AUGUST PROVIDES STARK REMINDER OF GLOBAL RISKS

Escalating US-China trade tensions roiled global equities in August, driving investors to perceived safe-haven assets. Eurozone sovereign bonds gained on increasing growth concerns and attendant expectations of policy easing by the ECB at its September meeting.

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Trade gloves off again

Following US-China trade talks in late July, which had been described as productive, President Trump surprised investors in early August when he announced 10% tariffs would be placed on an additional $300bn worth of Chinese imports. Equity markets predictably declined on the news, given the likely impact on an already slowing global economy. Partial relief came when Washington announced a delay of the planned tariffs on $160bn of Chinese imports until 15 December. However, China subsequently retaliated by announcing tariffs of between 5-25% on $75bn of US imports. President Trump immediately responded by announcing that tariffs on $550bn of Chinese products would be increased by a further 5% through September and October. Tensions eased somewhat towards month end as China suggested it would not retaliate against Trump's latest tariff increases and stated that its intention is to negotiate with the US in a calm and collaborative manner.

Managing dovish expectations

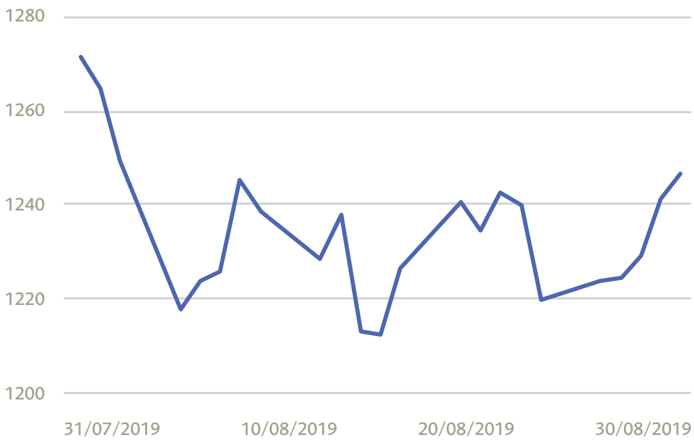
Over the month, US Federal Reserve (Fed) chair Jerome Powell highlighted the deteriorating growth outlook since the July meeting, mainly attributable to the increased trade tensions. Powell's language at the Jackson Hole gathering indicated little change from his previous 'mid-cycle adjustment' message, but markets continued to treat a September rate cut as a done deal. There were mixed messages from the European Central Bank (ECB). The Finnish central bank governor suggested the ECB should overshoot market expectations for further policy accommodation at the September meeting. Meanwhile, minutes from the July gathering revealed disagreement among board members over a possible tiering of the ECB's negative deposit rate, as well as debate around the need for a review of the central bank's inflation target.

Brexit uncertainty rumbles on

Despite the planned suspension of the UK parliament from mid-September by Prime Minister Boris Johnson, the probability of a 'no-deal' Brexit on 31 October has receded. The expected passing into law of a bill put forward by MPs against a 'no-deal' exit to force the government to seek an extension of Article 50 until 31 January limits Mr Johnson's ability to take the UK out of the EU without a deal at the end of October. A general election now seems inevitable and if this is held after the end of October, an extension of Article 50 seems highly likely. Nevertheless, significant uncertainty regarding the final Brexit outcome remains. In Italy, following the collapse of the government, a new more EU-friendly coalition appeared to be taking shape, thus potentially avoiding another conflict with the EU over the country's budget. In Germany, speculation grew over a possible fiscal stimulus package, although 'debt break' rules incorporated in the constitution mean any such stimulus is likely to be very limited.

CHART OF THE MONTH

Global equities



Source: ILIM, Bloomberg. Data is accurate as at 1 September 2019

Speedometer needle continues to drop

News flow on the economic front was somewhat mixed but generally pointed towards continued deterioration in the global economy. Flash global purchasing managers' indices (PMIs) dropped to levels consistent with growth of 2.4%. This was led by the US, where manufacturing entered contractionary territory at 49.9, while services fell 2.1 points to 50.9. Growth in US non-farm payrolls has fallen to an average of 140,000 per month from 225,000 last year. In China, loan growth disappointed, as did retail sales and investment spending, while year-on-year industrial production growth fell to a 17-year low. In the UK, while the labour market is strong, consumer and business sentiment readings fell to multi-year lows. While European PMIs recovered, they remain soft and ZEW and IFO sentiment readings fell further. German and UK GDP both contracted in the second quarter. By contrast, Japanese second-quarter GDP and industrial production data surprised positively, although retail sales disappointed.

MARKET ROUND-UP

Equities

Over the month the MSCI All Country World equity index fell -2.0% (-1.2% in €), having rebounded from its lows when it was down -4.7%. US equities outperformed, falling -1.7% (-0.7% in €), helped by expectations of further Fed rate cuts and relatively resilient economic data. Pacific Basin equities fell -4.3% (-4.7% in €) on growth concerns following the escalation of the trade war.

Bonds

Eurozone >5-year bonds rose 3.6%, with German 10-year yields falling to new all-time lows of -0.70% on weak eurozone economic data and expectations of additional policy accommodation at the upcoming ECB meeting. Italian 10-year spreads against Germany narrowed to 170bps due to expectations that a more pro-EU coalition will be formed, while Spanish 10-year spreads rose slightly to 81bps.

Currencies and commodities

The euro fell to 1.0982 against the US dollar on expectations of additional ECB policy easing, while the latter benefited from its safe-haven status in the risk-off environment. Commodities fell -5.6% (-4.6% in €), with West Texas Intermediate (WTI) oil down -5.9% due to increased global growth concerns.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2018 Return (%)
MSCI Ireland	-1.15	16.98	-21.24
MSCI United Kingdom	-3.61	9.77	-9.77
MSCI Europe ex UK	-0.63	17.79	-10.10
MSCI North America	-0.62	23.09	-0.41
MSCI Japan	0.08	11.10	-8.17
MSCI EM (Emerging Markets)	-3.80	8.17	-9.92
MSCI AC World	-1.25	18.61	-4.34
10-Year Yields	**Yield Last Month (%)**	**2018 Yield (%)**	**2017 Yield (%)**
US	1.50	2.68	2.41
Germany	-0.70	0.24	0.43
UK	0.48	1.28	1.19
Japan	-0.27	0.00	0.05
Ireland	-0.08	0.90	0.67
Italy	1.00	2.74	2.02
Greece	1.63	4.40	4.12
Portugal	0.13	1.72	1.57
Spain	0.11	1.42	1.57
FX Rates	**Current**	**2018 Rates**	**2017 Rates**
US Dollar per Euro	1.10	1.15	1.20
British Pounds per Euro	0.90	0.90	0.89
US Dollar per British Pounds	1.22	1.28	1.35
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2018 Return (%)**
Oil (WTI)	-5.94	21.34	-24.84
Gold (Oz)	6.79	18.86	-2.14
S&P Goldman Sachs Commodity Index	-5.62	6.74	-11.34

Source: ILIM, Bloomberg. Data is accurate as at 1 September 2019

THE ILIM VIEW – LOOKING AHEAD

Despite the pronounced volatility in August, equity markets have performed strongly year to date. The main contributor to the gains in equity markets has been the policy pivot evident among global central banks, driven in particular by the US Fed.

Much of the recent deterioration evident in economic news flow can be attributed to global trade tensions, which have led to reduced levels of business confidence and investment spending. It is now possible that a US-China trade deal might not be reached until after the US Presidential election in November 2020, which means that uncertainty could linger and thus remain a drag on activity levels and overall global growth for the foreseeable future.

Following the 15.1% gains in global equities in local-currency terms year to date, or 18.6% in euros, equity valuation levels have moved back either close to, or slightly above, long-term averages. In terms of the outlook for equity markets over the next 12 months, much will depend on developments in the global economy and the level of monetary-policy support provided by global central banks.

Recent weakness in activity and sentiment readings suggest growth in the remainder of the year will be slower. As things stand, we expect full-year growth to come in at 2.6%. With the risk of downward revisions to earnings forecasts in an environment where valuation levels are already close to our target levels, equity markets could struggle to make material gains on a 12-month view.

In short, given current valuation levels, risks of earnings downgrades and ongoing uncertainty over the economic outlook we believe equity markets offer limited upside on a 12-month view. More accommodative monetary policy from global central banks should provide support to markets and can help avoid a recession, although a final resolution of the trade war and general recovery in economic data are probably required to justify higher returns from equity markets. While our base case is for equity markets to be relatively close to current levels in 12 months time, the ongoing level of uncertainty could result in significant volatility in markets and therefore a potentially wide range of possible returns over the coming year.

THE MONTH AHEAD

Economic data and political events to watch

Economic data releases

5 September	US ISM non-manufacturing PMI (August)
6 September	Euro area GDP growth rate (3rd estimate, Q2) US non-farm payrolls (August)
8 September	China balance of trade (August)
9 September	Germany balance of trade (July) UK balance of trade (July)
10 September	China inflation rate (August)
12 September	ECB interest rate decision Germany inflation rate (August) US inflation rate (August)
13 September	US retail sales (May) US Michigan consumer sentiment (preliminary, September)
17 September	Germany ZEW economic sentiment index (September)
18 September	US Fed interest rate decision Japan balance of trade (August) UK inflation rate (August)
19 September	Bank of England interest rate decision
20 September	Japan inflation rate (August) Euro area consumer confidence flash (September)
23 September	Germany Markit manufacturing PMI flash (September)
24 September	Germany Ifo business climate (September)
25 September	Germany GfK consumer confidence (October)
26 September	US GDP growth rate (final, Q2)
27 September	Euro area business confidence (September) US durable goods orders (August)
30 September	UK Gfk consumer confidence (September) China NBS & Caixin manufacturing PMI (September) Spain GDP growth (final, Q2) UK GDP growth (final, Q2)

Source: ILIM, Trading Economics. Data is accurate as at 1 September 2019

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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