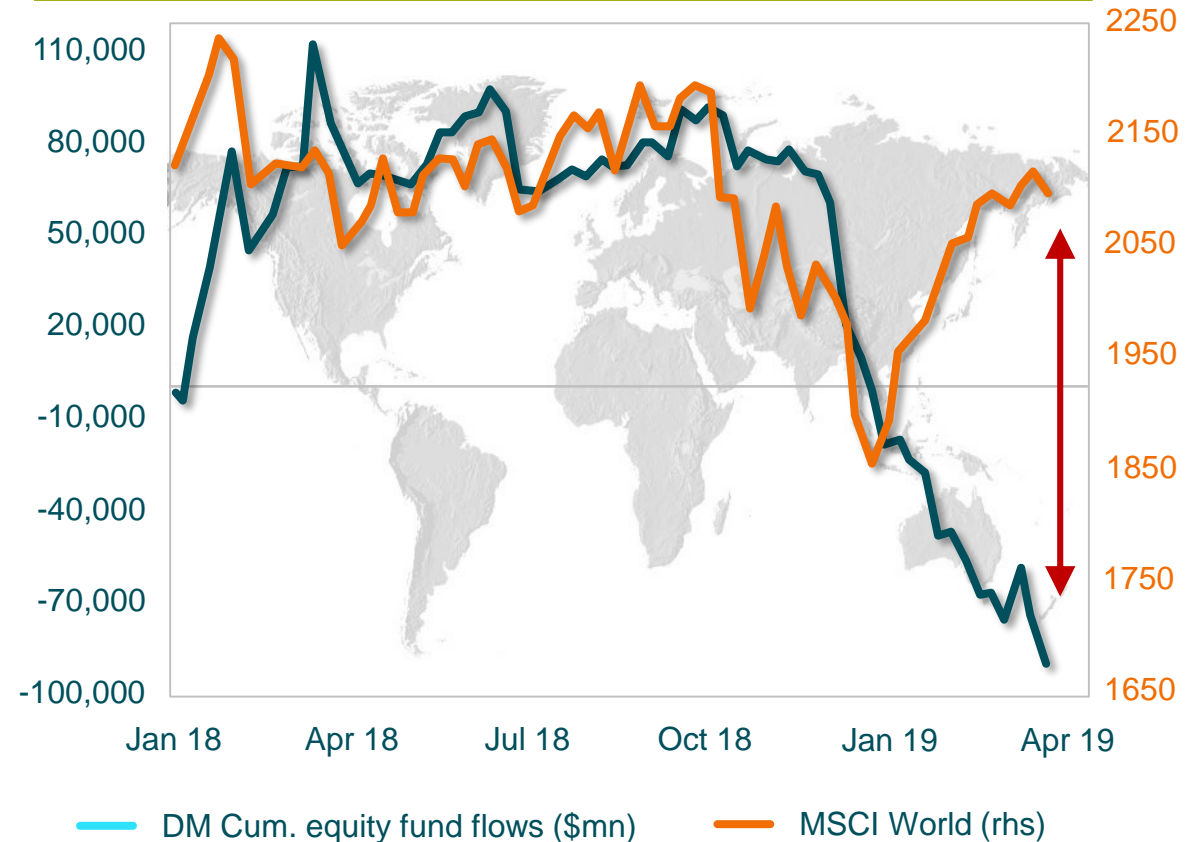
Constant state of the 'unsurprising'

Negative flows into equities despite strong performance in 2019

Only bonds, money market and EM equity funds had inflows ytd



The ytd decoupling between resilient equity performance and negative flows is stark



Track list

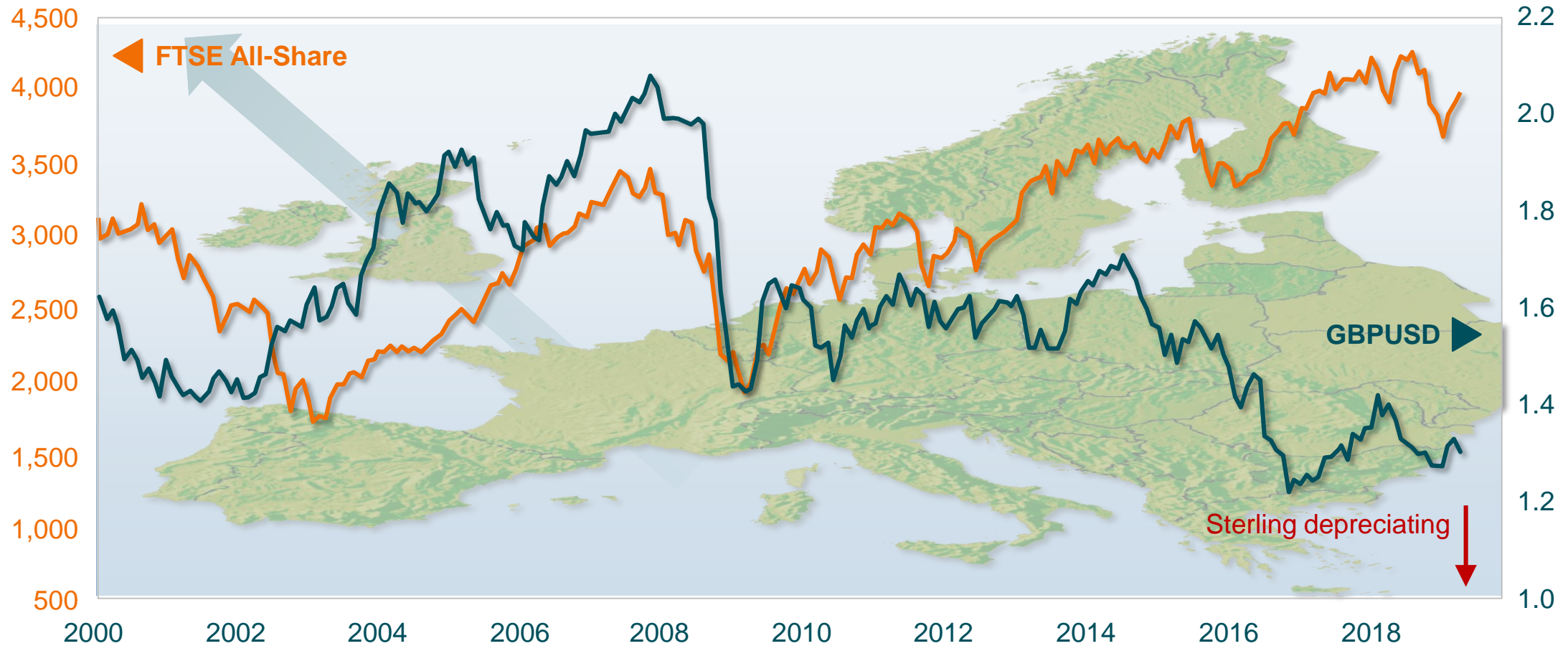
GLOBAL GREATEST HITS

1. Should I Stay or Should I Go Now
(The Clash)
2. When Two Tribes Go to War
(Frankie Goes To Hollywood)
3. Let It Grow
(Clout)
4. When Doves Cry
(Prince)
5. It's Getting Better
(Mama Cass)
6. China In Your Hand
(T'Pau)

Track 1 'Should I stay or should I go now?'

Brexit, what do we know?

FTSE All-Share vs. sterling



1. Hard Brexit/
No deal



2. Soft (Plan B)
/ No Brexit



3. Political
Crisis



GBP

Down

Up

Down

Breakevens

Up

Down

Up

Gilt Yields

Down
(risk off)

Up

Up

GBP credit

Widen
(uncertainty)

Down
(risk on)

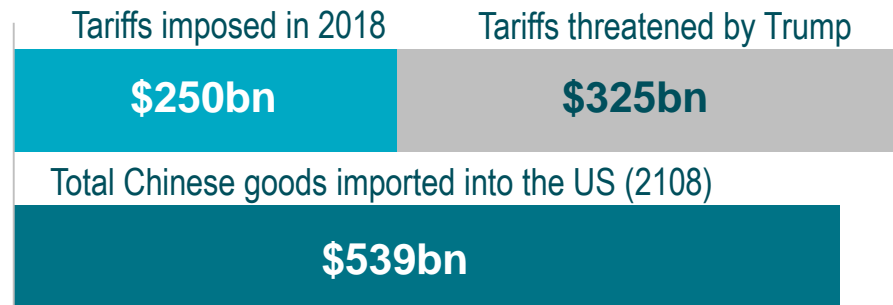
Widen
(uncertainty)

Track 2 'When two tribes go to war'

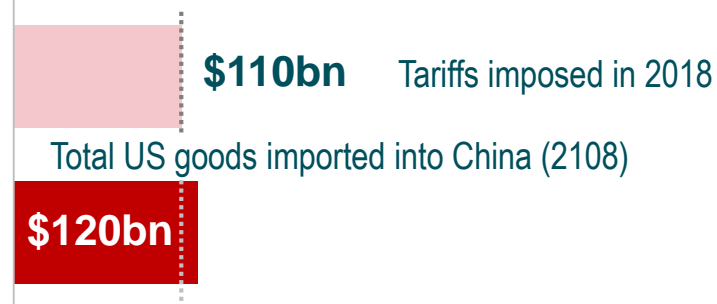
US China trade war, still playing out

How the trade war has played out

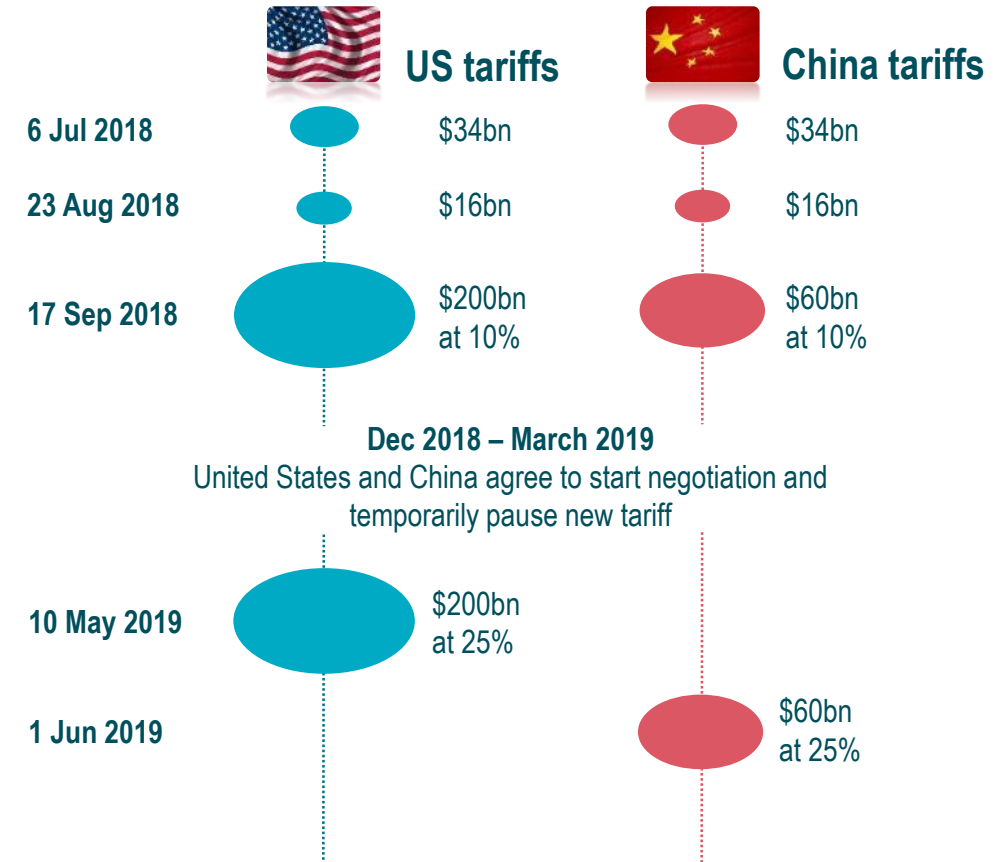
US tariffs on China



Chinese tariffs on US



How the US-China trade war has escalated

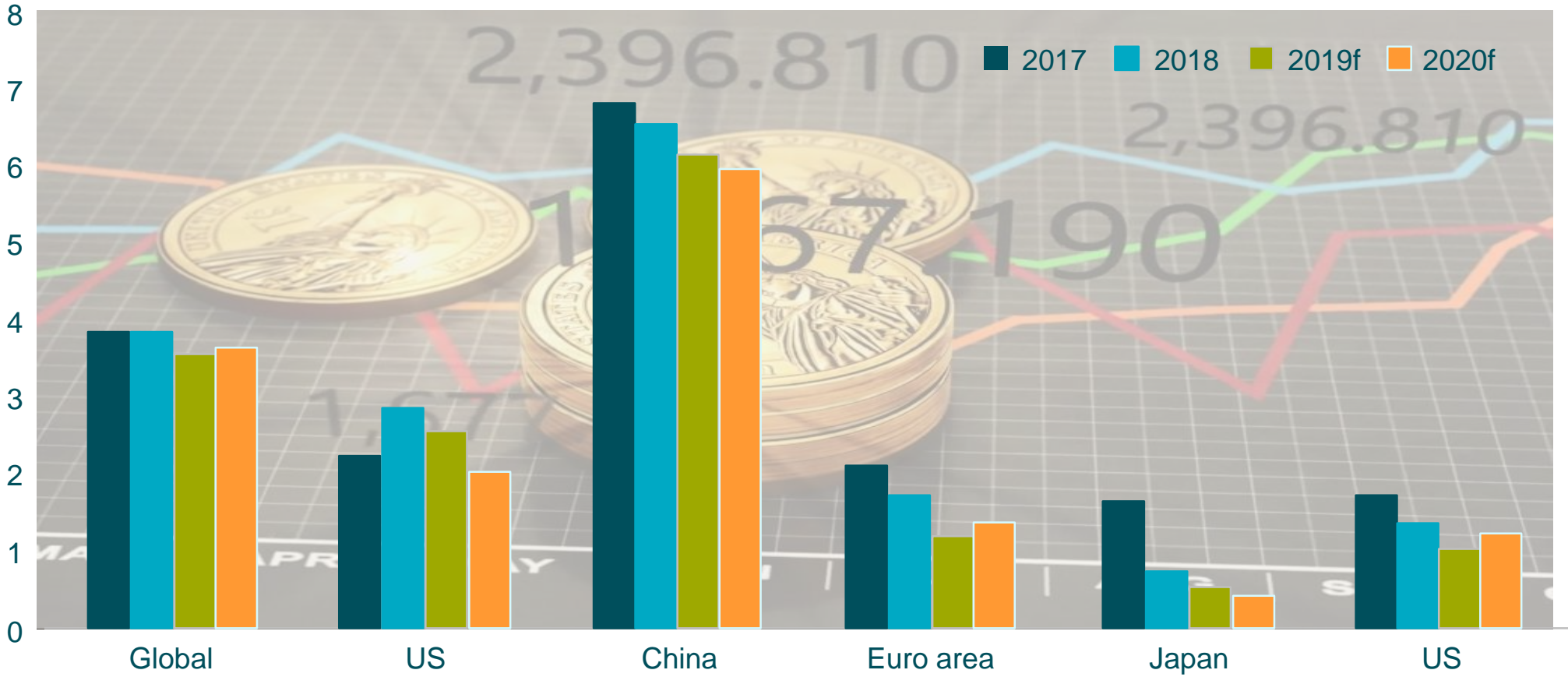


Note: Data as of 14 May 2019

Track 3 'Let it grow?' Global growth is forecast to slow in 2019

Concerns have been fuelled in part by moderating economic data

% change, calendar year average

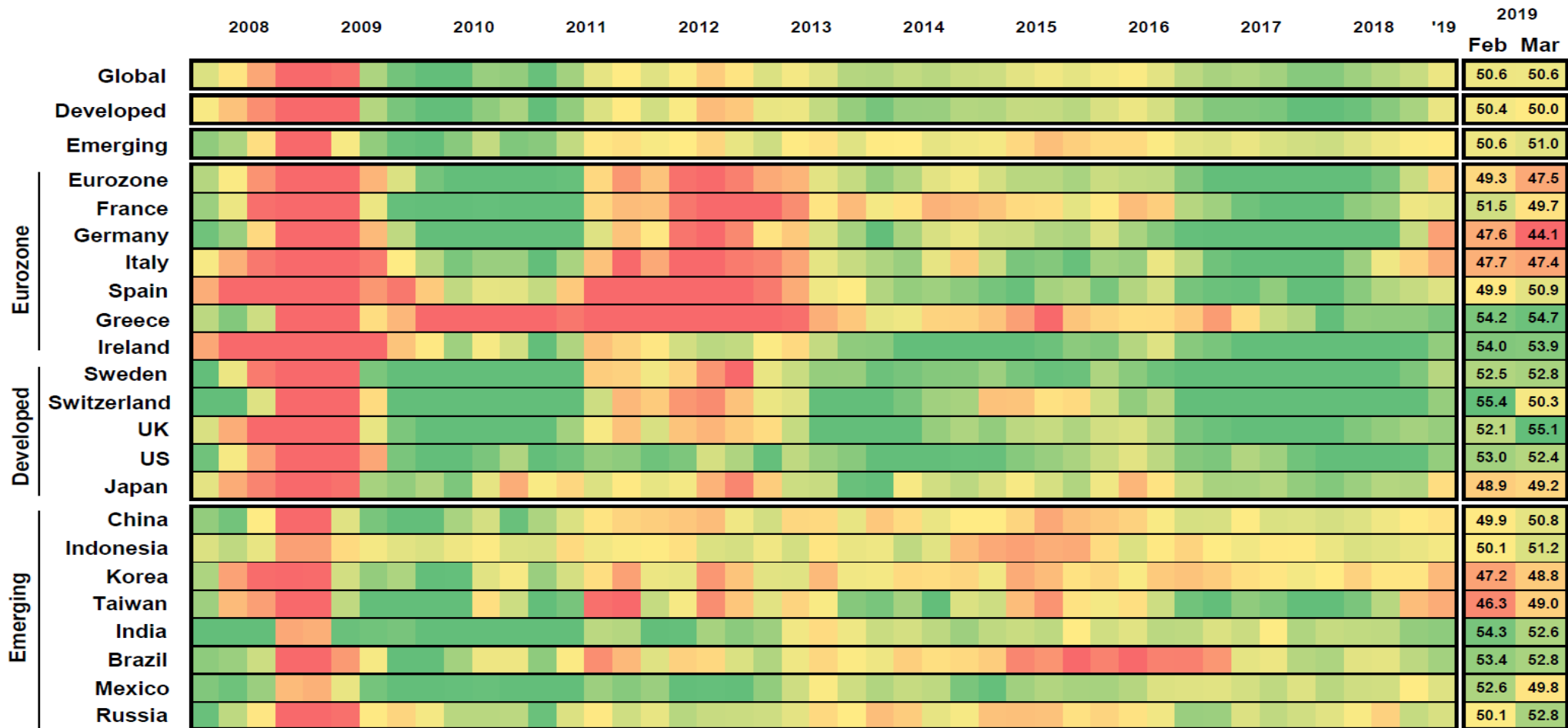


Growth is decelerating but it is not rolling over



Global business confidence softening

Global purchasing managers' index (PMI)



■ Below 50
 ■ At 50
 ■ Above 50

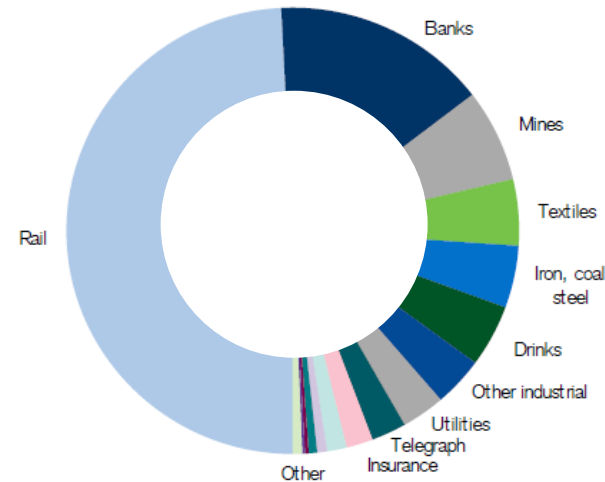
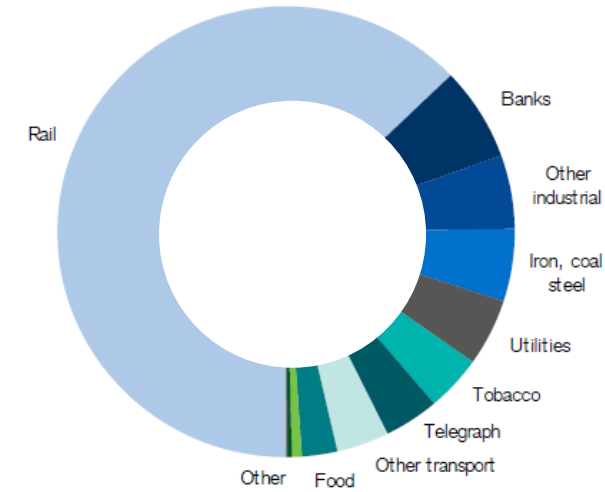
Understanding the driver of returns

Industry weightings in the USA and UK, 1900 compared with 2019

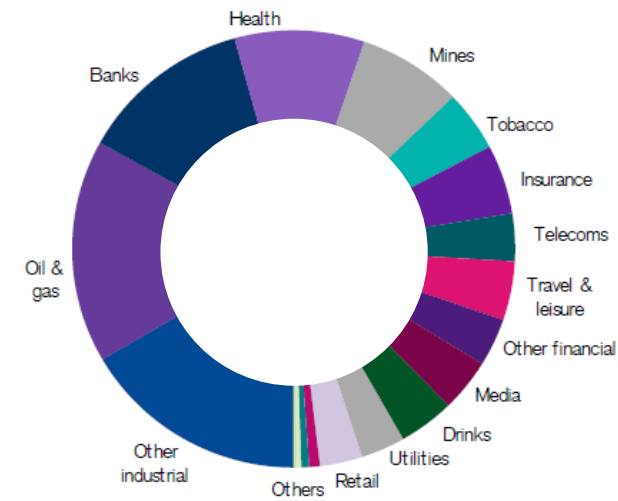
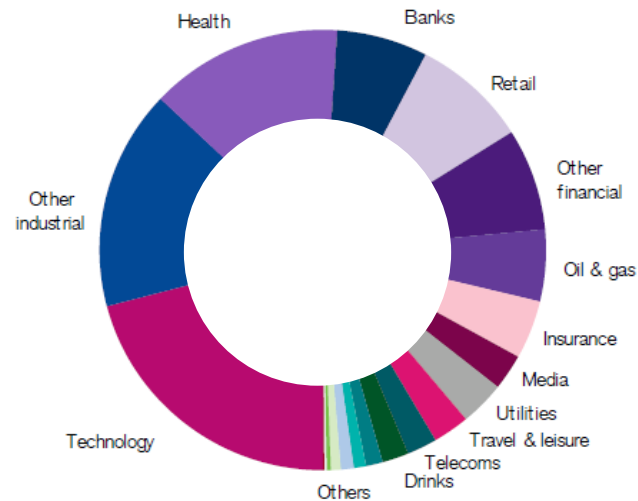
United States

United Kingdom

1900

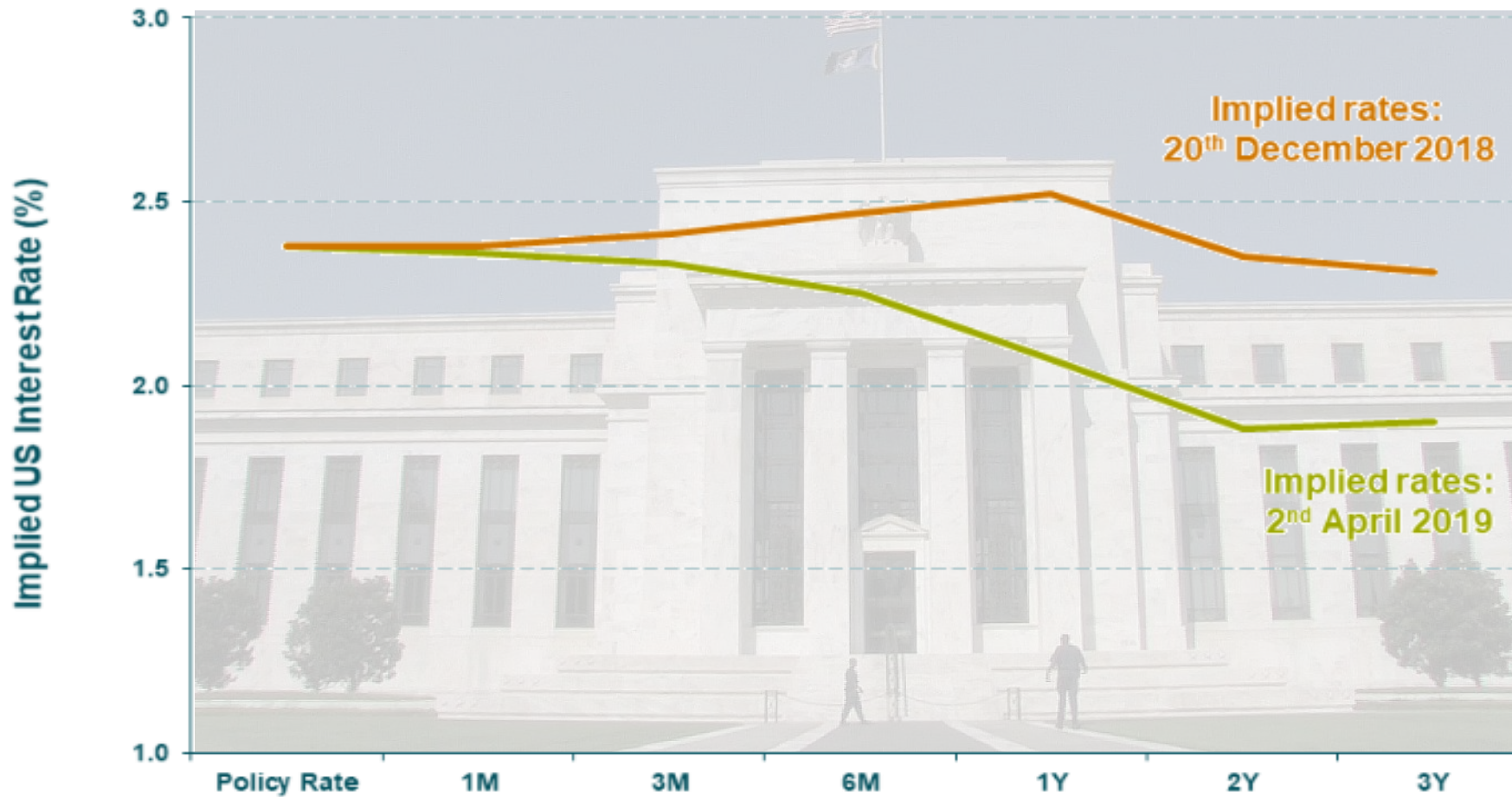


2019



Track 4 'When doves cry' A dovish Fed and changes in global interest expectations

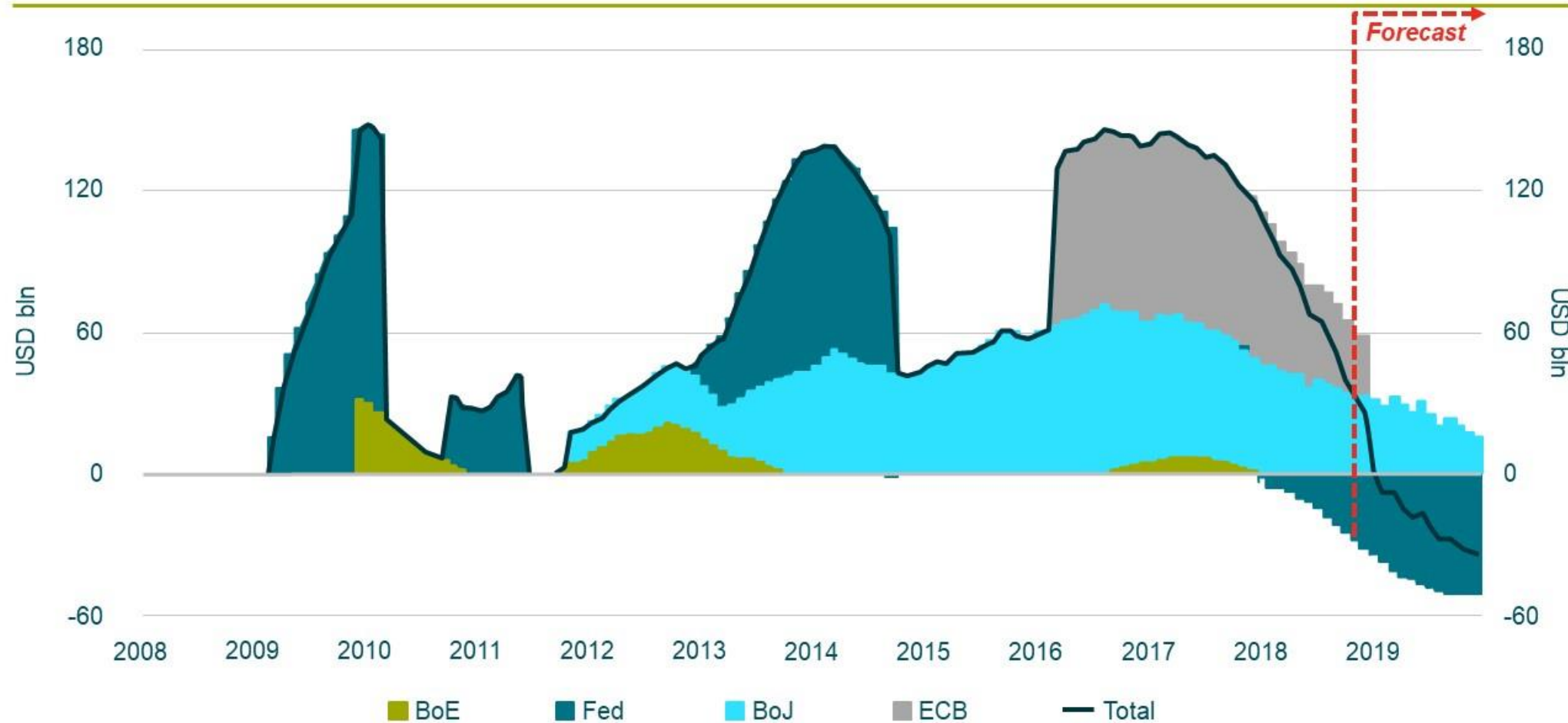
The needle has moved



Central bank liquidity declining, for now

Fed becoming hawkish in relation to QT

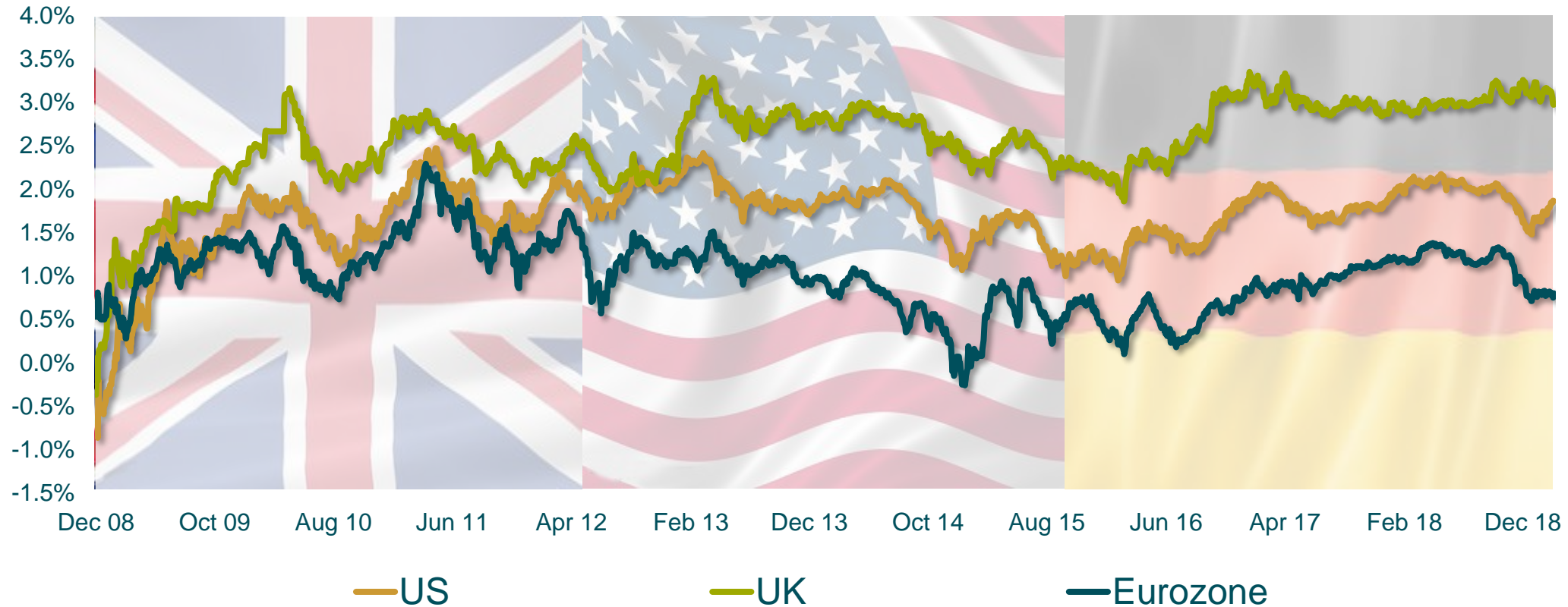
Monthly flow of G4 central bank assets purchases (MA)*



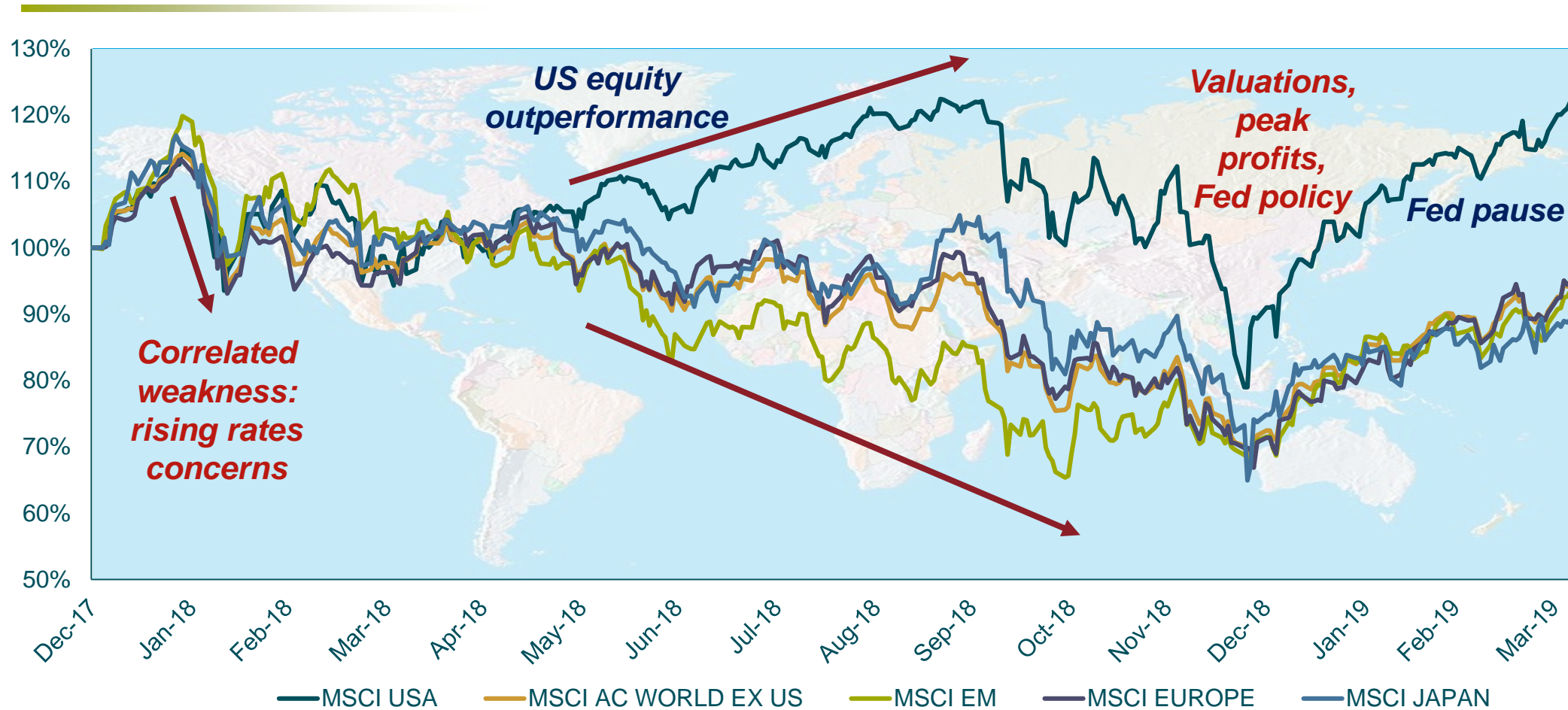
Inflation expectations

The cost of getting inflation protection: inflation breakevens

10y inflation breakeven rates for the UK, US and Germany



2018: Decoupling of US growth and performance vs the Rest of the World (ROW)

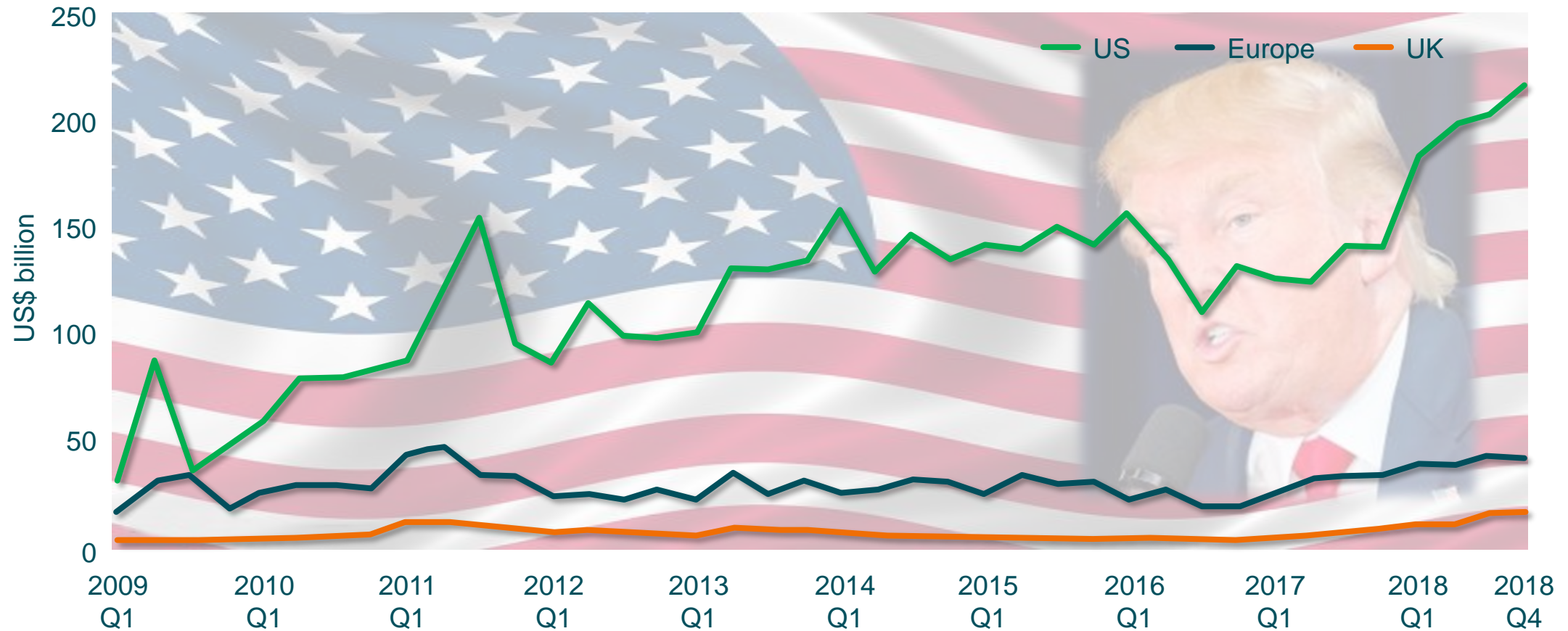


The end of US economic exceptionalism?

Trump's tax stimulus fuels 'buyback wave' in the US

Fuelled by corporate tax cuts, but who does it benefit?

Regional share buybacks

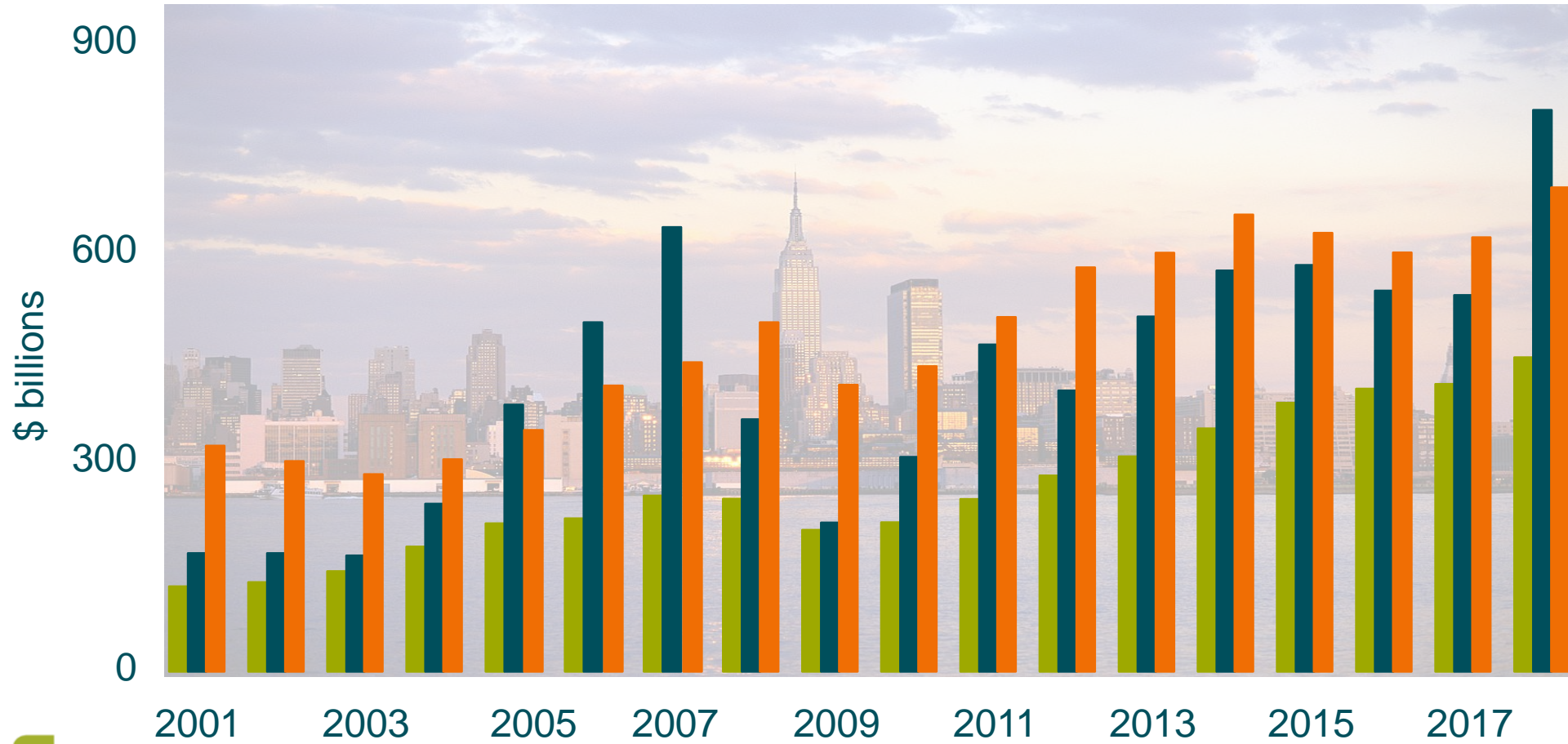


US companies announced a record \$1.0 trillion in stock buybacks in 2018

US share buybacks exceed capital expenditure in 2018

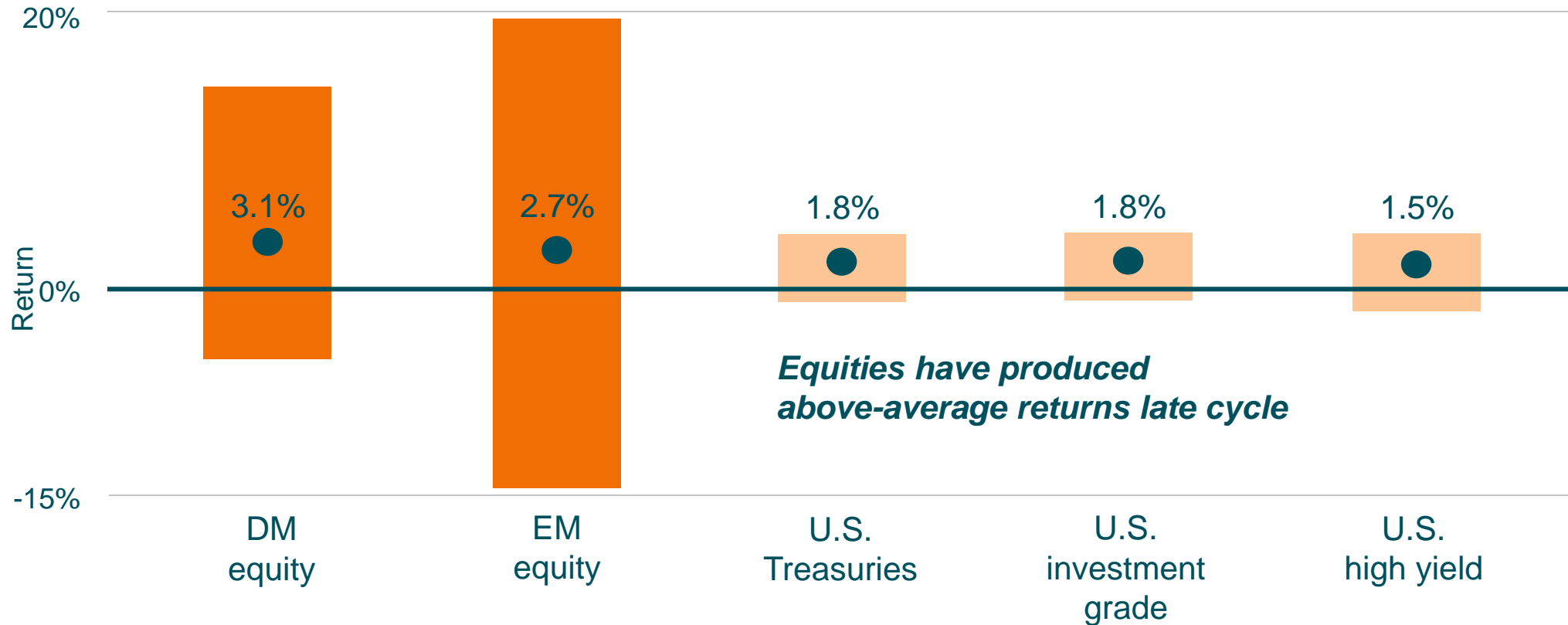
First time since 2007

S&P500 Index



How do markets perform in 'late cycle' phases?

Quarterly asset performance during U.S. late-cycle periods, 1988–2019

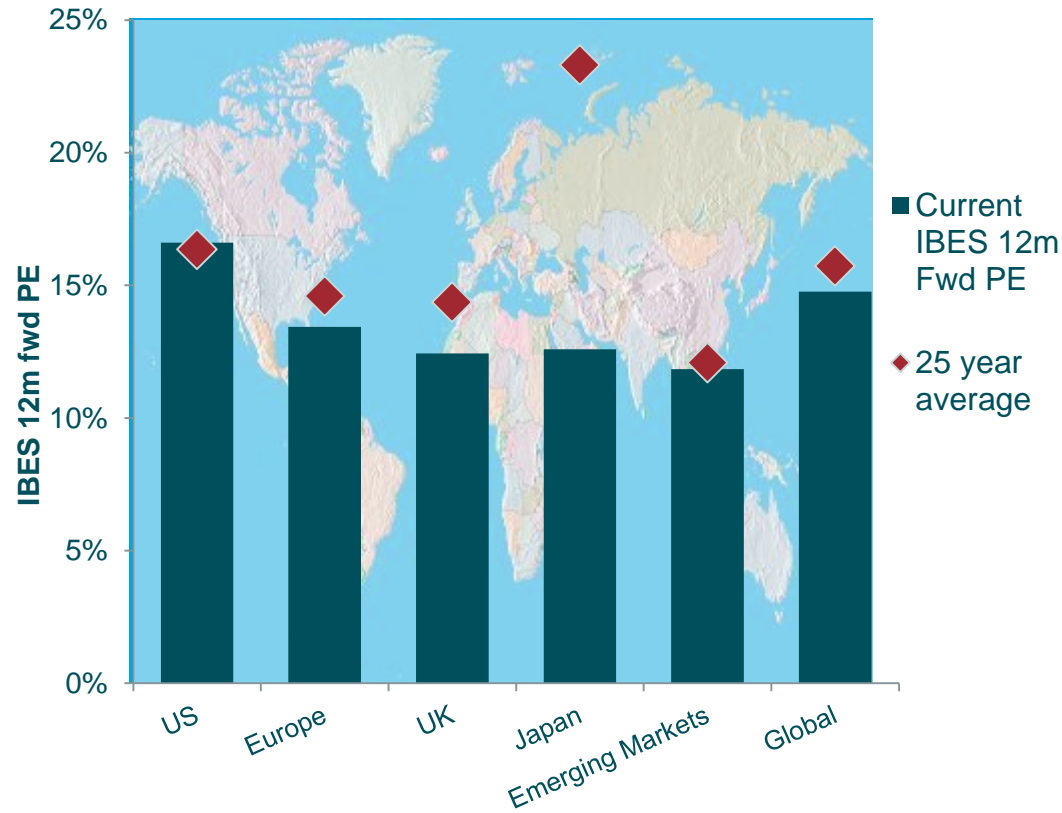


Equities have historically produced above-average returns

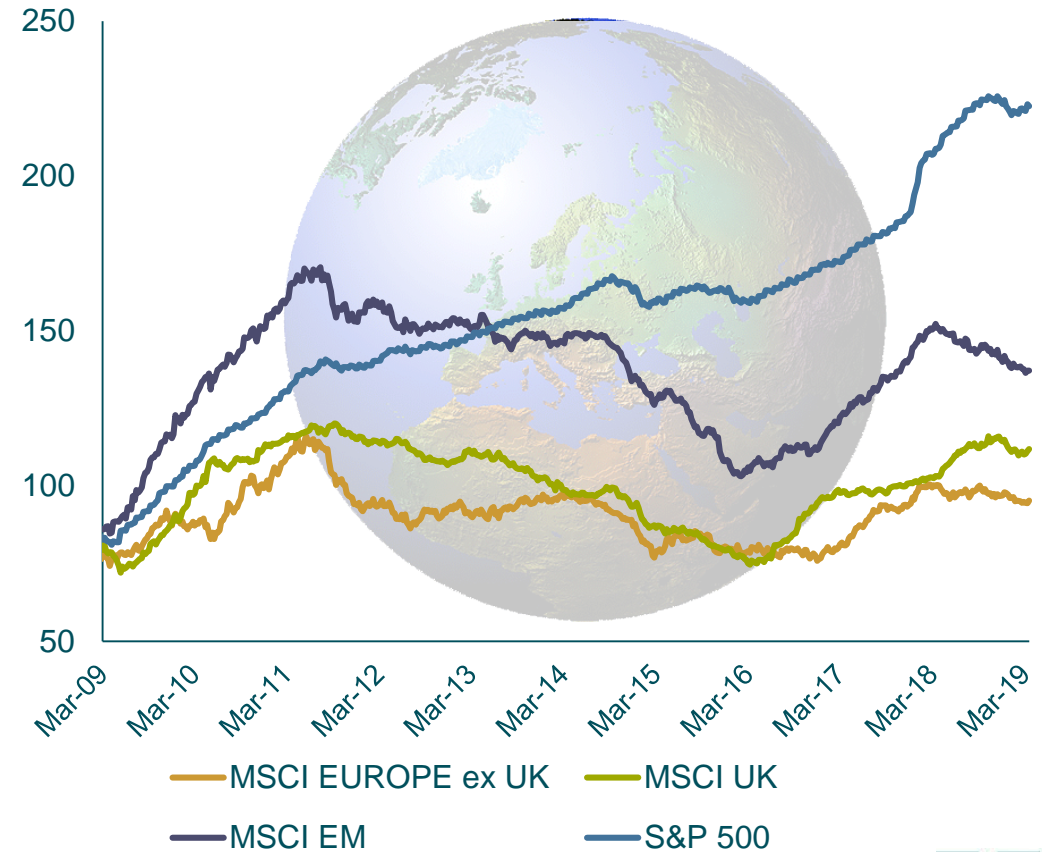
Track 5 'It's getting better' Equities face cross currents

Valuations have re-rated and earnings forecasts have seen some downgrades

IBES 12m forward PE ratio vs 25 year average



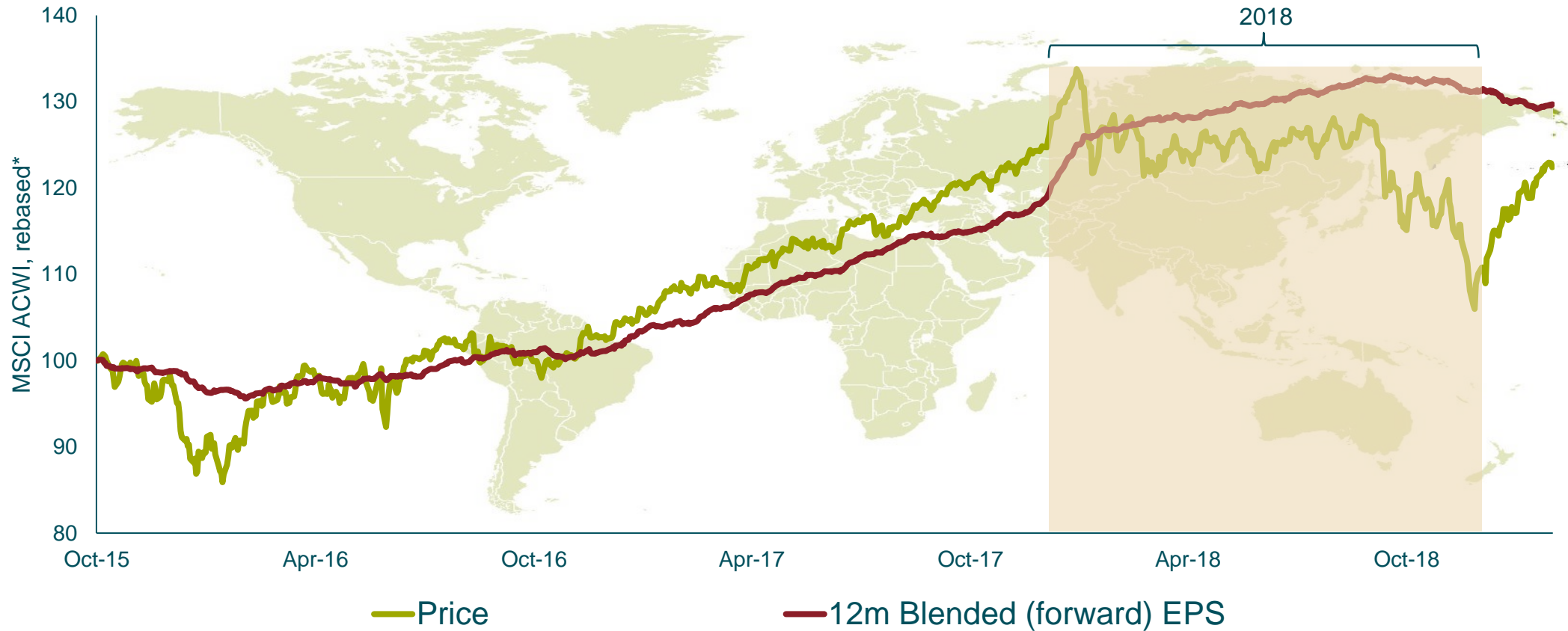
Global earnings per share, next 12m estimates (NTM)



A closer look at valuations

Global earnings continue to be robust

MSCI ACWI: Price vs 12 month forward EPS

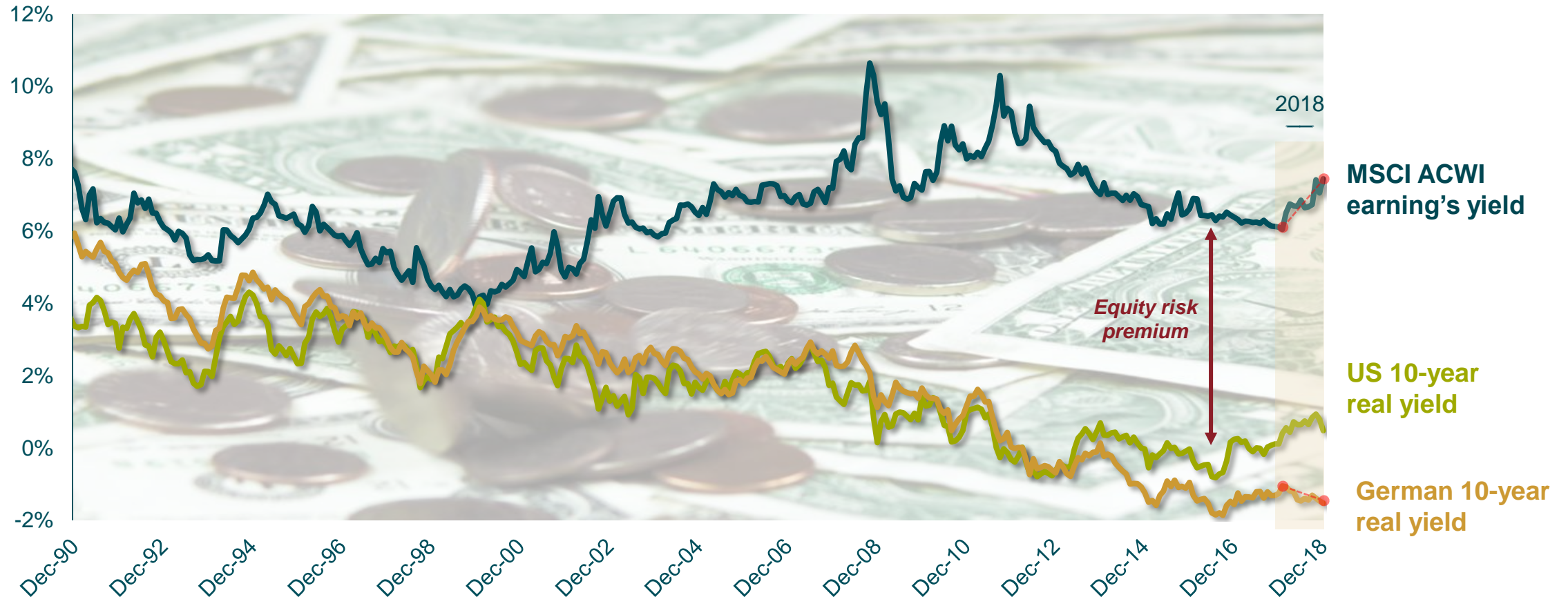


Markets followed earnings in 2017, but not in 2018

What's priced in today? Pessimism still dominates

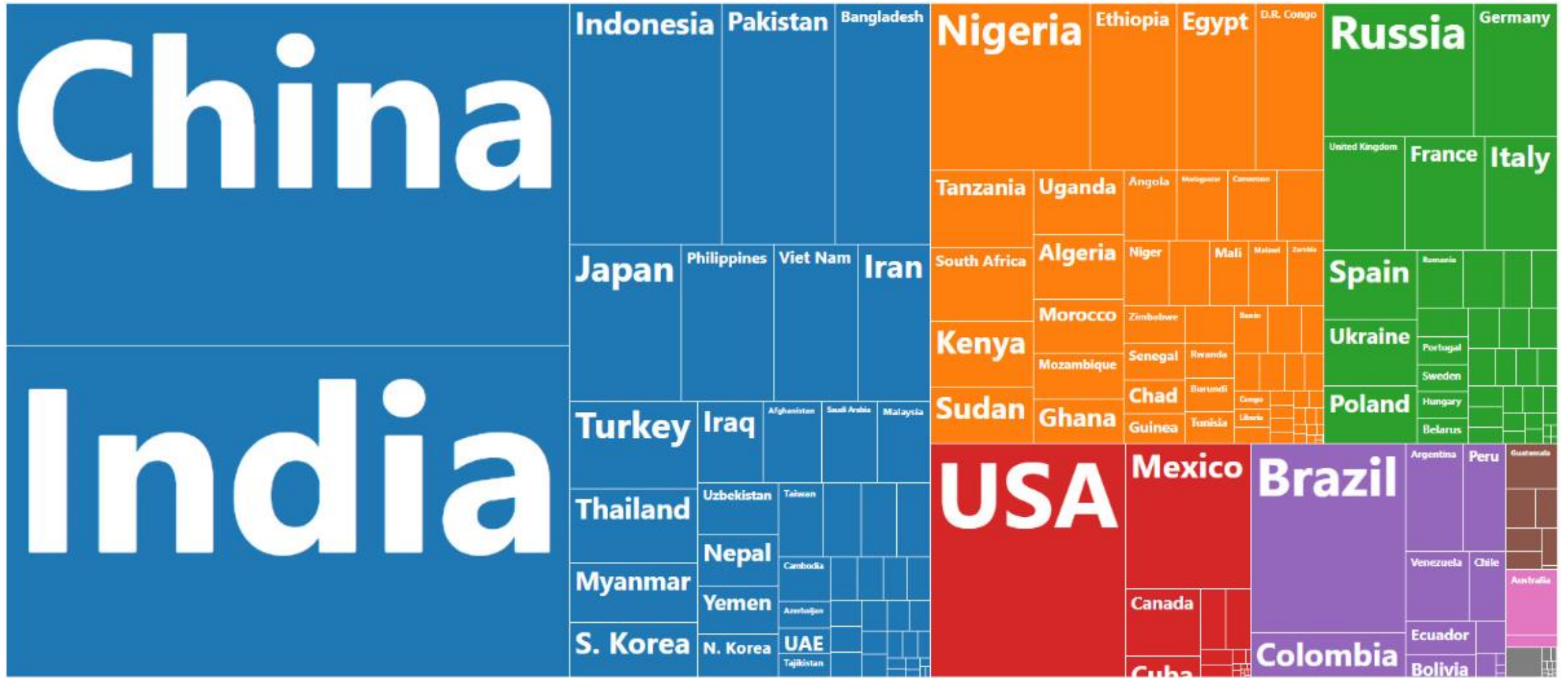
The key opportunity – margin of safety

MSCI ACWI earnings yield and real 10-year government bond yields (US and Germany)



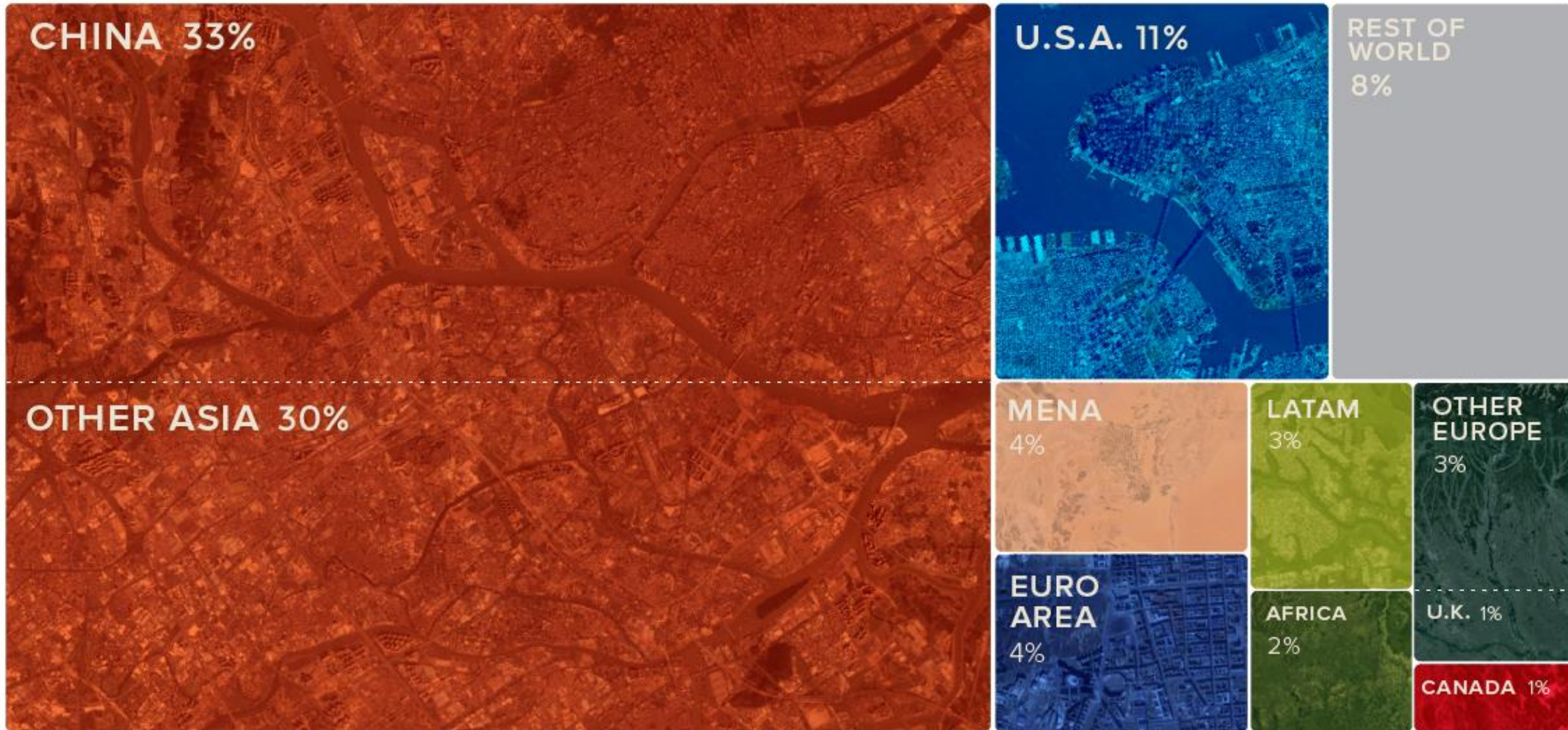
Track 6 'China in your hand' China, the biggest needle shifter?

1 in 5 people are Chinese



Why China

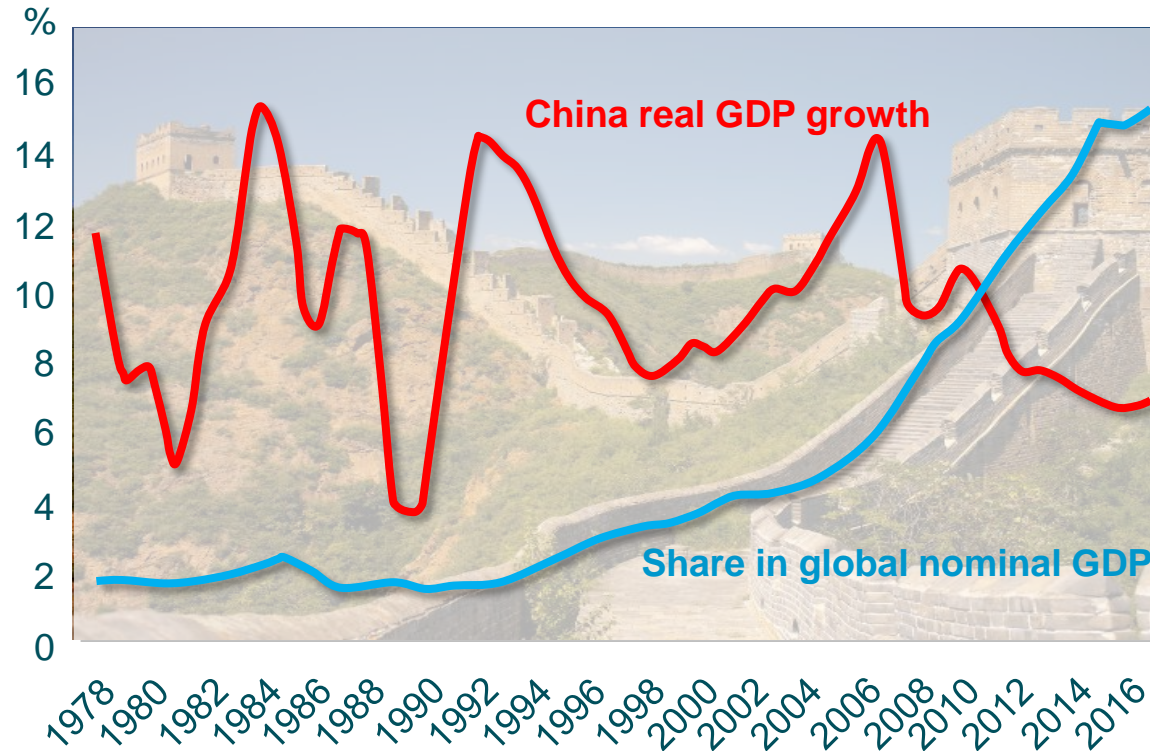
Share of global economic growth (2019f)



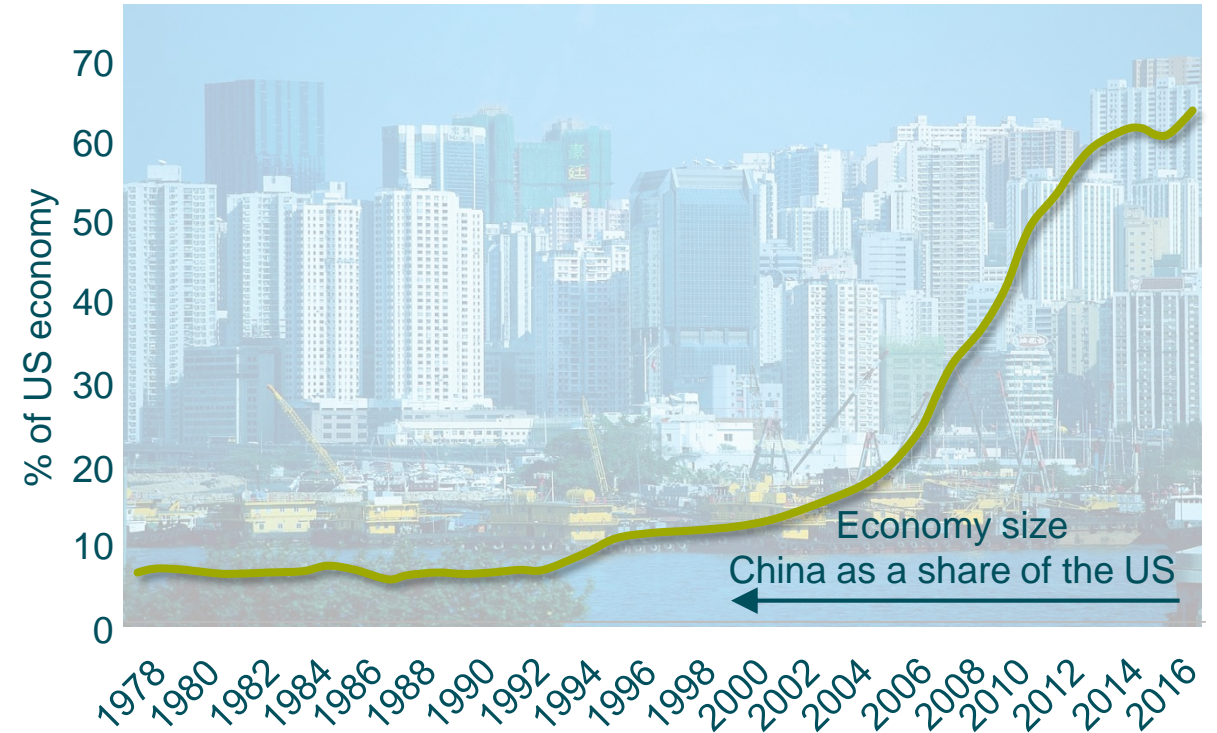
Why China

An economic super power

China's economic growth and share of global economy



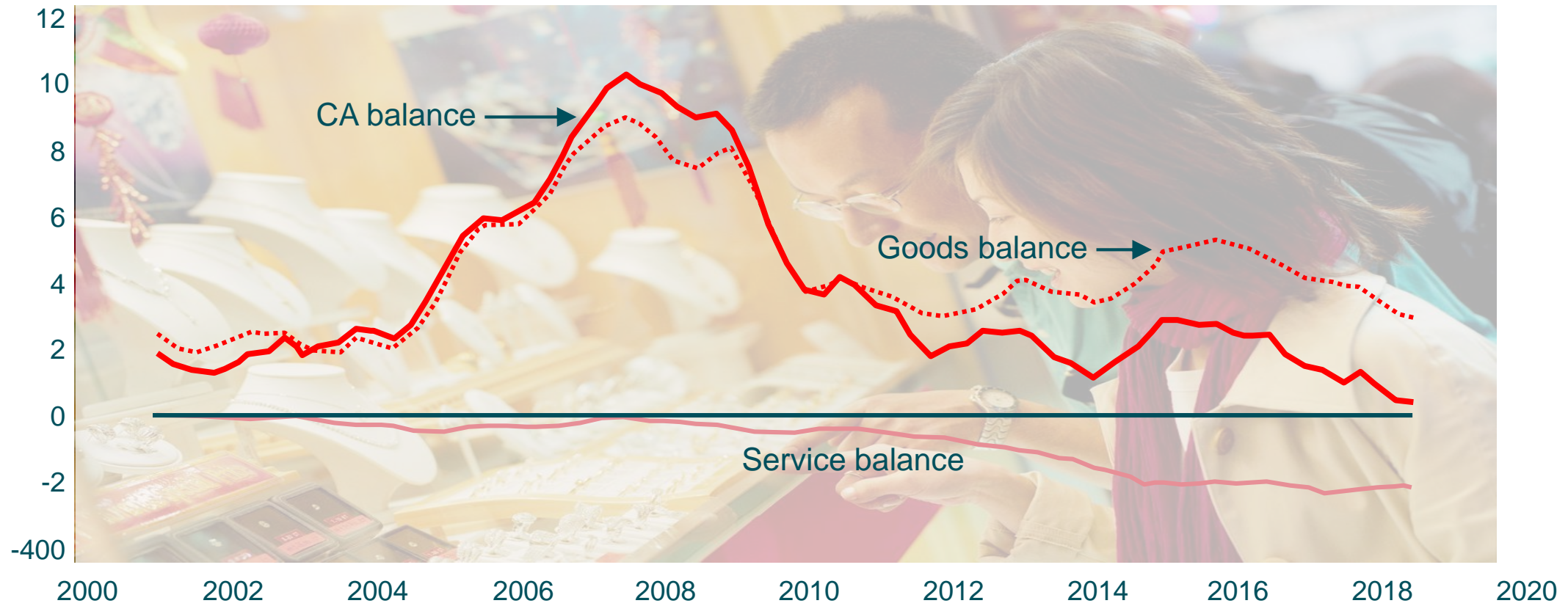
China's catch up with the US



Why China

A fast evolving economy

China current account balance (% of GDP)

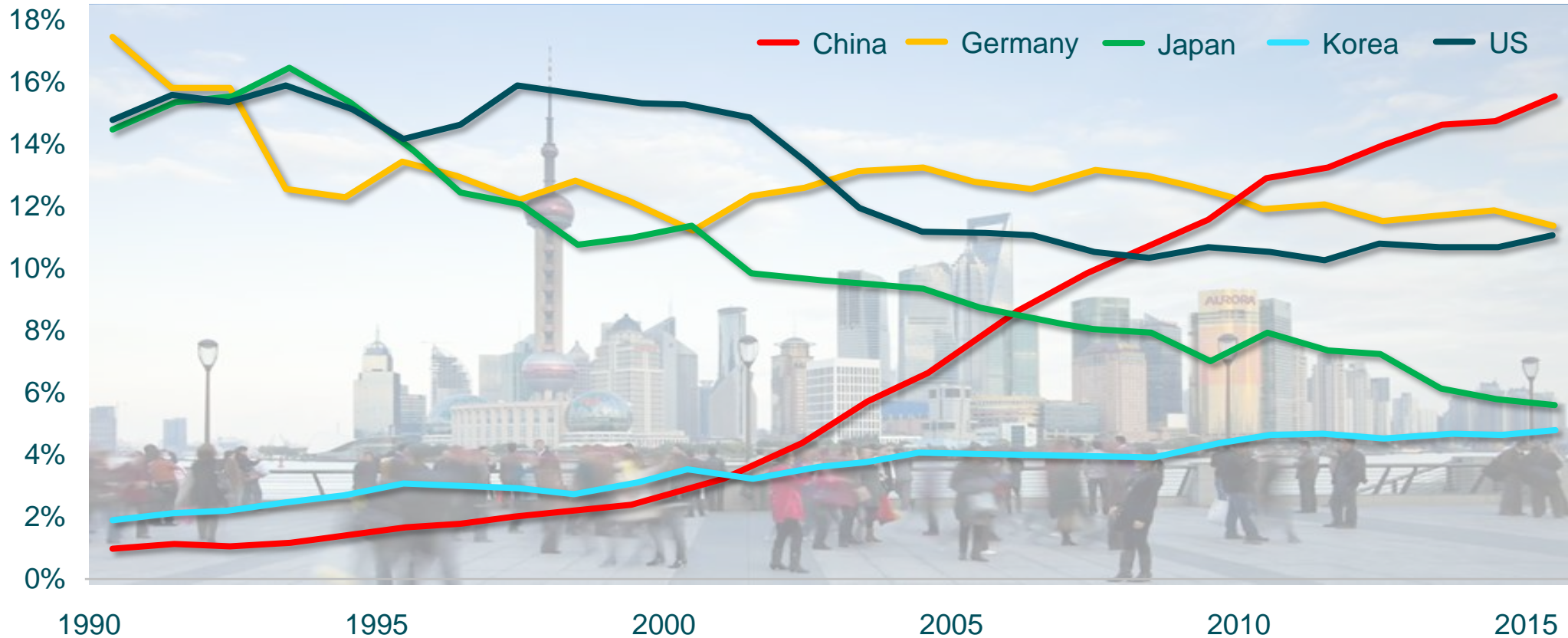


External AND internal factors behind China's move towards a current account deficit

Why China

Challenge the consensus view

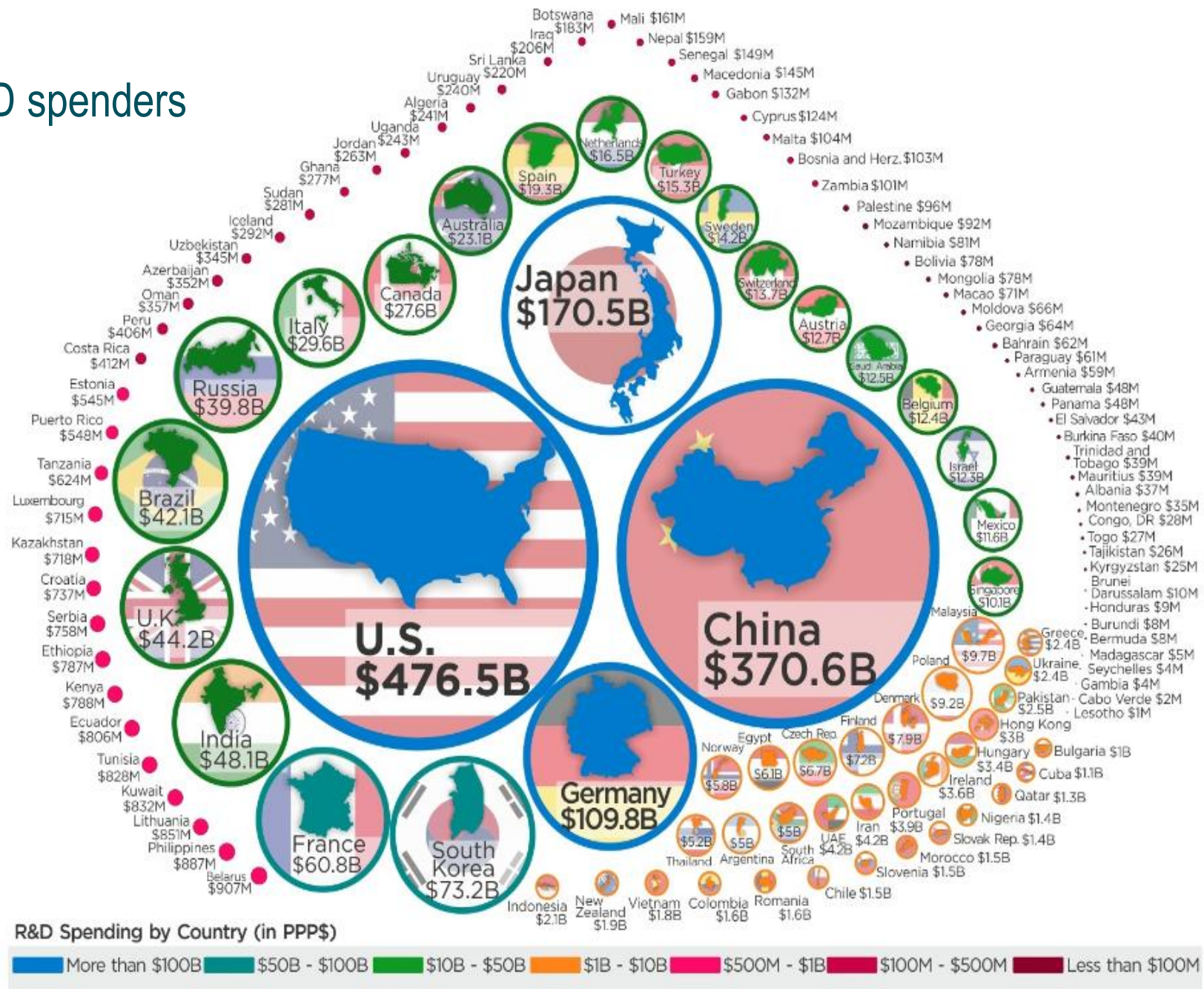
Global share of high value added exports



China doesn't just make cheap stuff !

Why China

2nd largest R&D spenders



Why China?

China's 5 year plans

2006

“Share of research and development (R&D) spending out of total GDP up from 1.3% in 2005 to 2% in 2010”



Why China?

China's 5 year plans

2011

Moving coastal regions from being the "world's factory" to hubs of research and development, high-end manufacturing, and the service sector

Value-added output of emerging strategic industries accounting for 8% of GDP



Why China?

China's 5 year plans

2016

“Innovation: move up in the value chain by abandoning heavy industry and building up bases of modern-intensive infrastructure”

“Achieve significant results in innovation-driven development”

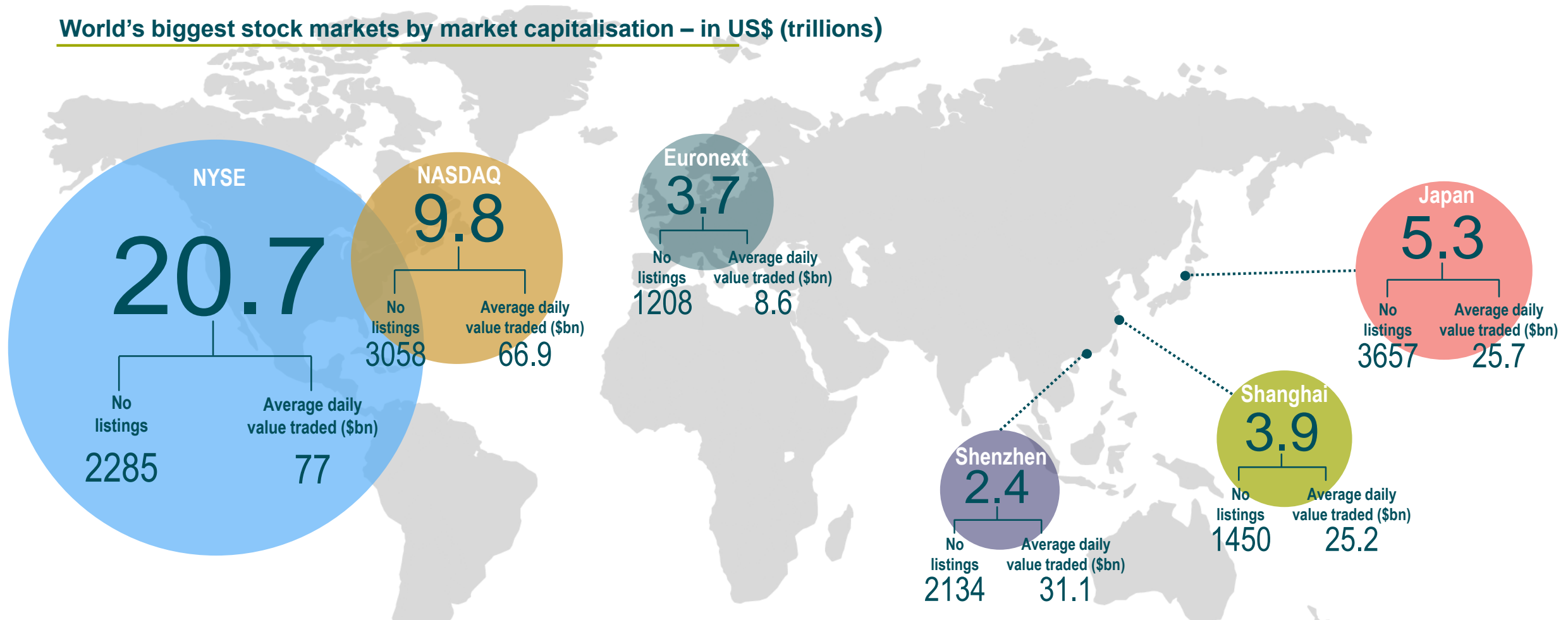
“Made in China 2025” - Initiative to comprehensively upgrade Chinese industry and to obtain a bigger part of the global production chains.”



Why China

A huge, diverse opportunity set

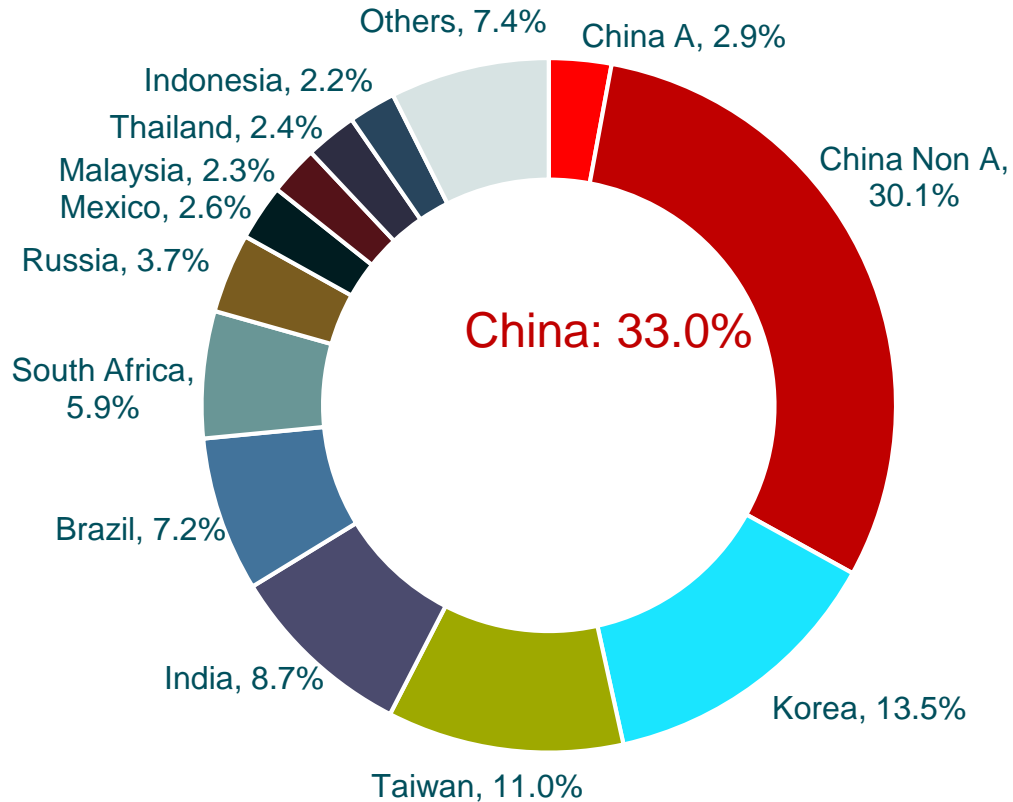
World's biggest stock markets by market capitalisation – in US\$ (trillions)



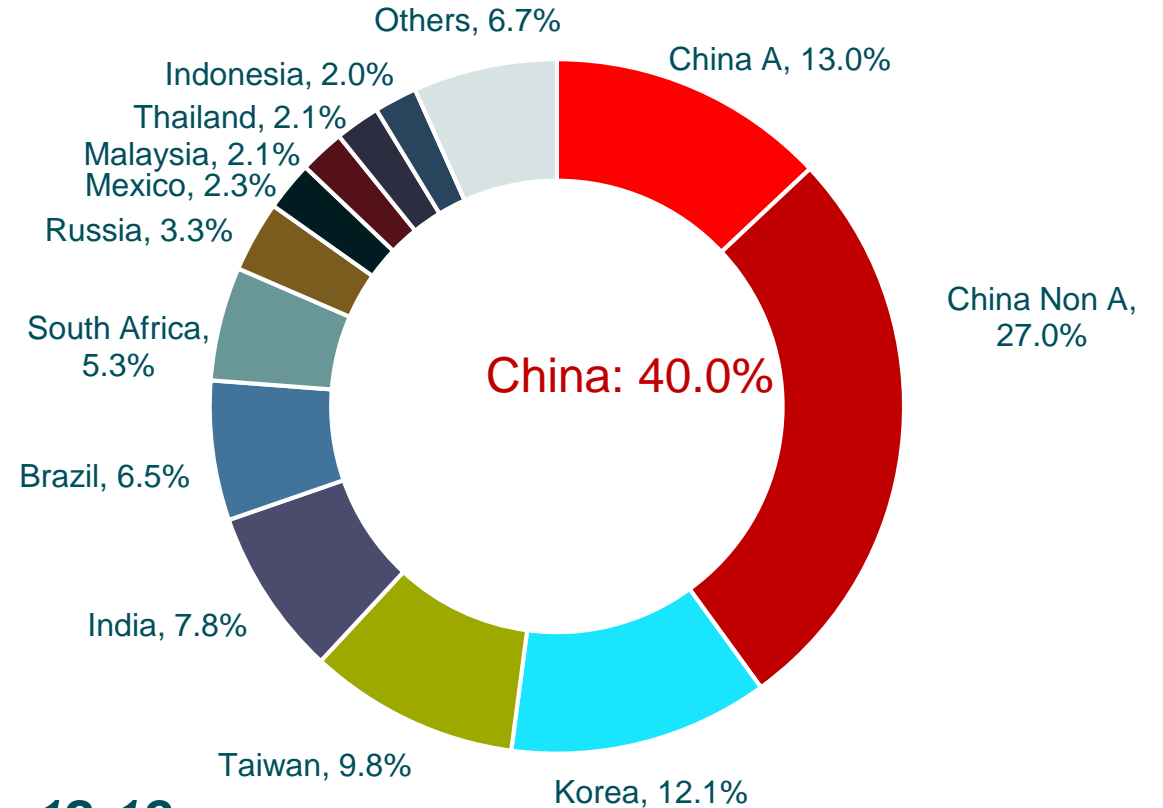
Why China

Opening up to international investors

MSCI China adopting 20% China A-shares inclusion factor



MSCI China adopting 100% China A-shares inclusion factor



A third of MSCI EM today - over 40% in 12-18m

Will this dominance change how investors access EM ?

Summary



Challenging conditions persist



Although a change in Fed rhetoric helped asset recovery



Relative value opportunities continue



China's continued growth now accessible to investors

Keeping up to date Our blogs

www.bondvigilantes.com

The image shows a collage of content from the Bond Vigilantes website and its Twitter presence. At the top is the website header with the M&G logo and the title 'BOND VIGILANTES'. Below this is a featured article titled 'Issuance in the brain. Dangerous precedents being set in Cyprus'. To the right, there's a section for following the team on Twitter. Below the website content is a screenshot of the Twitter profile for @bondvigilantes, showing a list of tweets and a 'Follow' button.

www.twitter.com/bondvigilantes

www.episodeblog.com

The image is a screenshot of the Episode blog website. The header features the M&G logo and the title 'EPISODE'. Below the header is a navigation menu with links for HOME, ABOUT, MARKET NOISE, THE AUTHORS, and ARCHIVE. The main content area displays an article titled 'Fed Fatigue' by Caitlin Hughes, dated 18 SEP. The article text discusses the Fed's actions and market reactions. To the right, there is a 'SIGN UP TO EMAIL UPDATES' form with fields for Email Address, First Name, and Last Name. Below the main article, there are two smaller article teasers: '...and not a drop to drink? Does lower liquidity flush out speculators?' by Stuart Canning and 'China Crisis? Yes, but no worse than two weeks ago.' by Juan Nevado.



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www.equitiesforum.com

The image is a screenshot of the Equities Forum website. The header features the M&G logo and the title 'The Equities Forum'. Below the header is a navigation menu with links for HOME, ABOUT, THE AUTHORS, and ARCHIVE. The main content area displays an article titled 'Winners and losers from Obama's healthcare revolution' by Martin Wales, dated 15 JAN 2016. The article text discusses the impact of the Affordable Care Act on the healthcare sector. To the right, there is a 'SIGN UP TO EMAIL UPDATES' form with fields for Email Address, First Name, Last Name, Job Title, and Company. Below the main article, there are two smaller article teasers: 'Artisan brands challenge the status quo' by Richard Halle and 'A letter to Santa' by Gerry Rinch.

Learning outcomes

- **Discuss:** the current global macro-economic environment
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