
Global markets: Eight issues to watch this week

Weekly Market Compass: Key votes and critical data releases could influence the markets as January ends

Jan 28, 2019 | Kristina Hooper, Chief Global Market Strategist

Last week was momentous as experts in Davos warned about the dangers of debt, more signs of a European slowdown emerged, and the longest government shutdown in US history came to an end. In today's blog, I discuss what we learned last week – and highlight eight things to watch during the final week of January.

What did we learn last week?

Experts are concerned about debt. The week started off on a disappointing note at the World Economic Forum in Davos, where the International Monetary Fund (IMF) announced that it was lowering its growth forecasts. That certainly exerted some temporary downward pressure on stocks. But one of the big takeaways from the week in Davos was how many business leaders and economists are worried about the growing debt load globally. (The growing world debt load has been a critical concern for me for years now, and I'm happy to see it's receiving increasing attention.) Unfortunately, in the last decade extraordinarily accommodative monetary policy encouraged the taking on of more debt, and that's a problem now that rates are rising and economies are slowing. David Lipton, the first deputy managing director of the IMF, rightly pointed out that, while debt is increasing, the ability to service the debt is the big issue: "There's vulnerability to macroeconomic changes. If interest rates were to rise sharply, that would change the debt-servicing situation substantially. A recession would do the same."¹

Economic pressure has been building in Europe. The European Central Bank (ECB) held a monetary policy meeting last week just as more signs of a European slowdown emerged. During the course of the week, a flash Purchasing Managers' Index (PMI) preliminary estimate for manufacturing in the eurozone showed a drop from 51.4 in December to 50.5 in January. It is important to note that, even though the reading indicates the economy is still in expansion mode, it is at a multi-year low. Not surprisingly, recent economic data releases in Germany and France have also indicated a slowdown, with France seeing its economy come under pressure from the yellow vest protesters. And so it's no surprise that ECB President Mario Draghi attempted to reassure markets by explaining, "We have lots of instruments and we stand ready to adjust them or use them according to the contingency that is produced." Draghi offered a laundry list of possibilities such as forward guidance on interest rates, bond purchases and long-term loans to commercial banks. In response, yields fell on various 10-year bonds, including the German bund – an indication of the power that Draghi's words still hold.

The US government reopens. The week ended with the welcome announcement that the US government shutdown was coming to an end after 35 days. There was no dramatic positive reaction from stocks, but that's likely because stocks never seemed to fully price in the shutdown to begin with.

1. The Chinese trade delegation's US visit. This week, the US and China will resume trade negotiations, as a Chinese delegation led by Vice Premier Liu He visits the US. US Commerce Secretary Wilbur Ross put a damper on expectations last week, stating in an interview that the two countries are "miles and miles from getting a resolution." The two countries are getting dangerously close to the March 1 deadline in which tariffs are slated to rise. However, I still believe there is the potential for the US to accept Chinese concessions on the trade deficit so that this US-China trade war can end quickly. The stakes are high, as Draghi explained that if the US-China trade dispute were settled, much of the global slowdown "would probably wash out."²

2. The Federal Reserve (Fed) meeting. The Fed is scheduled to meet this coming week. The problem is that, as a result of the lengthy government shutdown that just ended on Friday night, they may not have much data to work with as they attempt to exercise their "data dependent" monetary policy. Retail sales reports have been delayed, as have durable goods reports and a number of other data releases - and it is not clear how quickly they will be released now that the government shutdown is over. Think of this as the Fed's own personal "Bird Box Challenge": There seems to be danger all around, but Fed members have been blindfolded by the government shutdown, unable to see many indicators of the current state of the economy. In my view, the prudent course for the Fed would be to keep rates on hold, as they need time to assess the current state of the economy, including the damage created by the government shutdown.

But to me, the far more important issue is going to be the Fed's balance sheet. There is growing anticipation that the Fed might make an announcement about its normalization plan - perhaps paring it back. Last year, when I suggested that the Fed should dial down balance sheet normalization and thought there was a possibility they would, people looked at me like I had three heads. However, Fed Chair Jay Powell's assertion that the Fed's balance sheet normalization will remain on "autopilot" caused market jitters, and so he later appeared to walk back those comments, goosing expectations that the Fed could tinker with its balance sheet plan. I don't expect much more than the Fed re-asserting that the balance sheet plan is not on autopilot and could be altered if necessary, but in my view that would be a step in the right direction in terms of reassuring markets.

3. The UK Parliament's vote on "Plan B." As we come dangerously close to the March 29 Brexit date, the UK Parliament will vote on Prime Minister Theresa May's Plan B for withdrawal, which seems an awful lot like her Plan A - which was not exactly popular. It seems that May is continuing to gamble that Members of Parliament will vote for her plan because the only alternative she will allow is a "crash out" of the EU, which the UK is at "very high risk" of, according to EU deputy Brexit negotiator Sabine Weyland. I expect a flurry of bills as Parliament attempts to box May in and take control of negotiations with the European Union through proposed legislation such as the Cooper-Boles amendment, which would force May to seek an Article 50 extension if her Brexit proposal fails. I expect a wild ride for the pound this week.

4. Negotiations on "the wall." The US government shutdown has ended, but it may only be temporary. President Donald Trump has given Congress three weeks to negotiate with him on building a wall at the US-Mexico border - or the government could shut down again. We will want to follow this situation closely, especially the impact of continued economic policy uncertainty.

5. European GDP data. After the disappointing PMI data discussed above, it will be important to get the official gross domestic product (GDP) print to get an assessment of European economic growth. Draghi said last week that the risks to the downside have increased, blaming “the persistence of uncertainties related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility.” He also indicated that the ECB is open to stimulus measures – and more negative economic data would certainly hasten those measures.

6. US employment situation report. This will give us some sense of the damage wreaked on the US economy as a result of the government shutdown and the ongoing global economic deceleration.

7. January PMI data for China. This will give us insight into how China’s economy is holding up in the face of the US-Sino trade wars, given that China has been ramping up domestic stimulus to combat any negative impact. I expect Chinese economic growth to stabilize as a result of the stimulus, but this GDP print may be too soon to reflect that.

8. US earnings reports. There will be a flurry of earnings reports this week, including several high-profile ones, as we are in the heart of earnings season. Last week, US earning reports were relatively solid. According to FactSet Research Systems, 22% of the companies in the S&P 500 Index reported earnings as of Jan. 25 – and 71% of those companies exceeded estimates. This is in line with the five-year average. However, the FactSet data showed that revenues were not as strong, with 59% of companies exceeding revenue estimates, which is below the five-year average. Thus far today (Jan. 28), there have been some earnings disappointments, and they are largely being blamed on the global slowdown and the US-China trade wars. Recall that several weeks ago, the chairman of the White House’s Council of Economic Advisers warned that “a heck of a lot of US companies that have sales in China ... are going to be watching their earnings being downgraded [in 2019] until we get a deal with China.” He insisted that this places “a lot of pressure on China to make a deal,” but I believe this is placing even more pressure on the US to make a deal. I expect more volatility this week on news flow from negotiations.

Asset allocation implications

With so much trade policy uncertainty, I expect to see heightened volatility – and I believe small- and mid-cap companies with lower exposure to revenues outside their home countries may perform better in the short term. However, keep in mind that the market environment could change very quickly if the US and China do reach a deal. I also expect some currency swings given all that is going on geopolitically. That said, we at Invesco believe that it’s critical to plan for the long term, and I believe investors should consider the potential diversification benefits of alternative asset classes.

Source

¹Business Insider, "The world's record-shattering debt load was the talk of Davos. Here's what the biggest experts from around the globe had to say," Jan. 24, 2019

²Associated Press, "ECB: Trade peace would remove big drag on eurozone growth," Jan. 28, 2019

Important information

Diversification does not guarantee a profit or eliminate the risk of loss.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Volatility is a statistical measurement of the magnitude of up and down asset price fluctuations over time. Low volatility describes investments that consistently demonstrated lower volatility than securities in the same asset class. Low volatility cannot be guaranteed.

In a "no-deal" or "crash out" Brexit, the UK would leave the EU in March 2019 with no formal agreement outlining the terms of their relationship.

The Eurozone Manufacturing PMI® (Purchasing Managers' Index®) is produced by IHS Markit based on original survey data collected from a representative panel of around 3,000 manufacturing firms. National data are included for Germany, France, Italy, Spain, the Netherlands, Austria, the Republic of Ireland and Greece.

The Caixin/Markit Purchasing Managers' Index (PMI) for China is considered an indicator of economic health for the Chinese manufacturing sector. It is based on survey responses from senior purchasing executives.

Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

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