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March overview: Interest rates driven lower on concerns of slower global growth

Major stock indexes have rallied this year despite a slowdown in global growth, in part because central banks have signalled that they will back off plans to normalize monetary policy (increase interest rates to more normal levels) for the foreseeable future. This helps share markets on a relative valuation basis. However, signs that momentum continues to cool across major economies have challenged investors, raising questions about whether a soft patch of data could mark the start of a more persistent downturn. In March, the global bond market rally also continued as investors drove bond prices higher (thus yields lower) in wake of the ambiguous outlook on economic growth.

In the news, the US-China trade negotiations have taken a quieter note, but there is no shortage of noise relating to Brexit. Apparently it takes a British constitutional crisis to divert attention away from Mr Trump's twitter account.

UK: Deal or No Deal?

Brexit has many possible parallels to the game show 'Deal or no Deal', but the UK hopes it is not the version where the contestant is left with the case with only £5 in it at the end. Theresa May desperately offered up her premiership on a last gasp attempt to win support for her Brexit deal, telling an emotional meeting with Tory MPs she will quit if they vote for her plan to take Britain out of the EU. However, her dramatic move failed to move some hard-line Eurosceptics and the Democratic Unionist party. Now Mrs May is struggling to hold the Tory party together amid a political gridlock and is holding a fresh round of "indicative votes" on rival options to her deal. If the indicative votes fail to identify a viable pathway for Mrs May, the possibility of another election rises.

MPs may not have coalesced around another option yet, but if a no-deal exit scenario is to be avoided, the strongest alternatives are a permanent customs union or a second referendum. Both came closer to win the support of parliament than all the attempts to pass Mrs May's deals. The customs union has a more obvious pool of votes to draw from, but the option for a second referendum is gaining momentum.

To further complicate matters, even if the parliament eventually does agree on a proposed course of action there is no guarantee that it will be acceptable to the EU. Mrs May told MPs "I cannot commit the government to delivering the outcome of any votes held by this House," arguing that an alternative to her deal could be impossible to negotiate with the EU. "No government could give a blank cheque to commit to an outcome without knowing what it is."

As long as multiple factions have hope, they have little reason to compromise. Neither the referendum backers nor supporters of the customs union will wish to give ground to the other. Equally, hardliners may see renewed hope for a no-deal exit as UK draws closer to the deadline without an alternative to a hard exit.

US: An impressive run starts to tire

The Commerce Department confirmed in its third reading that fourth-quarter US Gross domestic product increased at a modest 2.2% annualised rate. That was down from the 2.6% pace estimated by analysts in February. The downward revisions to the fourth-quarter GDP reading reflected reductions to consumer and business spending, as well as government outlays and investment in homebuilding. The softer data looks likely to flow into US profit margins, which are on track to suffer their first fall since 2015, as companies increasingly struggle to pass on costs of rising labour, transportation and raw materials to customers.

A record 58% of respondents to the latest National Association for Business Economics survey of business conditions reported rising wage costs, while only 19% reported that they had increased the prices they charged customers. Some on Wall Street are now bracing for an "earnings recession". That was underscored by weaker profits in the fourth quarter.

Talks on resolving the trade dispute between America and China are set to resume, with the aim of signing a deal in late April. Senior American officials including Steven Mnuchin, the Treasury Secretary, are preparing to travel to Beijing for negotiations, followed by a reciprocal visit from a Chinese delegation led by Liu He, a vice-premier, to Washington. One of the sticking points is a timetable for unravelling the tariffs on goods that each side has imposed on the other.

The headwinds from the fading stimulus, slowing global growth, Washington's trade war with China and uncertainty over Britain's departure from the European Union contributed to the Federal Reserve's decision to bring its three-year campaign to tighten monetary policy to an abrupt end. The US central bank abandoned projections for any interest rate hikes this year after increasing borrowing costs four times in 2018.

Also in March, in what many see as a warning sign for the economy, yields on benchmark U.S. 10-year treasury notes fell below three-month rates for the first time since mid-2007, an 'inversion' that has in the past signalled the risk of recession. While it may be understandable for markets to be nervous when the yield curve flattened, the 'inversion' was only brief and some are still confident the US economy is in "a very good place" and the likelihood of a recession in 2019 or 2020 is "not elevated" (a top Federal Reserve policymaker, John Williams, said).

Looking back on an impressive run, the stimulus from \$US1.5 trillion in tax cuts and government spending helped the US economy grow by an impressive 2.9% for 2018 (only just missing the White House's 3% target) and the current expansion looks set to be the longest on record come July.

Europe: Sluggish

When the US and China catch an economic cold, the eurozone gets influenza as the eurozone has proved the most vulnerable to the slowdown in the world economy. It is economically and politically important that its economy escapes another recession (two successive quarters of negative growth). While a recession in Europe still looks unlikely it is a growing probability.

A recent report showed factory output in the eurozone fell in March at the fastest pace in nearly six years, while a gauge of U.S. manufacturing activity slipped to its lowest level in nearly two years. The data sent bond prices rising and yields sliding, with the German 10-year bond yield dropping below zero for the first time since 2016.

Australia: softer growth vs strong labour market

The February reporting season by listed companies was weak. The Australian Bureau of Statistics (ABS) measure of corporate profits growth eased in the fourth quarter of 2018.

Australia's most recent Labour Survey was mixed, with employment rising by less than expected but the unemployment rate falling unexpectedly alongside a lower participation rate. Generally speaking, the labour market remains tight and unemployment low across Australia.

The Reserve Bank of Australia's (RBA) Assistant Governor Michele Bullock reiterated the Bank's cautious but relatively sanguine views on developments in Australia's housing market, noting that debt remains well secured, repayments steady and arrears rates low. The RBA reiterated its neutral policy stance, highlighting its patience in waiting for incoming data "that could help resolve the current tensions in the domestic economic data" – namely softer growth vs a strong labour market.

New Zealand: Dovish surprise

The Reserve Bank of New Zealand kept interest rates on hold on 27 March but warned that the flagging world economy meant that its next move is more likely to be loosening monetary policy than tightening. That news sent the 10-year New Zealand government bond yield tumbling (by 11bp) to a record low of 1.76% and was enough to ripple through other bond markets.

For the fourth quarter in 2018, NZ GDP growth expanded by +0.6% compared to the previous quarter which was in line with consensus expectation but below the RBNZ's expectations.

Summary

In 2019 the dovish tones from central banks have helped to support share markets which suffered from the Federal Reserve's path of tightening end of last year. Headwinds from a slowing global economy, fading stimulus in the US, US-China trade negotiation and uncertainty over Britain's departure from the European Union are the top on the list of central banks' concerns.

We believe that maintaining your long-term neutral asset allocation continues to be appropriate in light of the current environment.