

## Quarterly Market Outlook

October 2019

### Slowing Global Growth

Global growth continued to face headwinds in Q3 from trade tensions. The IMF recently downgraded its 2019 global growth estimate to 3%, the lowest rate since the Global Financial Crisis.<sup>(1)</sup> The weakness is most apparent in the manufacturing sector, where US and European manufacturing PMIs (indices representing manufacturing activity) have reached post crisis lows.<sup>(2)</sup>

### Central Banks Easing Policy

The Federal Reserve cut interest rates by 0.25% at their July, September and October meetings, marking the first rate cuts since the Global Financial Crisis in 2008. The Fed Funds target range is now 1.50% – 1.75%. The European Central Bank (ECB) also cut interest rates by 0.10% (from -0.40% to -0.50%) and restarted their quantitative easing program, committing to monthly bond purchases of 20 billion euros beginning in November.

### Japan and Europe, a Sign of Things to Come?

Markets reacted with a yawn to the ECB's latest stimulus announcement, with the euro actually trading up on the day of the announcement (contrary to the ECB's desired outcome). With the majority of bonds in Europe and Japan now having negative yields, there is little benefit to those economies from lower interest rates. Outgoing ECB president Mario Draghi echoed this sentiment when requesting that future stimulus come from Eurozone fiscal policy. While the Federal Reserve has a bit more room to maneuver, the US is not far off from being in a similar situation as interest rates trend lower.

### The Brexit Saga Continues

UK Prime Minister Boris Johnson was finally able to get a Brexit deal approved by Parliament, but his timeline for an October 31<sup>st</sup> completion was rejected. He responded by shelving his deal in favor of a new general election, now scheduled for December. The European Union has granted an extension for a Brexit deal to January 31, 2020. A lack of clarity on the path forward will continue to be a headwind for the UK economy.

### Ongoing Volatility from the US/China Trade War

President Trump announced additional tariffs on Chinese imports in late-July. China responded by allowing the Chinese yuan to weaken below the 7 RMB/USD level, at which point the US labeled China a "currency manipulator." Market volatility picked up-intra quarter as a result, and emerging market assets (stocks and

bonds) ended the quarter lower. With an election approaching and weakening global growth now impacting both the US and China, incentives are now aligning for a deal. Both sides returned to the negotiating table in October and reached a verbal “Phase One” agreement, where the US has promised to reduce some tariffs in exchange for Chinese purchases of US agricultural products. There seems to be little progress on thornier issues like forced technology transfer, which will be addressed in future negotiations.

### Potential for a Positive Surprise?

A counterbalance to the manufacturing weakness has been the strength of the US household sector, which has benefited from low unemployment and US rate cuts (through a positive wealth effect and lower borrowing rates). While we don’t expect a material pickup in growth, a positive consumer outlook combined with progress in US/China trade negotiations have the potential to stabilize growth at the current levels.

### Impeachment

A firestorm erupted in September over a whistleblower allegation that President Trump was withholding foreign aid in an attempt to pressure Ukrainian president Volodymyr Zelensky into an investigation of a political rival, Joe Biden. Nancy Pelosi responded by announcing that the House would launch a formal impeachment inquiry. Given a republican majority in the Senate it’s unlikely that President Trump will be removed from office, but the conflict is likely to drag out for some time further increasing political gridlock in the Capitol.

### Politics Taking on Greater Importance

With central banks running low on ammunition and populism on the rise, trade and fiscal policy are taking on greater importance in shaping economic and market outcomes. We are closely watching the US presidential election, US/China trade policy, Brexit, and negotiations around fiscal expansion in Europe as key drivers of global growth going forward. In our view, high valuations, low interest rates and a wide range of potential economic outcomes argue for greater diversification in investment portfolios.

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#### Footnotes

- (1) Source: Gopinath, Gita. “The World Economy: Synchronized Slowdown, Precarious Outlook.” *IMF Blog*. 10.15.2019. <https://blogs.imf.org/2019/10/15/the-world-economy-synchronized-slowdown-precious-outlook/>
- (2) Source: Li, Yun. “US Manufacturing Survey Shows Worst Reading In A Decade.” *CNBC Markets*. 10.01.2019. <https://www.cnbc.com/2019/10/01/us-manufacturing-economy-contracts-to-worst-level-in-a-decade.html>

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