Global Economic and Financial Market Overview

Q3 2019

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Global Economic and Financial Market Overview

1. Performance in 2019 YTD

2. Economic outlook

3. Current financial market backdrop

1. Performance in 2019 YTD

2019 YTD market highlights
Summary

- Positive performance across all asset classes

- Strong performance across equity markets. Developed markets outperform, led by the US and Europe ex UK

- DM government bond yields fall sharply, but underperform rest of FI

- Credit markets positive on lower yields and spreads. HY outperforms IG

- Low or negative rates weighed on cash returns

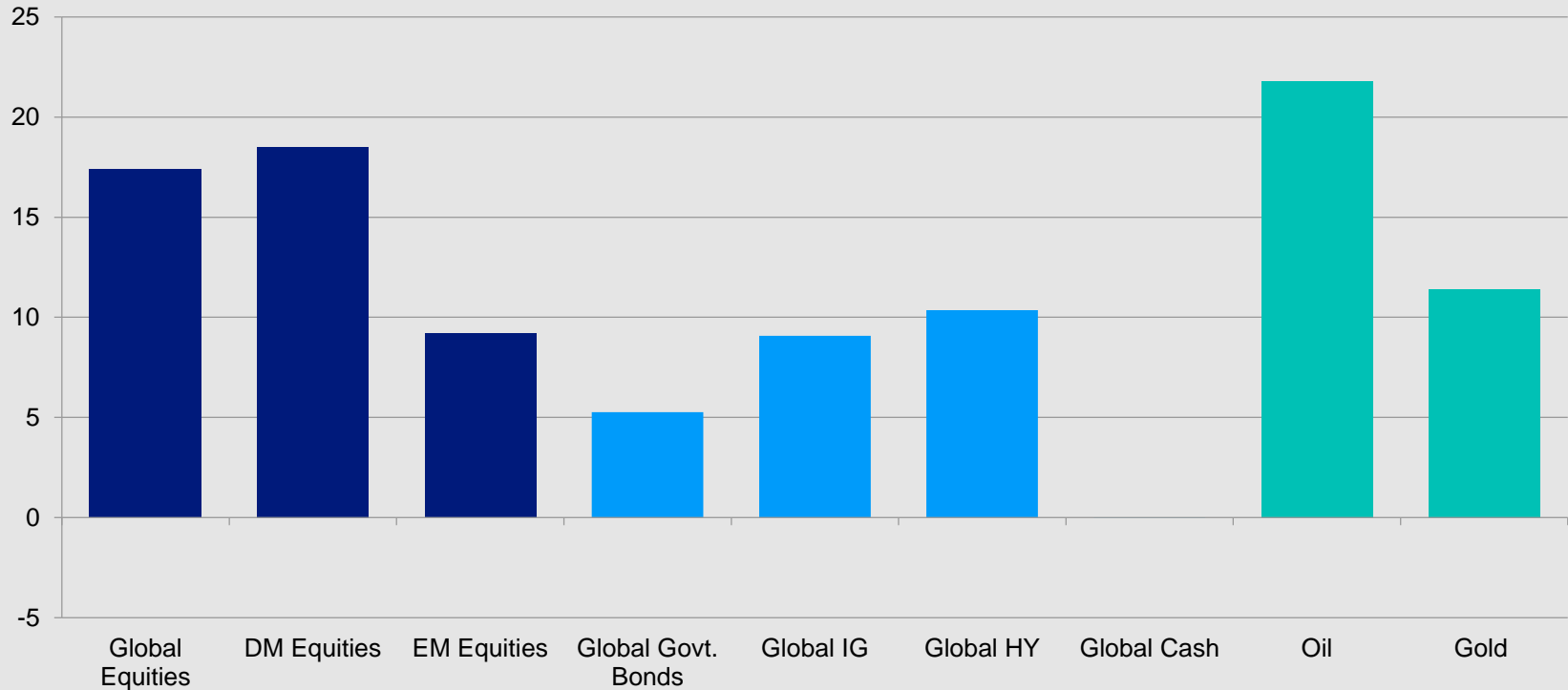- Oil gives up some of gains. Gold rallies

2019 YTD market highlights
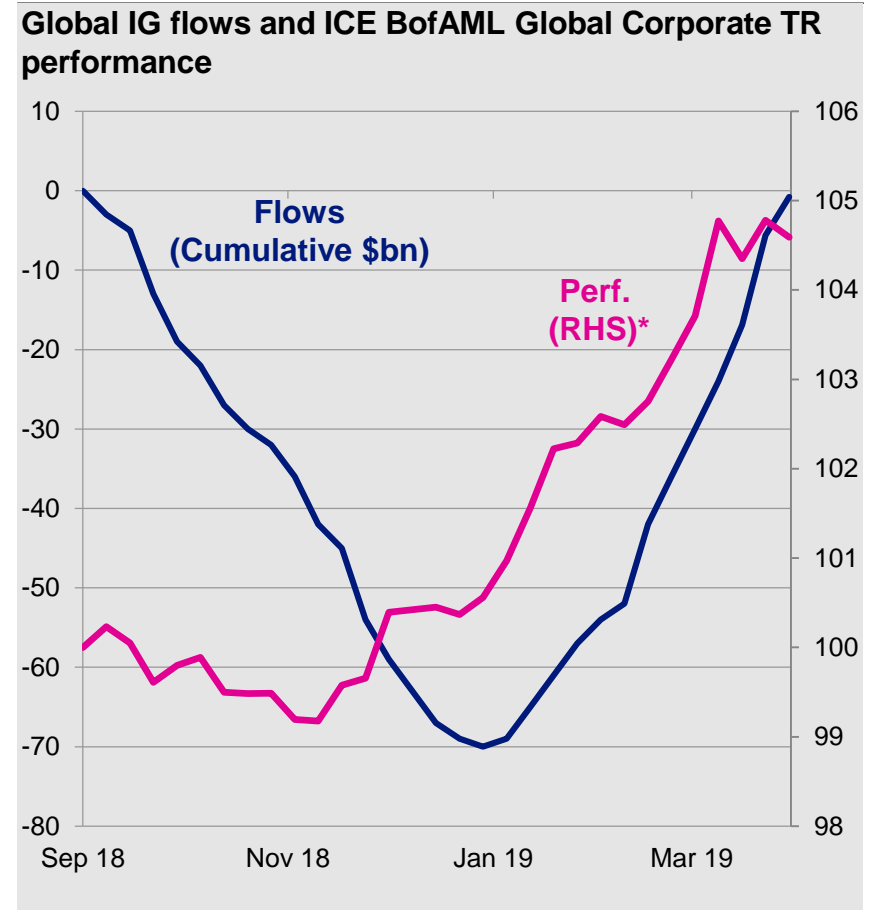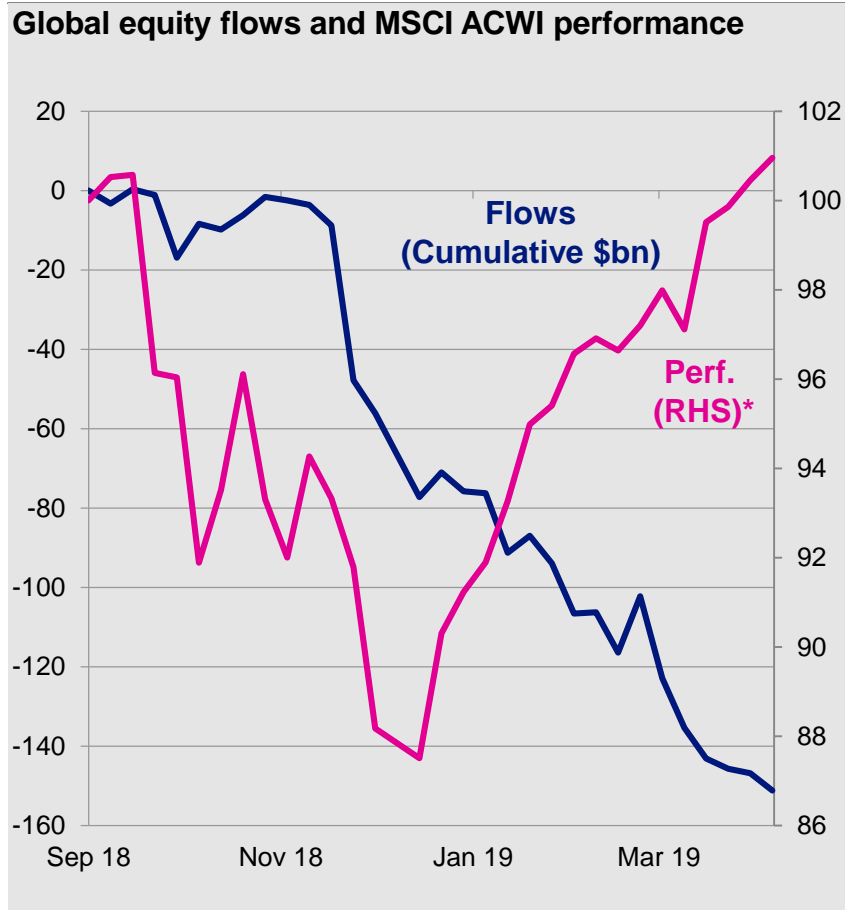## Performance Overview

Global Asset Classes – Total Return performance in 2019 YTD (local currency %)*

Source: Datastream as at 1 August 2019. *Indices used are: Global Equities – MSCI ACWI, DM Equities – MSCI World, EM Equities – MSCI EM, Global Govt. Bonds – ICE BofA ML Global Government, Global IG – ICE BofA ML Global Corporate, Global HY – ICE BofA ML Global High Yield, Global Cash – JPM Global Cash 1m, Oil – Crude Oil BFO M1 Europe FOB $/bbl, Gold – Gold Bullion LBM U$/Troy Ounce.

Asset class flows
The rally has not been reflected in equity fund flows…but FI has seen substantial inflows
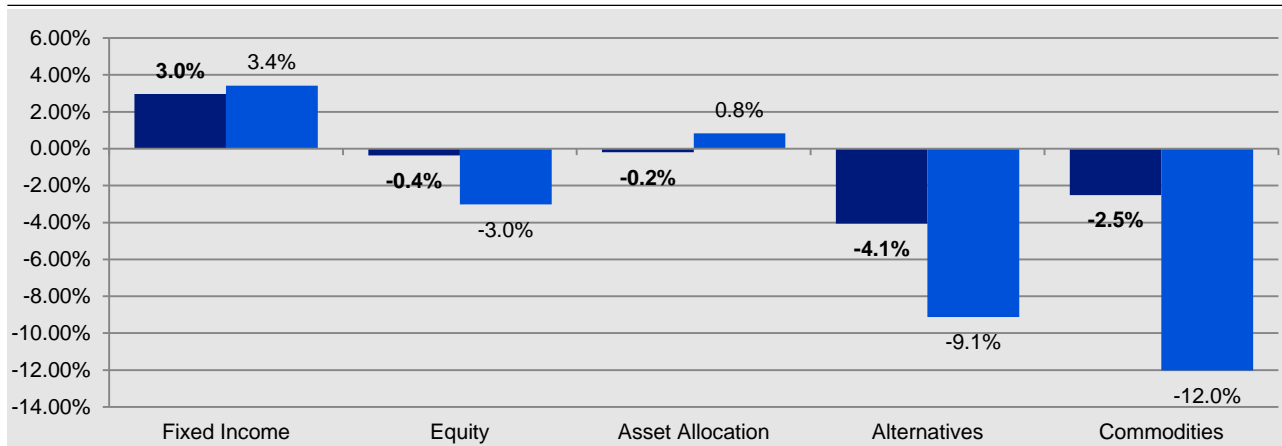
Global equity flows and MSCI ACWI performance

Flows (Cumulative $bn)

Perf. (RHS)*

Global IG flows and ICE BofAML Global Corporate TR performance

Flows (Cumulative $bn)

Perf. (RHS)*

Source: BofAML as at 2 August 2019. *Rebased 100 = 19 September 2018. $ = US.

Market highlights
Flow summary

YTD net flows (quarterly flow growth rate %)

Chart values: Fixed Income 3.0% / 3.4%, Equity -0.4% / -3.0%, Asset Allocation -0.2% / 0.8%, Alternatives -4.1% / -9.1%, Commodities -2.5% / -12.0%

YTD – Top/Bottom 5 sectors by Net Flows

Chart values: Global Flexible Bond-USD Hedged 8.76bn, EUR Corporate Bond 7.49bn, Global Bond 5.28bn, USD Flexible Bond 4.01bn, Global Large-Cap Blend Equity 3.78bn, Asia ex Japan Equity -2.71bn, US Large-Cap Value Equity -3.11bn, Global Emerging Markets Equity -3.32bn, Alt - Market Neutral - Equity -3.96bn, Eurozone Large-Cap Equity -8.32bn

2019 Q2:

- **Investors have switched to the "save mode".** Less risky asset classes (government bonds, corporate bonds) are preferred
- **Market inflows continue to be positive during 2nd quarter** (EUR 32bn)
- Fixed income investments **attracted the most flows** (EUR 64bn) whereas outflows in equities accelerated (EUR -25bn)
- After being a "top sector" by net flows in Q1, **Emerging Markets (equities & bonds) lost in Q2**

Source: Morningstar Direct, Estimated Net Flows from 01/01/2019 to 30/06/2019, Net Flows/Total Net Assets in EURO as stated in Morningstar Direct Asset Flow application.

2. Economic outlook
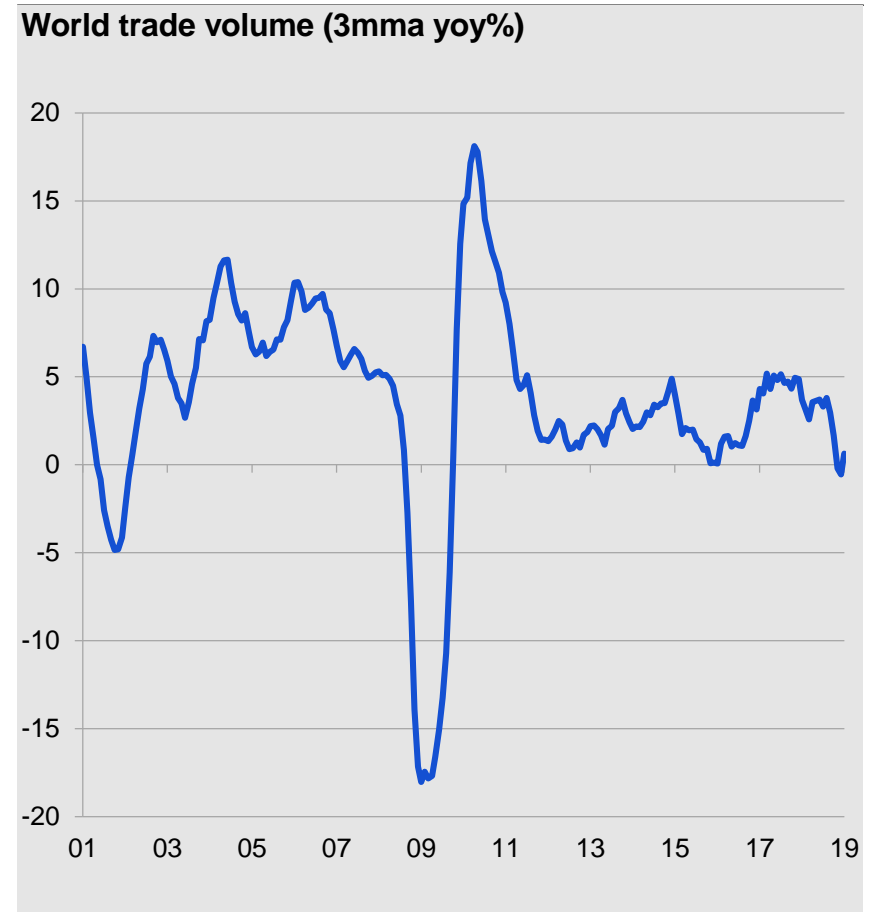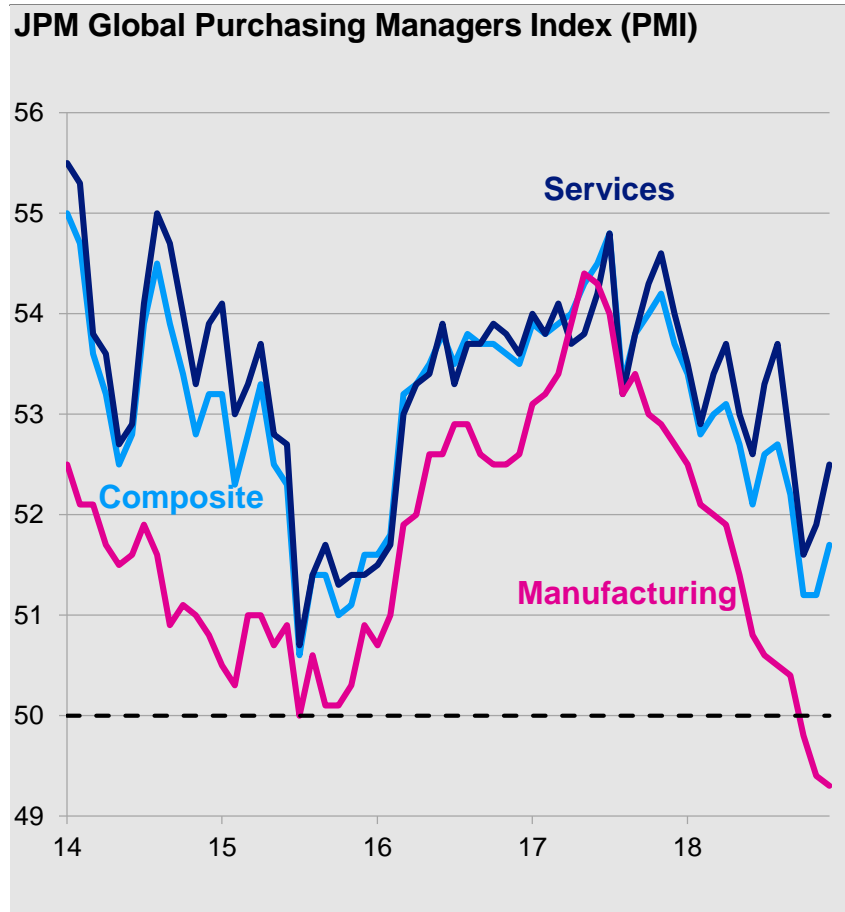
The global macro backdrop
Heightened levels of uncertainty…

Global Economic Policy Uncertainty index*
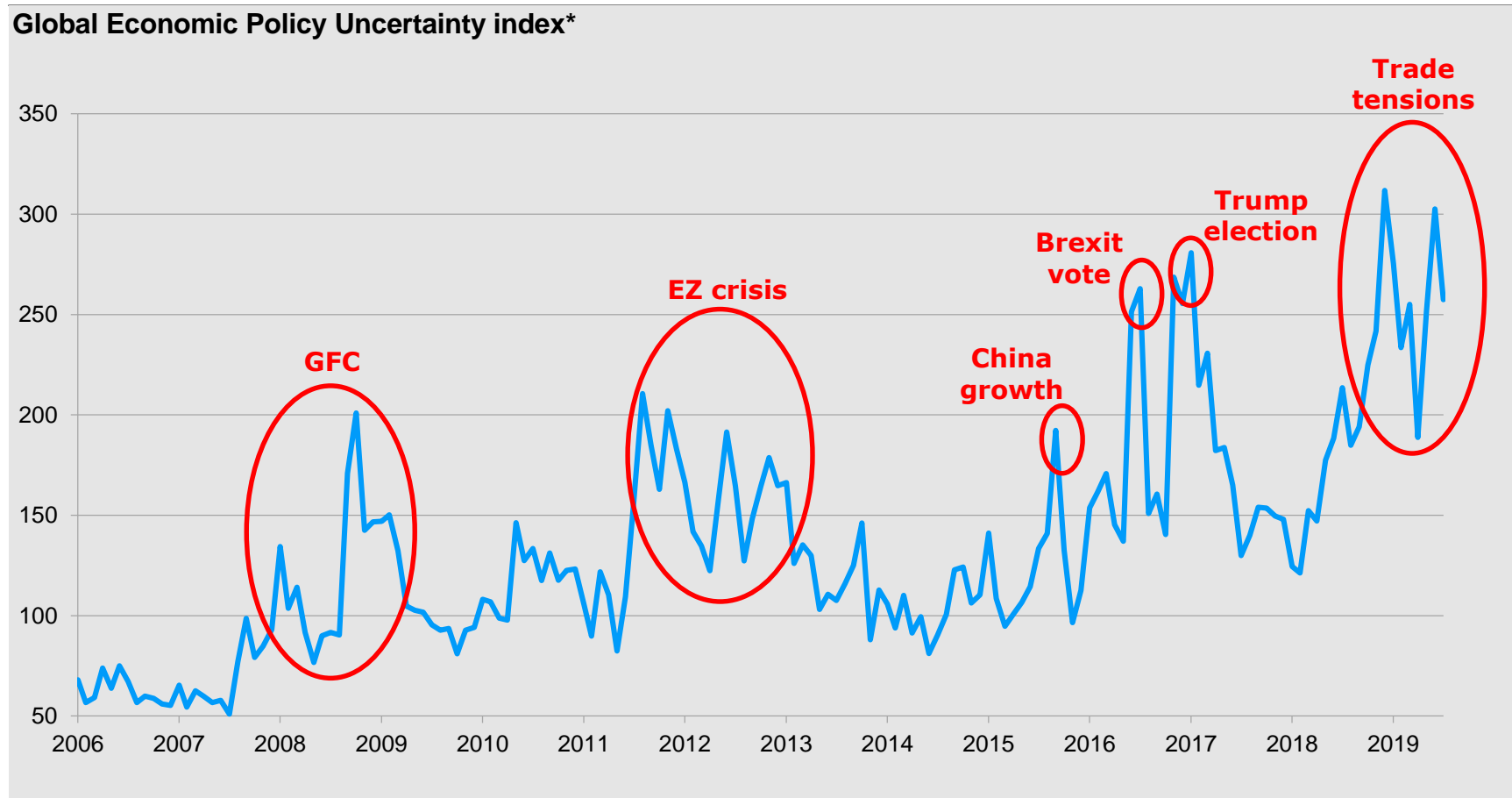
Source: Bloomberg as at 6 August 2019. *Based on current price GDP weights. GFC = Global Financial Crisis.
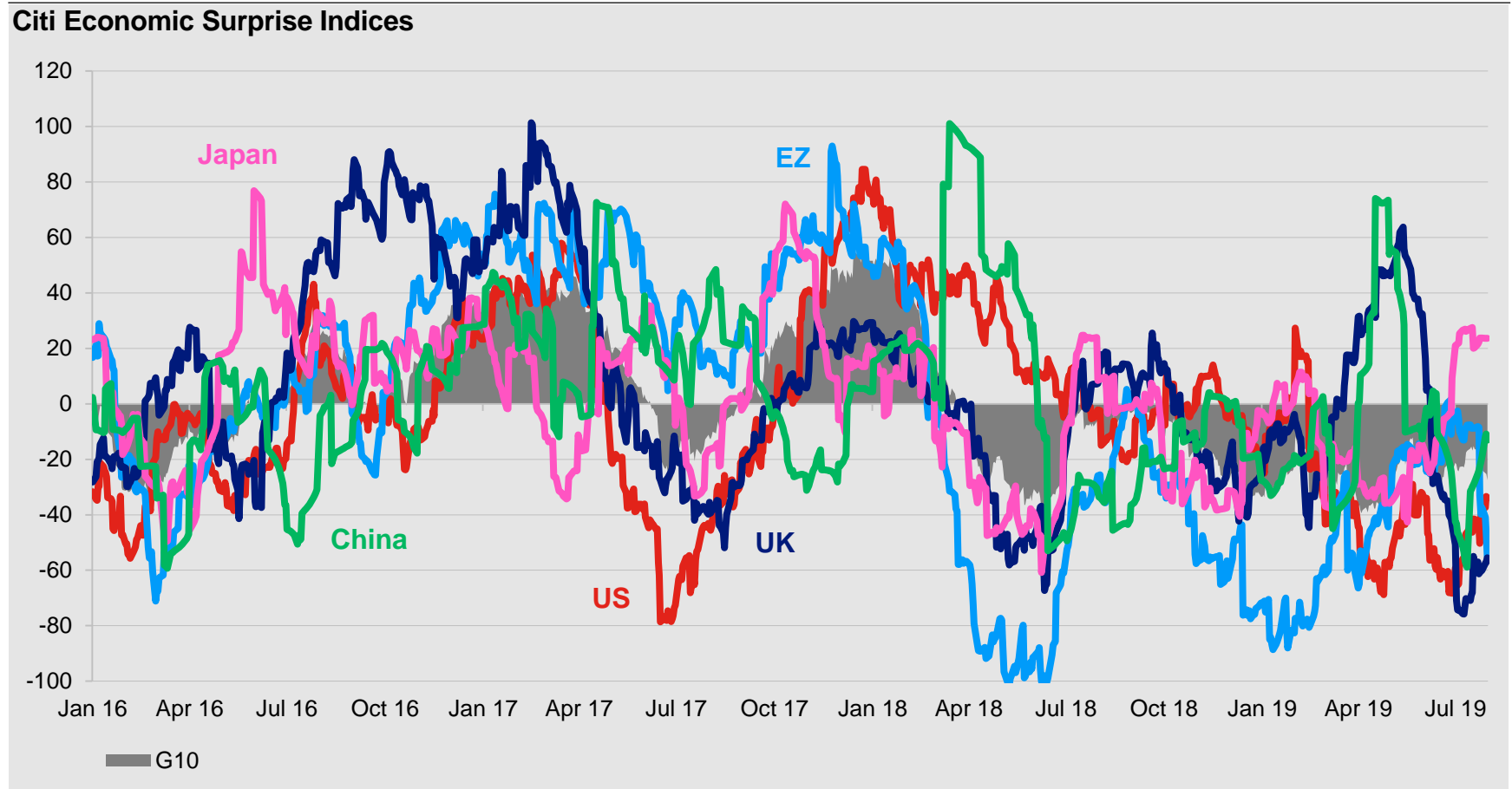
The global macro backdrop
…has led to further weakness in PMIs and a sharp fall in global trade…

JPM Global Purchasing Managers Index (PMI)

World trade volume (3mma yoy%)

Source: Bloomberg and Datastream as at 6 August 2019.

The global macro backdrop
…and a record period of negative G10 economic newsflow
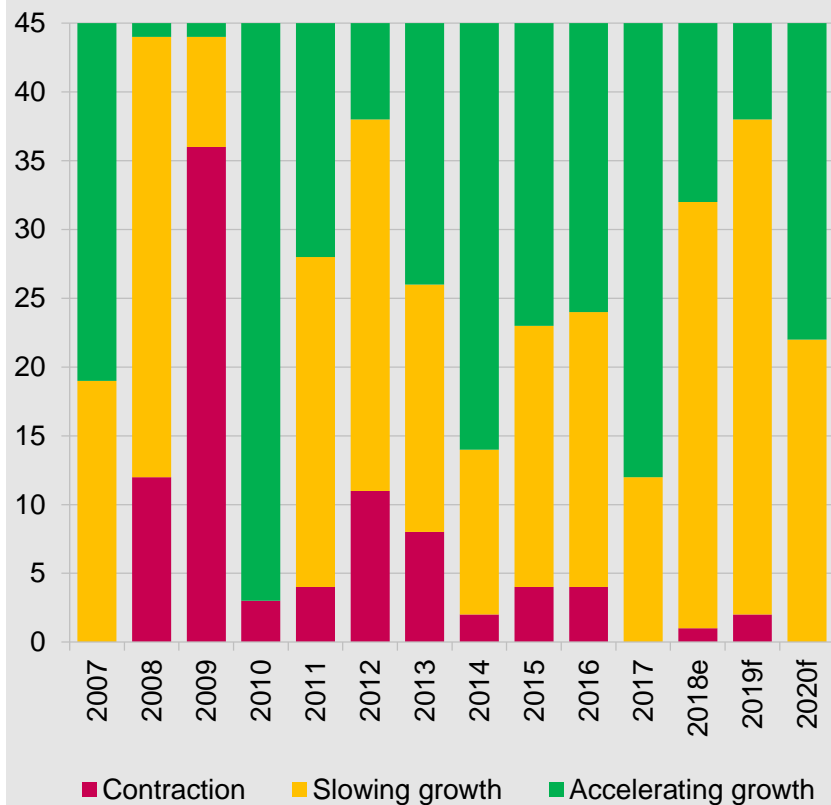
Citi Economic Surprise Indices

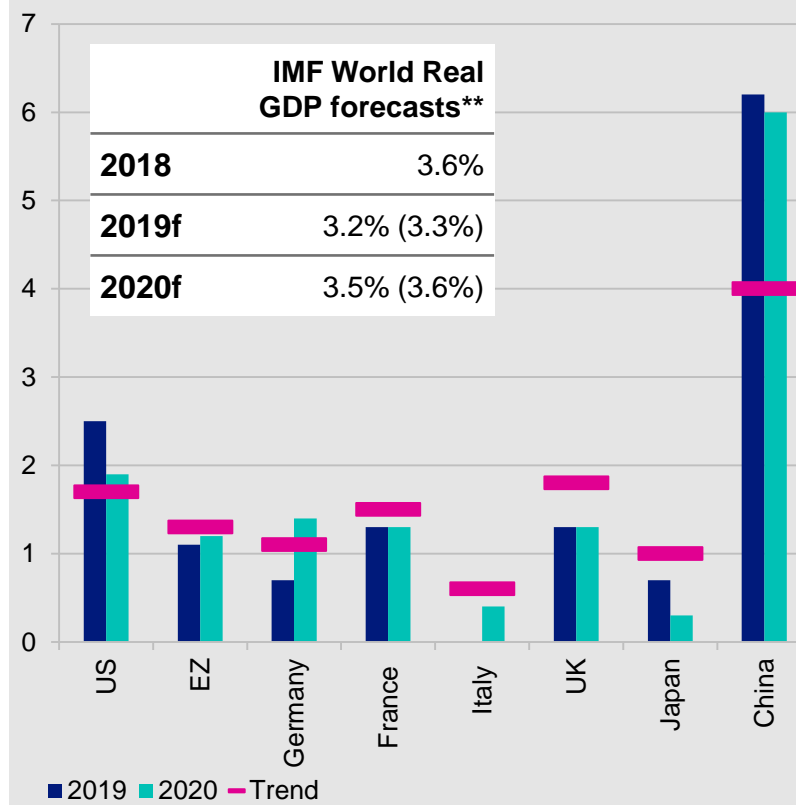Source: Datastream as at 1 August 2018.

The global macro backdrop
A synchronised slowdown in 2019…but with the global outlook currently forecast to improve in 2020
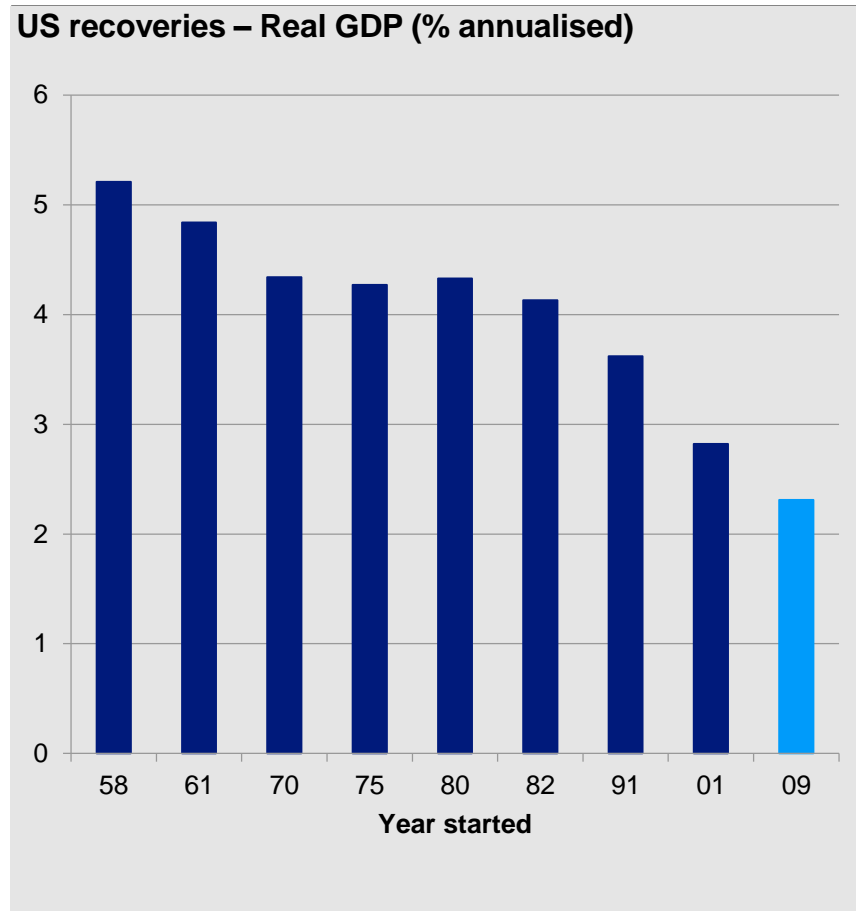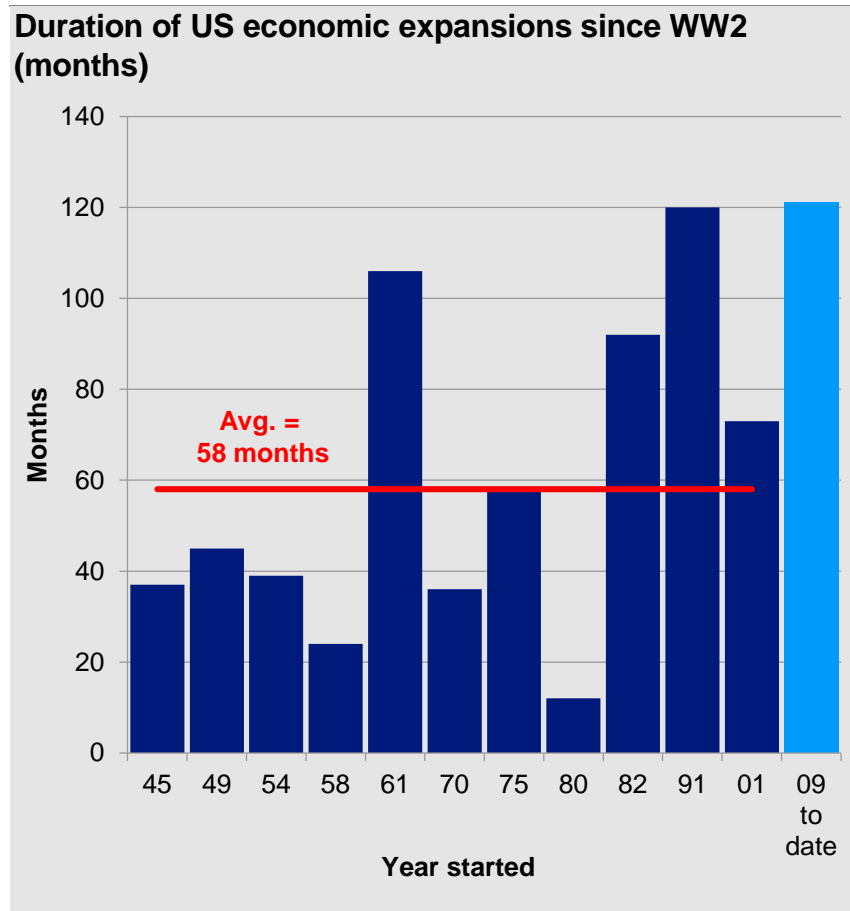

Country GDP growth performance (number)

Legend: Contraction, Slowing growth, Accelerating growth

Consensus GDP forecasts for 2019 and 2020 (%)*

IMF World Real GDP forecasts**	
2018	3.6%
2019f	3.2% (3.3%)
2020f	3.5% (3.6%)

Countries: US, EZ, Germany, France, Italy, UK, Japan, China

Legend: 2019, 2020, Trend

US recession risk
A record US recovery…but at much slower growth rates than in previous cycles

Duration of US economic expansions since WW2 (months)

Avg. = 58 months

US recoveries – Real GDP (% annualised)

Source: LHC: NBER (National Bureau of Economic Research) as at 1 August 2019. RHC: NBER and Datastream as at 1 August 2019.

US recession risk
Near-term recession risks appear low currently (1/2)

Yield curve inversion – 10yr-2yr UST spread (%)

Recessions

Conference Board Lead Indicator (CLI)*
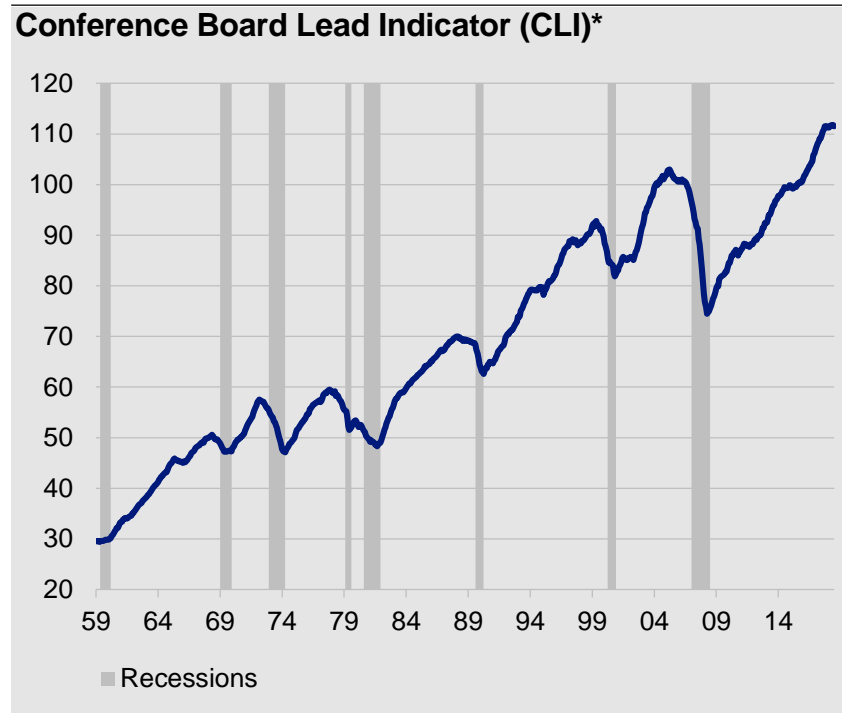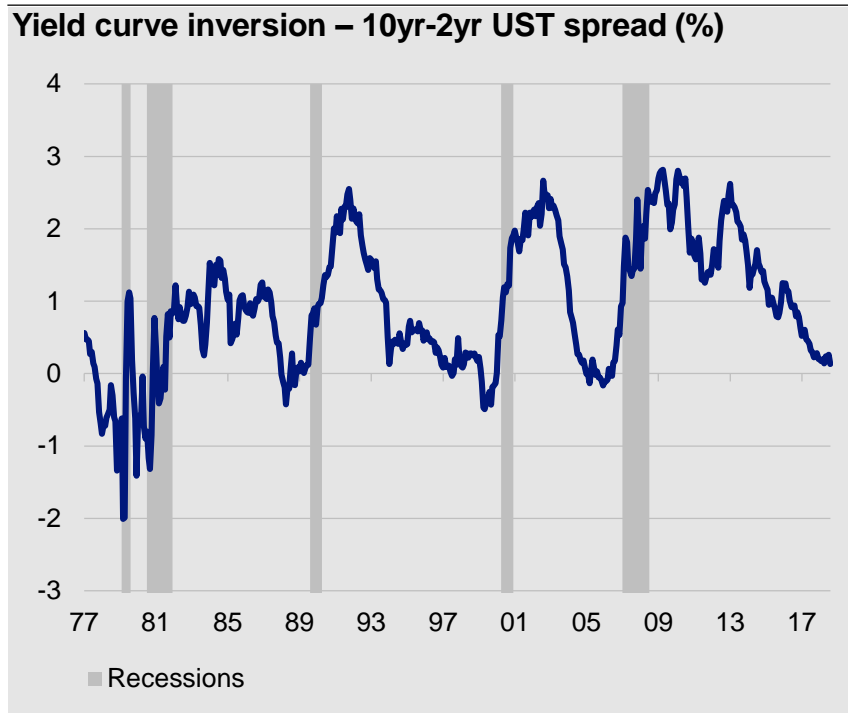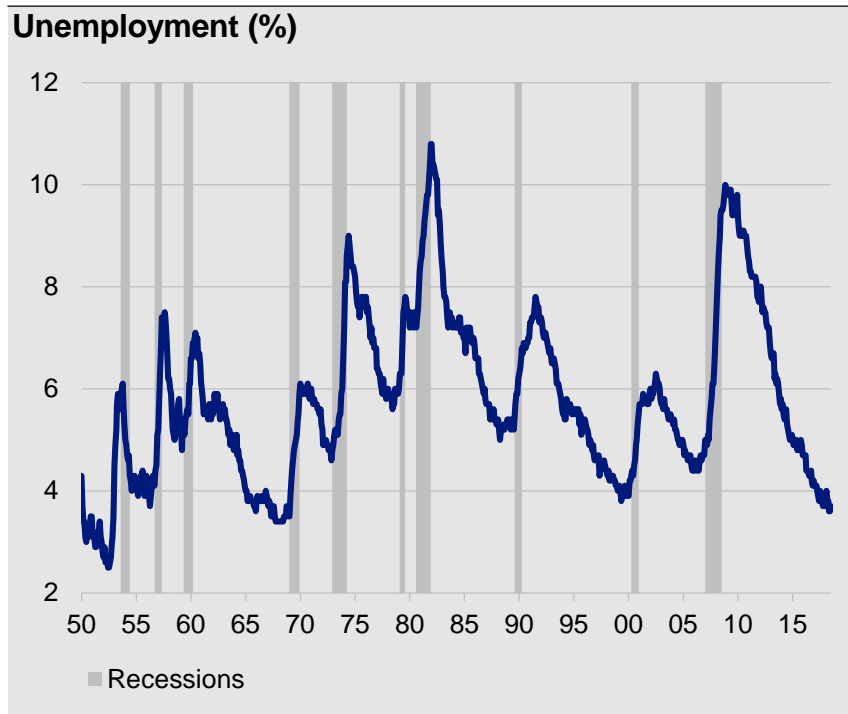

Recessions

- Historically an inversion of the yield curve has been the most consistent lead indicator of a recession with an average 21 month lead (10 – 34m range) over the past 40 years

- Not yet inverted this cycle, but at 12bp back close to flattest it has been (11bp)

- The CLI has historically peaked on average 15 month ahead of a recession (9 - 22m range)

- Currently the CLI has declined marginally from its recent peak
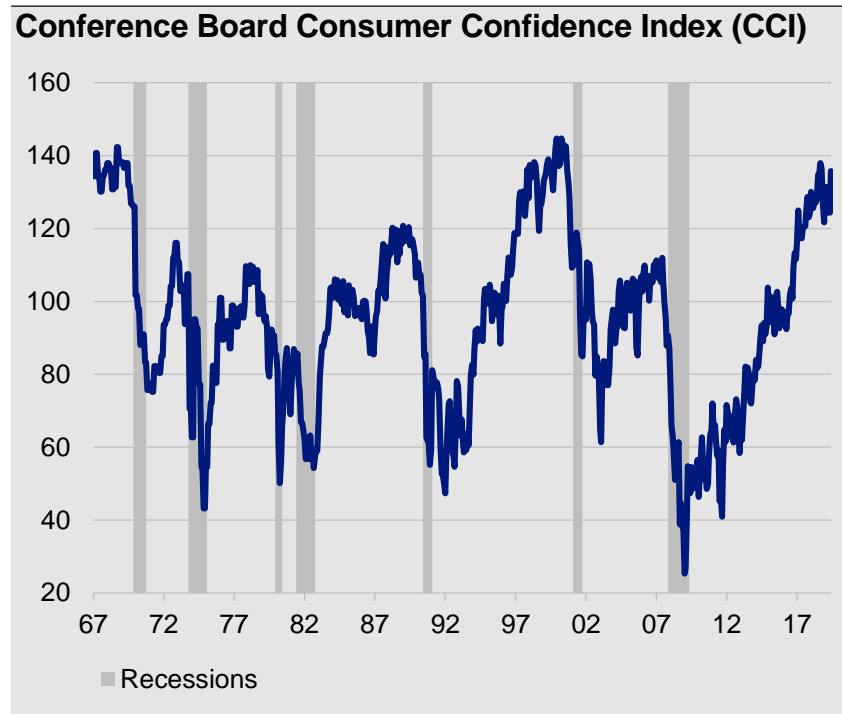
Source: Datastream as at 1 August 2019. *The CLI is the composite average of the following: Average weekly hours, manufacturing; Average weekly initial claims for unemployment insurance; Manufacturers' new orders, consumer goods and materials; Vendor performance, slower deliveries diffusion index; Manufacturers' new orders, nondefense capital goods; Building permits, new private housing units; Stock prices, 500 common stocks; Money supply, M2; Interest rate spread, 10-year Treasury bonds less federal funds; Index of consumer expectations.

US recession risk
Near-term recession risks appear low currently (2/2)

Unemployment (%)

Recessions

Conference Board Consumer Confidence Index (CCI)
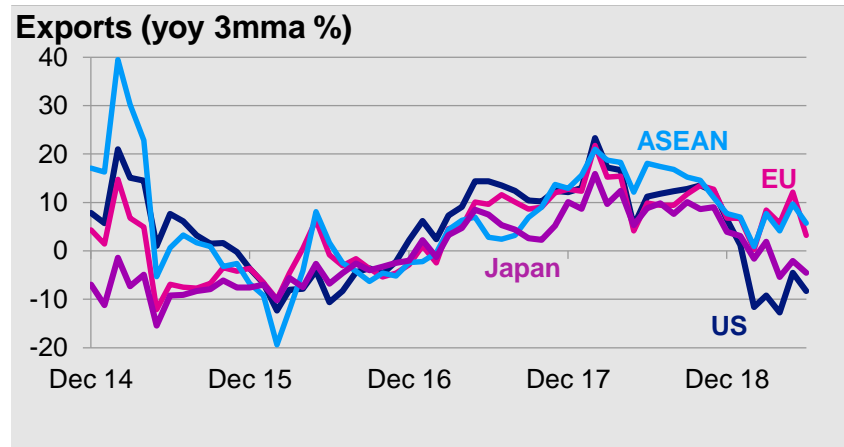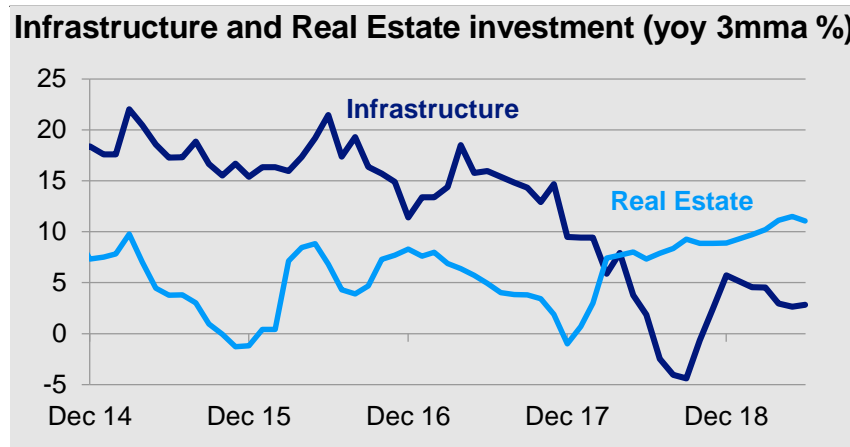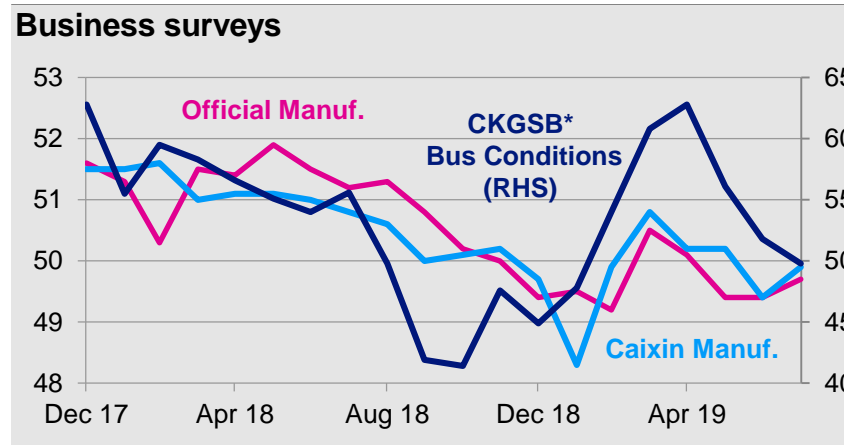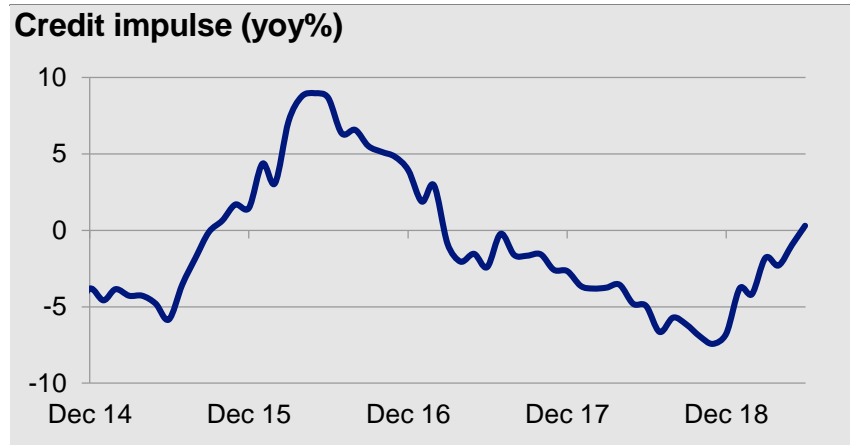

Recessions

- Unemployment has historically troughed on average 10 months ahead of a recession (2 - 17m range)
- The latest unemployment figure shows a rise from cyclical low of 3.6% to 3.7%.

- The CCI has historically peaked on average 15 month ahead of a recession (6 - 22m range)
- Currently the index is rising and close to cycle highs

Source: Datastream as at 1 August 2019.

Positive developments?
Chinese green shoots?

Credit impulse (yoy%)

Business surveys
- Official Manuf.
- CKGSB* Bus Conditions (RHS)
- Caixin Manuf.

Infrastructure and Real Estate investment (yoy 3mma %)
- Infrastructure
- Real Estate

Exports (yoy 3mma %)
- ASEAN
- EU
- Japan
- US

Source: Datastream and Bloomberg as at 1 August 2019. *CKGSB = Cheung Kong Graduate School of Business.

Positive developments?
Eurozone growth outlook - The backdrop remains challenging…
particularly for the industrial sector

Exports and Manufacturing production (yoy%)

Non-EZ exports

Manufacturing

Unemployment and Consumer Confidence

Cons Conf (RHS)

Unemployment (%)
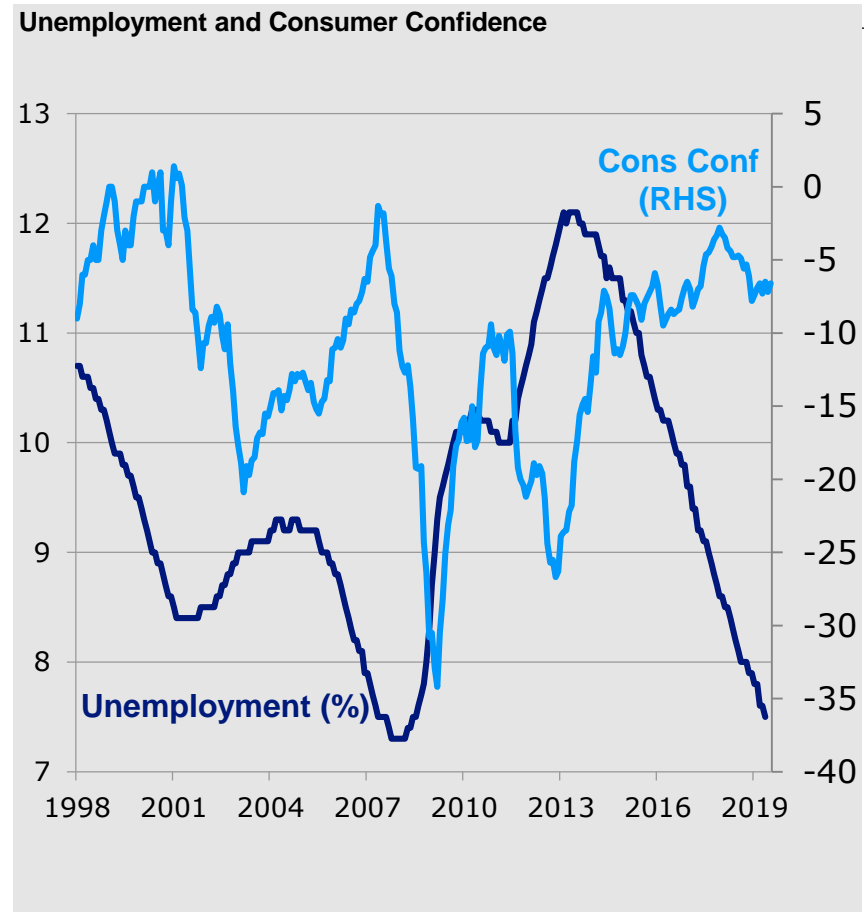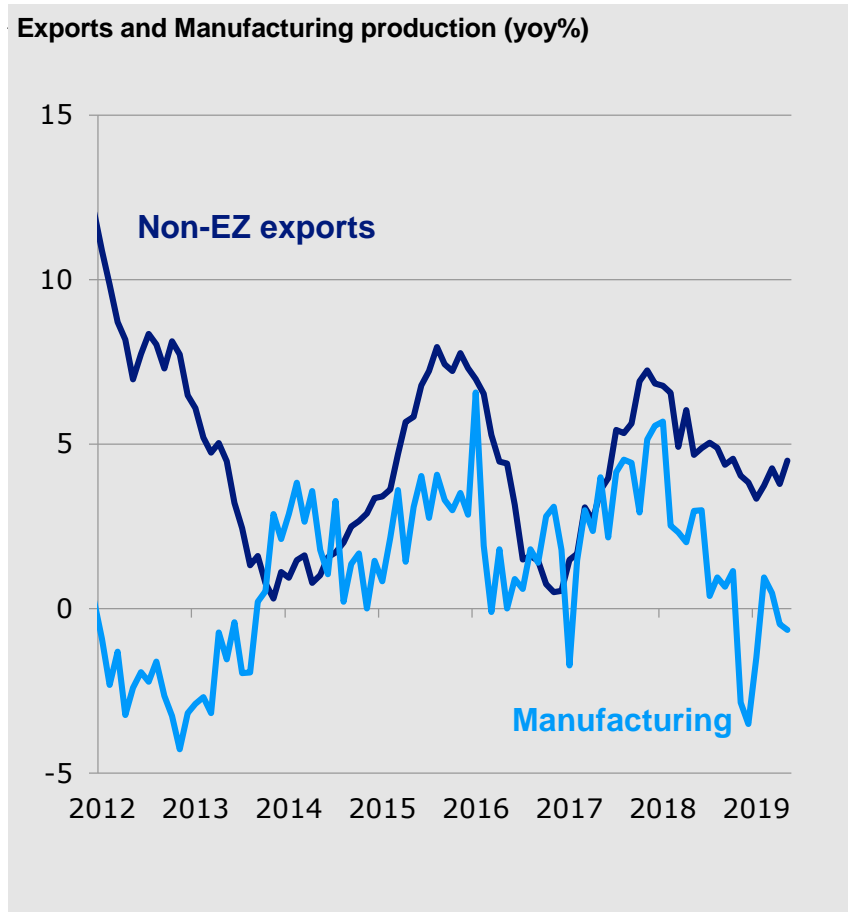
Source: Datastream as at 27 July 2019.

Positive developments?
Financial conditions have eased further

Goldman Sachs (GS) US Financial Conditions Index

GS Financial Conditions Index and ISM Manufacturing PMI

Positive developments?

Fiscal policy is a tailwind in 2019…particularly in China and the EZ…and further easing may be in the pipeline

Change in cyclically-adjusted primary balance as % potential GDP (%)

Regional change in cyclically-adjusted primary balance as % potential GDP (%)
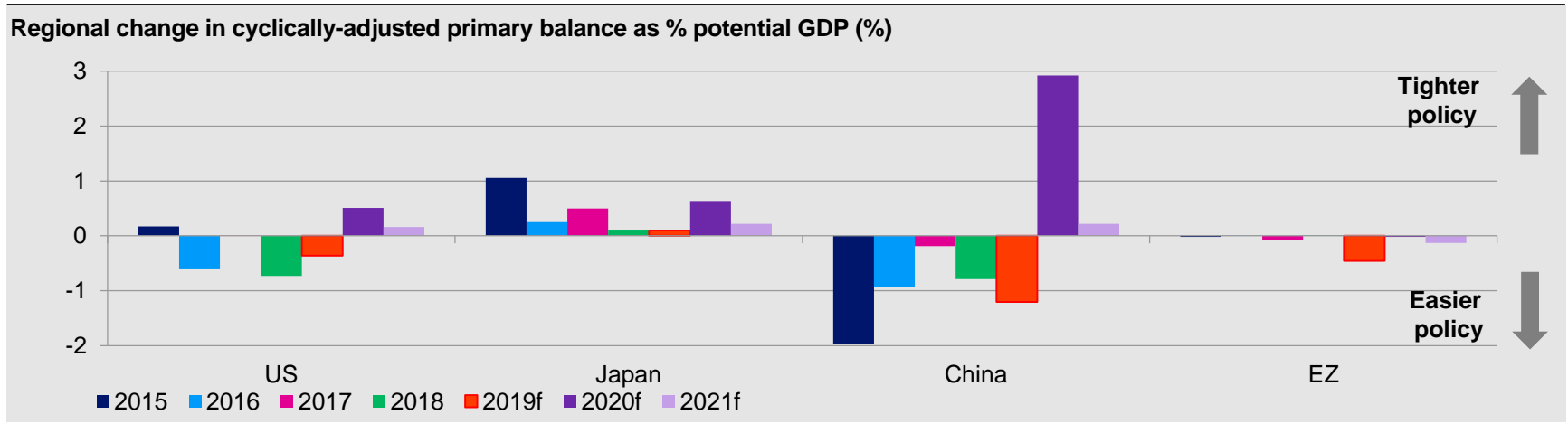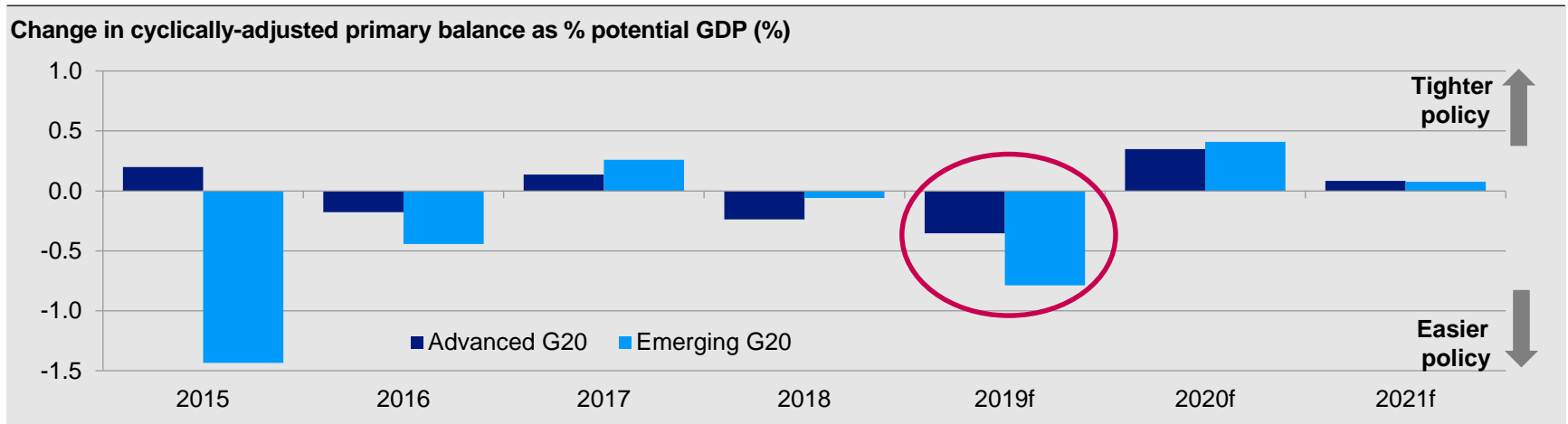
Source: Top chart: IMF and Datastream as at 10 April 2019. Bottom chart: IMF and Datastream as at 10 April 2019.

Positive developments?
Potential for amelioration of tensions on the trade front?

USMCA ratification

Section 232 auto tariff decision

US – China trade negotiations

US bi-lateral free trade negotiations with Japan and Europe

Source: Invesco as at 1 August 2019.

Trade
Exposure to US / China trade tensions varies hugely…and not every country is a loser?

Share of country exports to China and US (%)

Asian exports to US (yoy%)
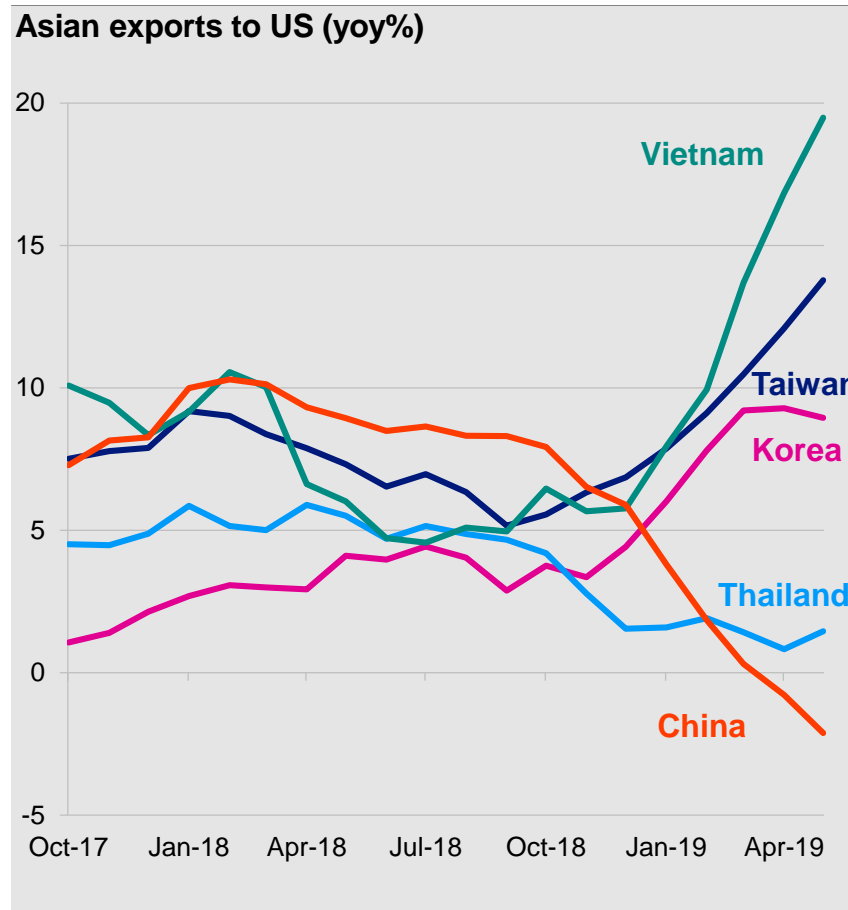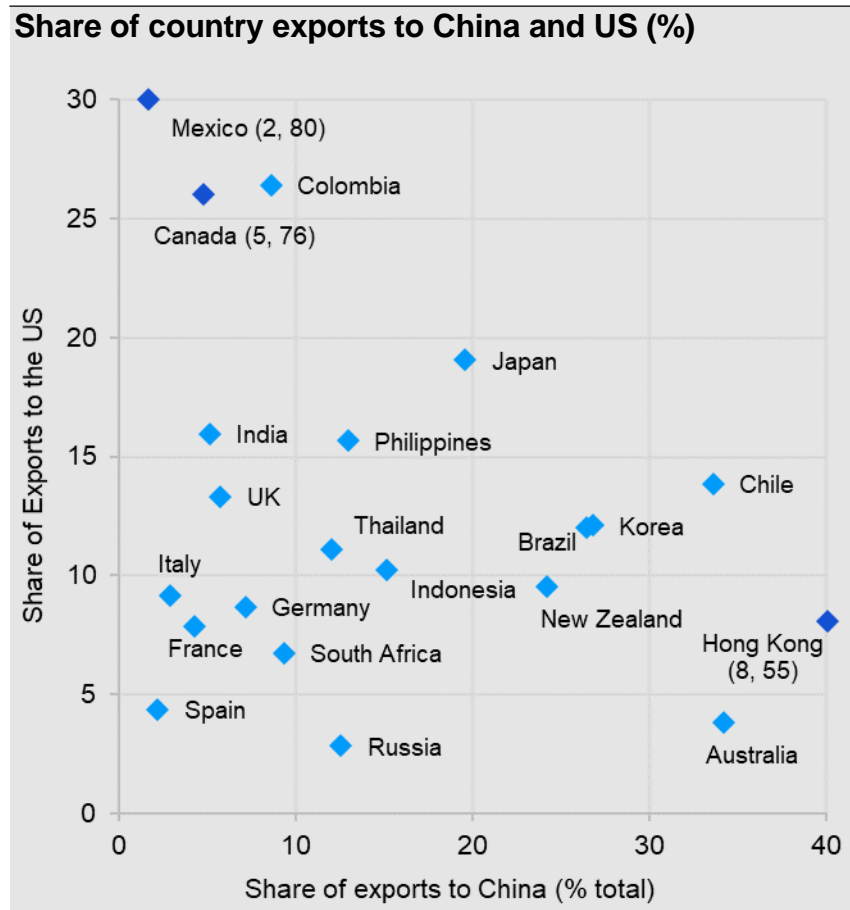
Source: LHC: Source: HSBC as at 27 July 2019. Note that Mexico, Canada and Hong Kong figures have been adjusted to appear in the scatter chart – actual numbers are shown in parentheses). RHC: Source: Datastream as at 1 August 2019.

Brexit
Increased risk of No Deal

Brexit options

Re-negotiation and new deal	General election	Referendum	Cancel Brexit	No-deal Brexit

UK import tariffs from the EU27 post No Deal (%)*

- 82%
- 13%
- 5%

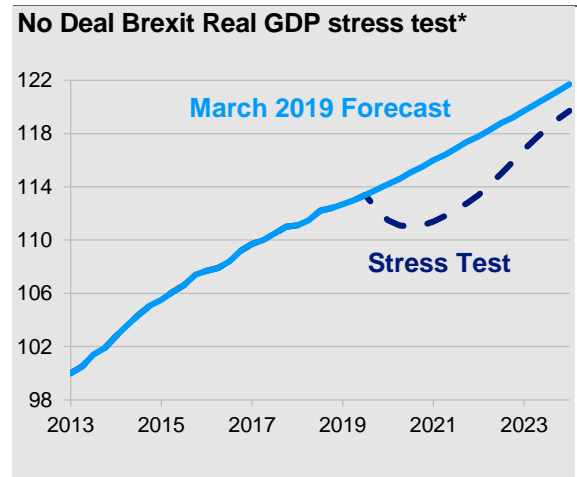- ■ Tariff free
- ■ Subject to tariff =<10%
- ■ Subject to tariff >10% or non-ad valorum tariff

EU27 import tariffs from the UK post No Deal (%)*

- 49%
- 45%
- 6%

- ■ Tariff free
- ■ Subject to tariff =<10%
- ■ Subject to tariff >10% or non-ad valorum tariff

No Deal Brexit Real GDP stress test*

March 2019 Forecast

Stress Test

Source: Top chart: Invesco for illustrative purposes only. Bottom LHC and MC: Dmitry Grozoubinski of ExplainTrade.com as at July 2019. *Based on average imports 2016 – 2018. UK data based on UK's temporary No Deal tariff regime. Bottom RHC: OBR as at 17 July 2019.

Positive developments?
US$ relatively stable

US$ Trade Weighted and JPMorgan EM Currency indices*

JPM EM currency index

Broad Trade Weighted Index
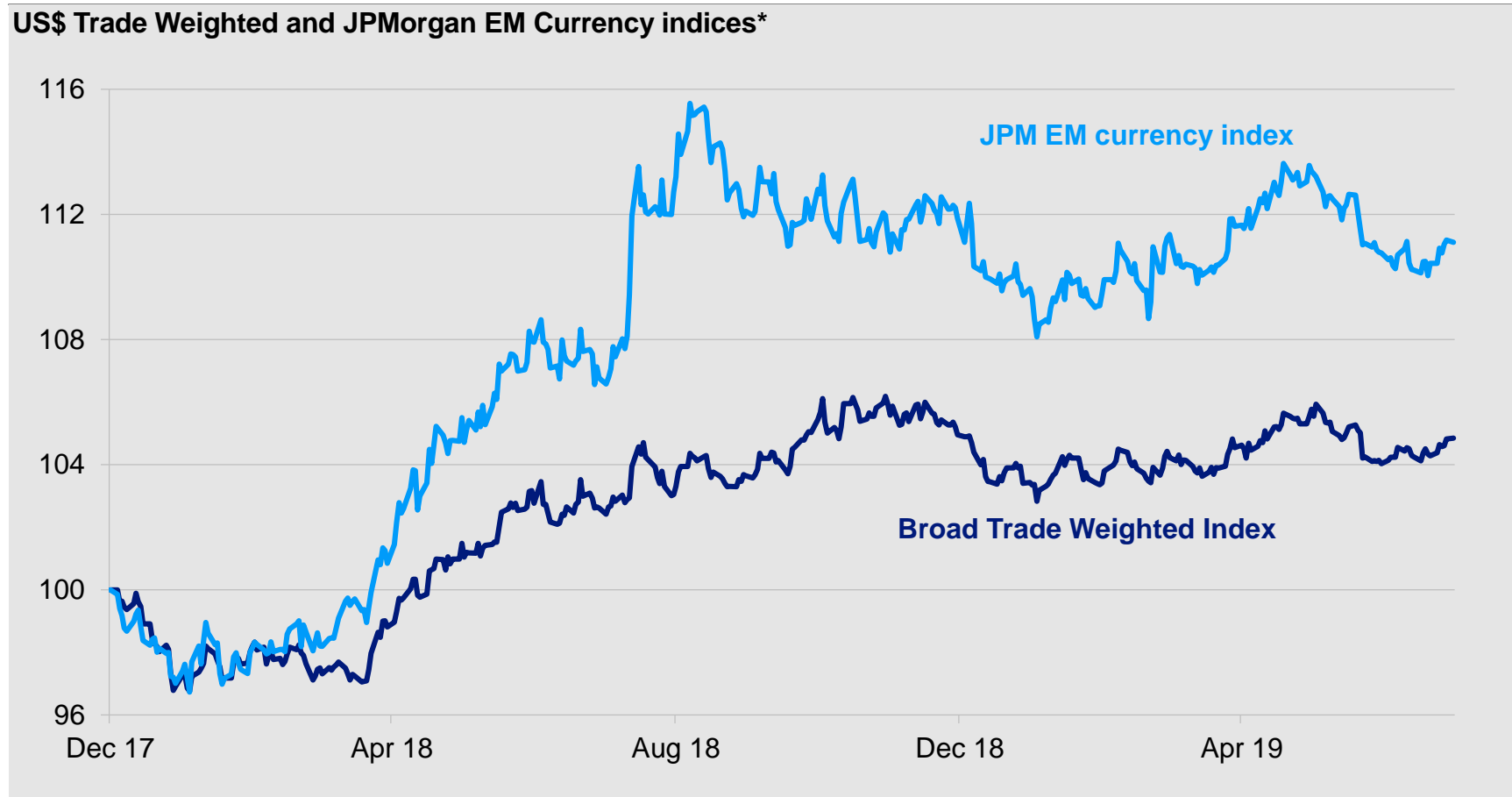
Source: Datastream as at 1 August 2019. *Rebased 100 = 29 December 2017.

Positive developments?

Markets expecting more dovish Central Banks, especially the Federal Reserve, but major additional QE not yet on agenda…

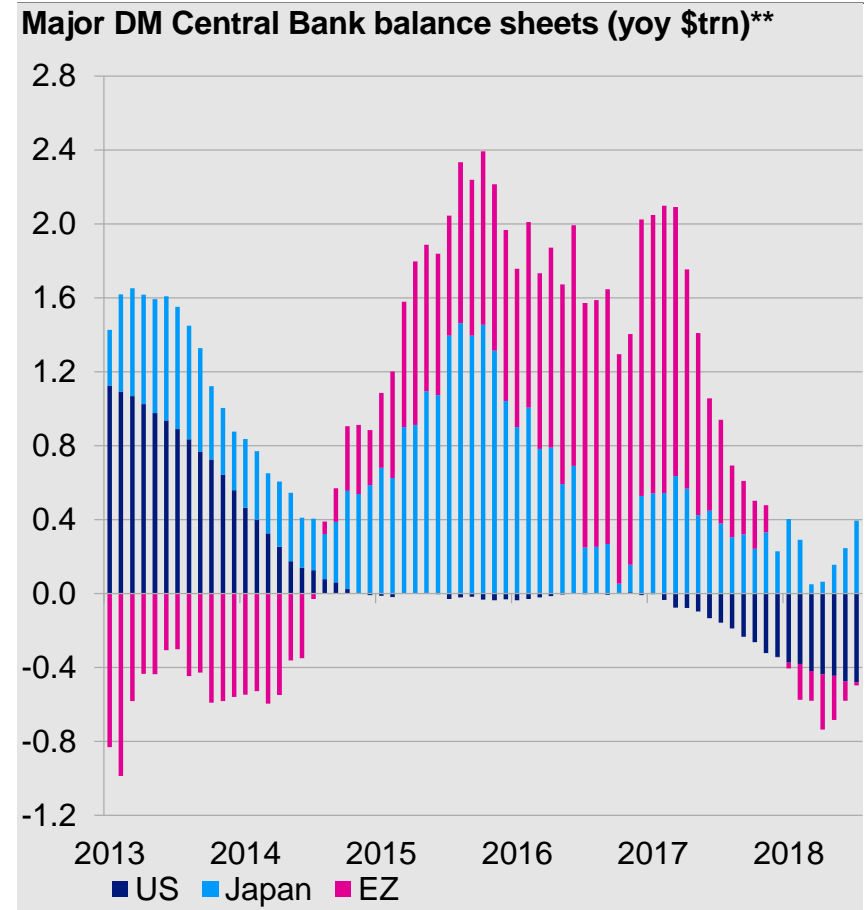**Expected interest rate change over next 12 months (%)***

US, EZ, UK, Japan

Major DM Central Bank balance sheets (yoy $trn)**

US, Japan, EZ
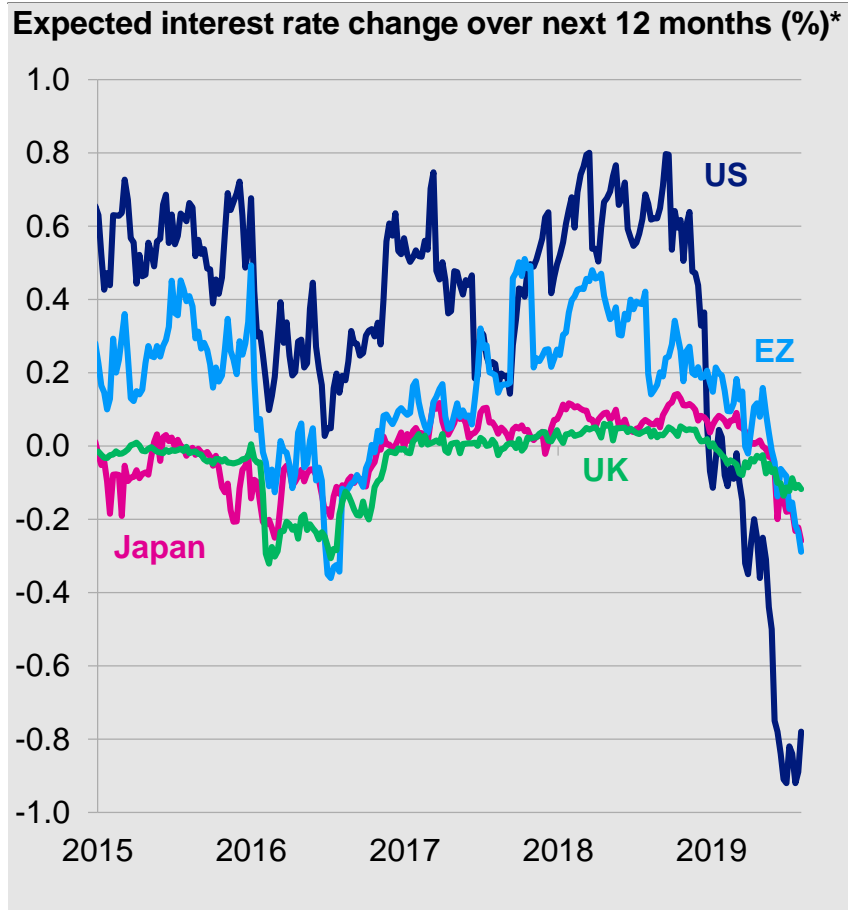
Source: LHC: Bloomberg as at 1 August 2019. *US – USD OIS Forward Swap 1y 1m minus US Fed Funds Effective Rate, Japan – JPY Forward Swap 1y 1m minus Bank of Japan Estimate Unsecured Overnight Call Rate, EZ – Eur Eonia Forward Swap 1y 1m minus EMMI Euro Overnight Index. RHC: Source: Datastream as at 1 August 2019. **US, EZ and Japan in US$.

Monetary policy
…and far less room on the conventional policy front too

Major DM Central Bank policy rates (%)

Legend: US, EZ, Japan, UK, Australia, Canada, NZ, Sweden, Switzerland

US rate cuts around recent recessions (%)

X-axis: Jun 89 - Sep 92, Jan 01 - Jun 03, Sep 07 - Dec 08, Current to zero bound
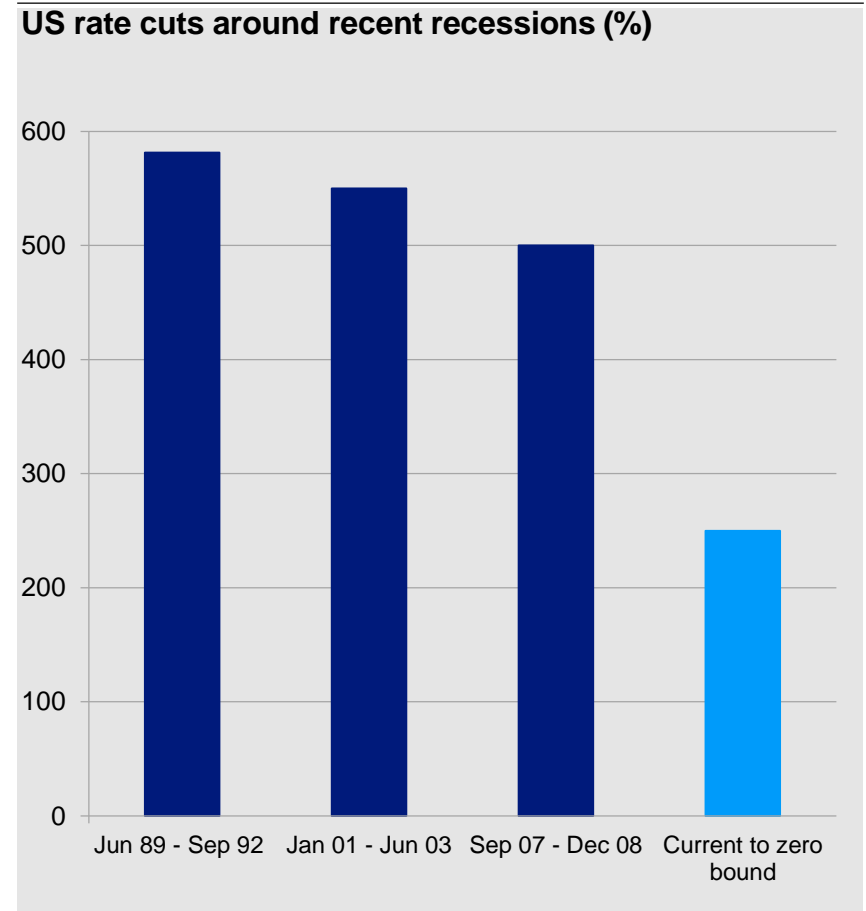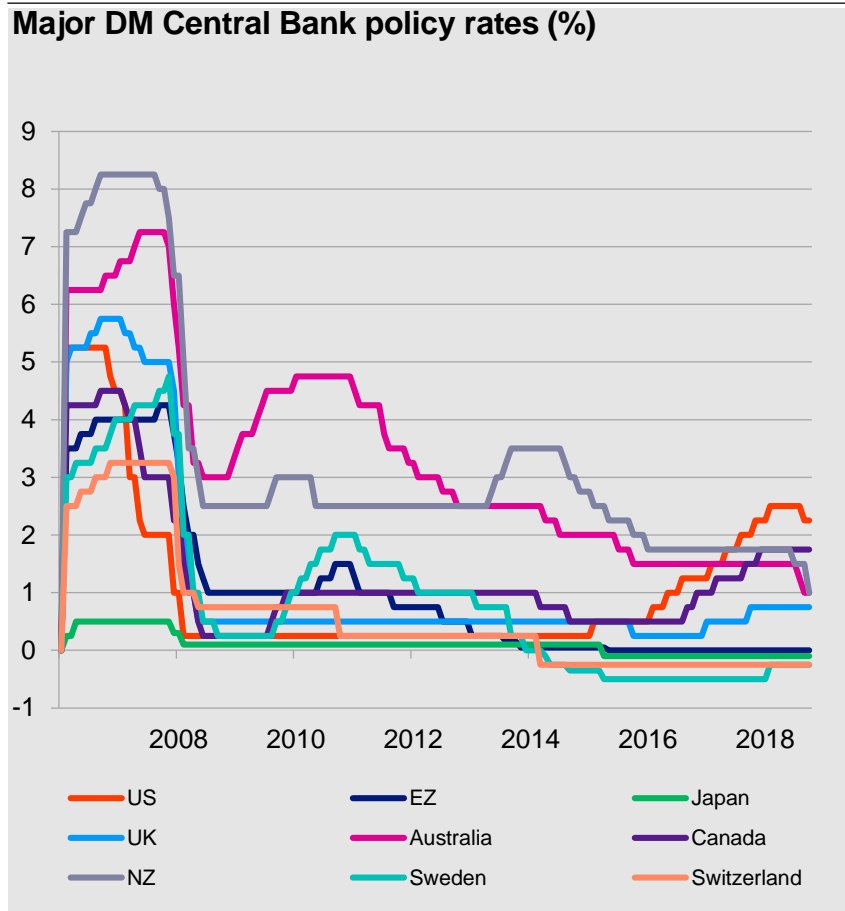
Source: LHC: Bloomberg and Datastream as at 7 August 2019. RHC: Datastream as at 1 August 2019.

Inflation outlook
Central Banks have struggled to hit their inflation targets since the GFC…and may continue to do so…

Inflation relative to Central Bank inflation objectives since the GFC*

Headline inflation and Central Bank forecasts (yoy %)*
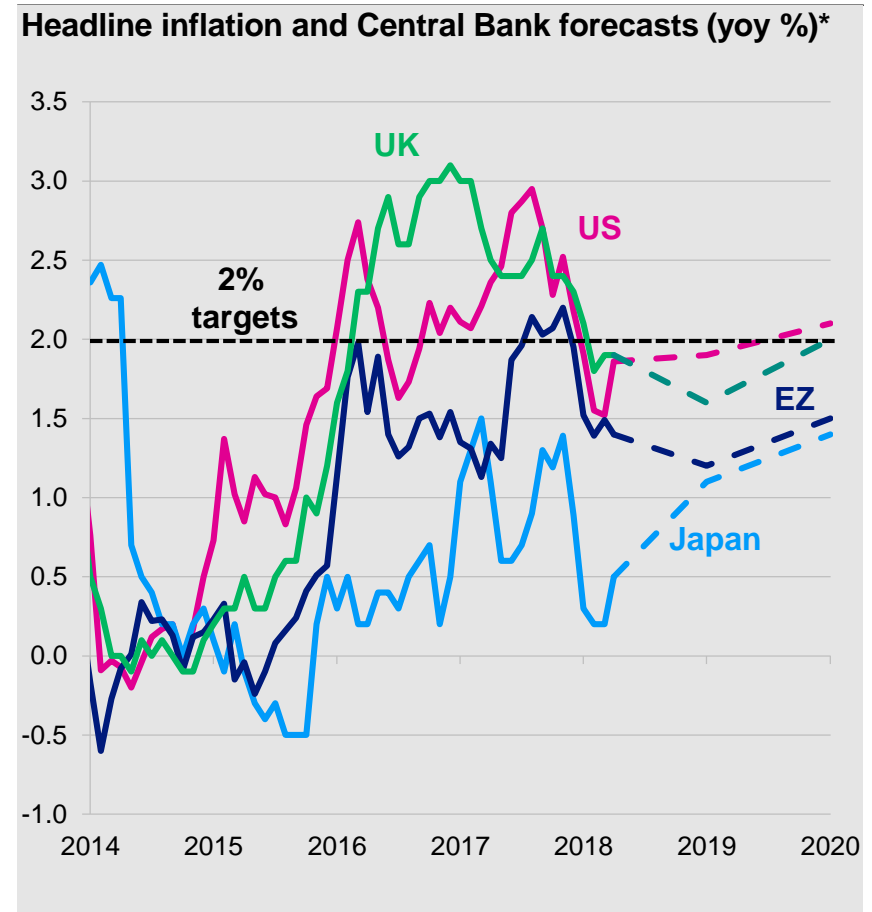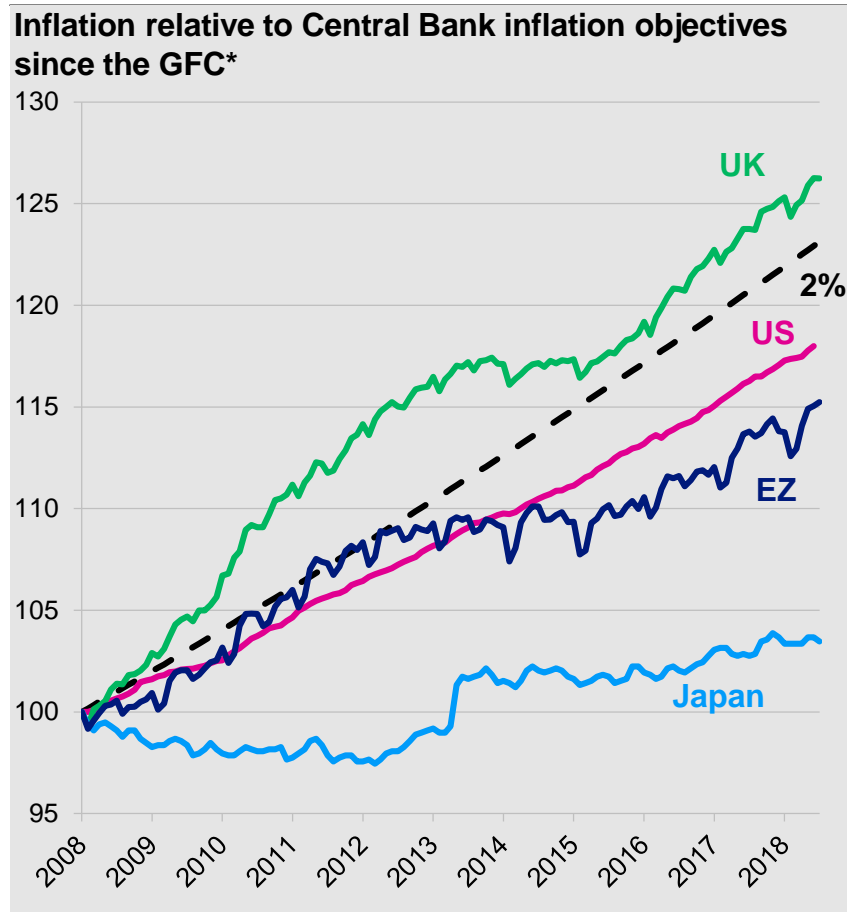
Source: LHC: Source: Datastream as at 1 August 2019. *Rebased 100 = 31 December 2008. RHC: Source: Datastream and Central Banks as at 1 August 2019. *Dashed lines are Central Bank forecasts to end of 2020. Japan forecast is ex Fresh Food and includes impact of consumption tax hike in October 2019. US is based on PCE inflation.

Inflation outlook

…as monetary pressures remain muted…while wage growth is only accelerating slowly…

OECD – Broad money supply and CPI (yoy %)

Money supply

Avg. 8.7% yoy

CPI

Avg. 3.4% yoy

Avg. 6.3 yoy

Avg. 1.7% yoy

14
12
10
8
6
4
2
0
-2

1995 1998 2001 2004 2007 2010 2013 2016

Wage growth (3mma yoy%)

UK

US

Germany

Japan

6
4
2
0
-2
-4
-6

2001 2004 2007 2010 2013 2016 2019
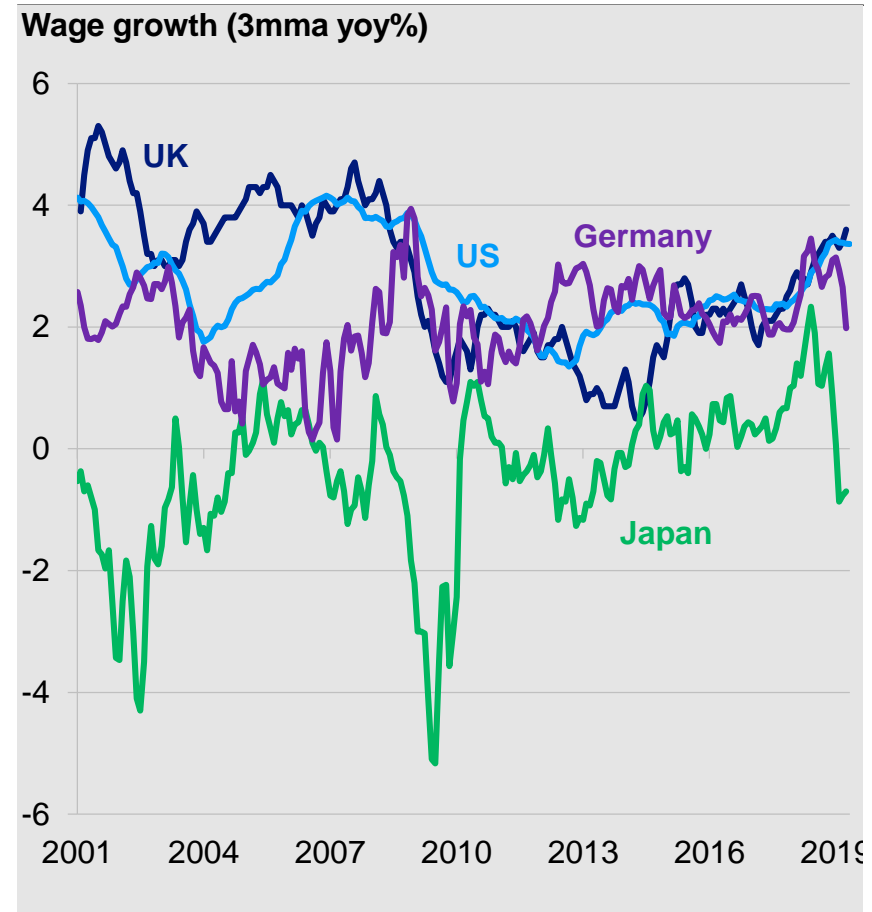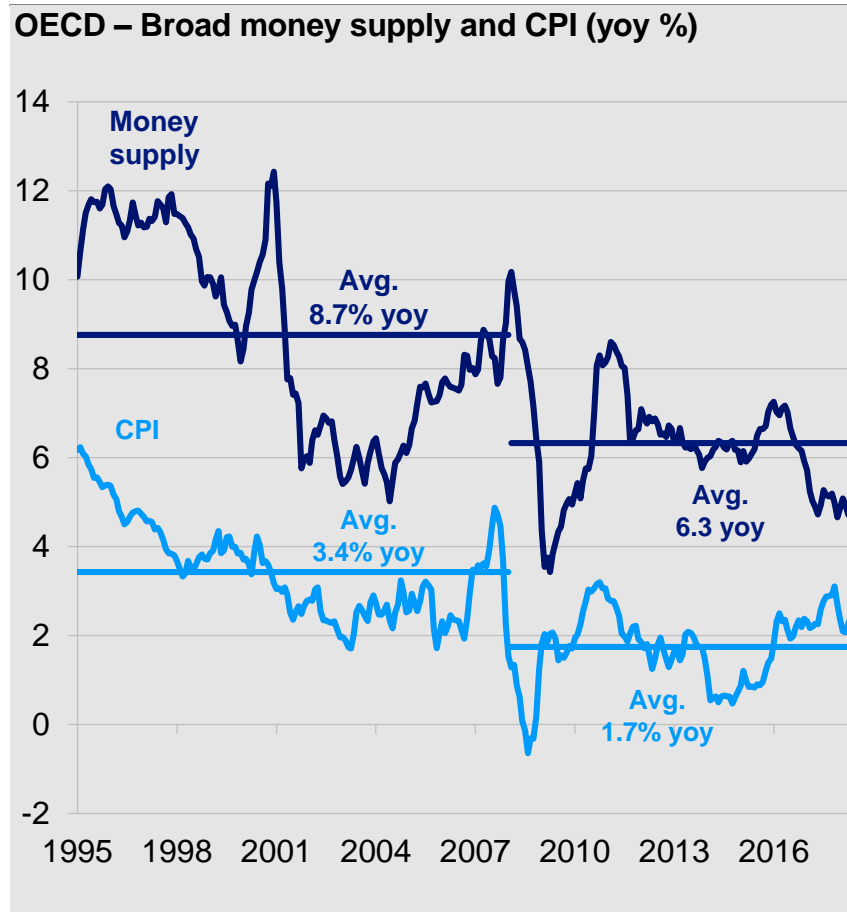
Source: LHC: Datastream as at 1 August 2019. RHC: Source: Datastream as at 1 August 2019. OECD = Organisation for Economic Co-operation and Development.

High debt levels

High levels of debt remain a structural headwind to global growth…
alongside weak productivity and demographics

Advanced Economies and Emerging Markets non-financial sector debt to GDP (%)
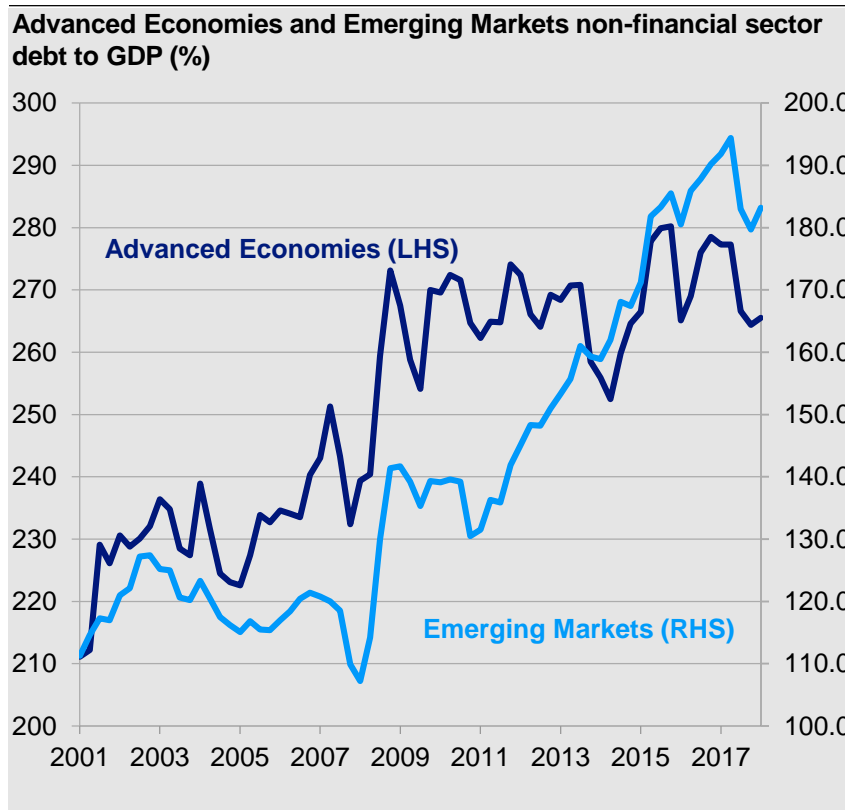
Global financial vulnerabilities*

	Sovereigns		Non financial firms		Households	
	2007	**Latest**	**2007**	**Latest**	**2007**	**Latest**
US						
Euro area						
Other DM						
China						
Other EM						

Quintiles

Highest				**Lowest**

Economic outlook
Summary

US Economy

- Remains strongest growing DM by a significant margin.
- Slowing growth from a high level as fiscal stimulus eases
- Record length of expansion, but recession risk appears low
- First rate cut since GFC. QT ended early
- Trump policy unpredictability creates uncertainty

Eurozone Economy

- Growth outlook challenging with Germany and Italy the laggards
- Export rather than domestic led weakness
- Political risks remain elevated
- Inflation struggling to hit target
- ECB pointing to renewed policy easing

UK Economy

- Economy struggling against Brexit uncertainty
- Consumer backdrop remains mixed
- BoE likely to normalise monetary policy slowly
- Brexit by 31 October whether deal or no-deal?

Japan Economy

- Growth remains weak relative to other major economies
- Inflation struggling to hit 2% target
- Stimulative monetary policy remains in place
- Abenomics drives change

EM Economies

- Growth expectations under pressure
- Idiosyncratic risks weigh on a number of economies
- US$ stabilisation and a more dovish Fed helpful
- China policy response focused on stabilisation not reflation

Source: Invesco as at August 2019. Where Invesco has expressed views and opinions these may change.

Investment risks and important information

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Important information

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All data is as at August 2019 and sourced from Invesco unless otherwise stated.

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