Market E-digest
June 2019 Issue

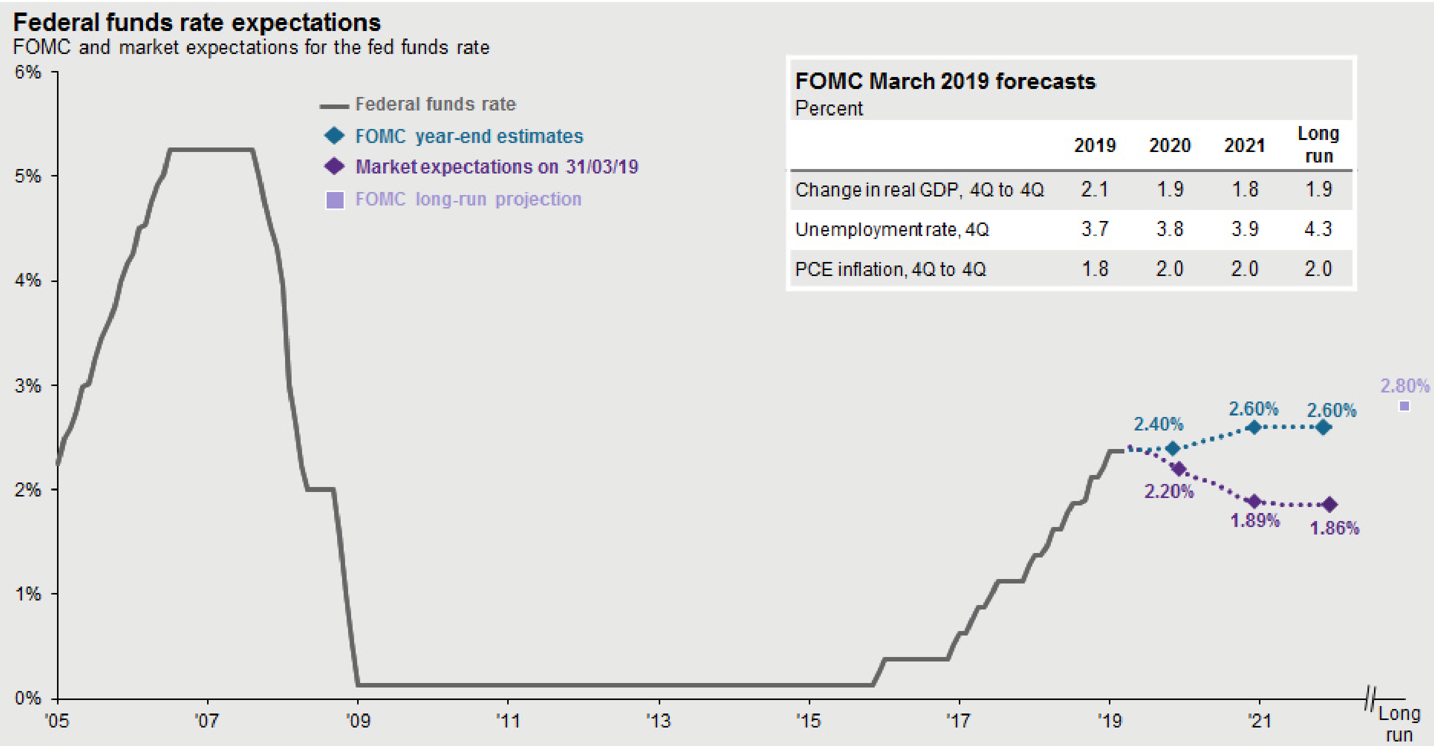
A) A Flexible Bond Strategy Helps Expand Income Potential

The recent monetary policy pause by the US Federal Reserve (Fed) with interest rate cut expectations in the market lowers the risk of a US recession in the near term, and helps extend the country's decade-long economic expansion. Within the fixed-income space, investors may wish to consider opportunities in US securitised credit – in particular, consumer asset-backed securities (ABSs) – which offer quality returns while the economy drifts closer to a recession. Global high-yield and emerging-market (EM) bonds also offer attractive yields.

A flexible fixed-income strategy involving investment in the full spectrum of fixed-income assets will help capture a range of income opportunities across geographies and sectors.

The Fed will act as appropriate to sustain the expansion

US Federal Reserve chairman Jerome Powell surprised markets in January with a pivot on monetary policy. In June, the policy-setting Federal Open Market Committee (FOMC) kept the key rate in the 2.25-2.5% range, but said "uncertainties about this outlook have increased" and the Fed "will act as appropriate to sustain the expansion." The Fed is to delay its next policy move, given softer inflation, tighter financial conditions, and slower foreign growth - particularly in Europe and China.



FOMC March 2019 forecasts
Percent

	2019	2020	2021	Long run
Change in real GDP, 4Q to 4Q	2.1	1.9	1.8	1.9
Unemployment rate, 4Q	3.7	3.8	3.9	4.3
PCE inflation, 4Q to 4Q	1.8	2.0	2.0	2.0

Source: Bloomberg Finance L.P., FactSet, Federal Reserve, J.P. Morgan Asset Management. Market expectations are the federal funds rates priced into the Fed Fund futures market as of 31.03.2019. Federal Reserve projections shown are median estimates of FOMC participants.

Over-tightening by the Fed often has the effect of throwing the US economy into recession. Indeed, investor concerns about an impending recession have risen over the past few months amid slowing global growth, weakening trade, and a flattening yield curve.

The Fed's pre-emptive move is likely to hold rates steady, and its ending of quantitative tightening this year has significantly reduced the risk of a US recession in the near term. The US expansion is likely to be extended. In this late-cycle environment, investors may wish to consider opportunities in US securitised credit as well as global high-yield and EM bonds.

US securitised credit offers quality in late cycle

Despite the US economy apparently winding down, American households are in relatively good shape in fundamental terms. They are significantly deleveraged now that the global financial crisis is over. The household debt service ratio remains low, while household net worth has increased substantially in recent years.

High-yield bonds offer rising yields

The Fed's pressing of the pause button earlier has two major benefits for global high-yield bonds. Firstly, it is more difficult for Treasury bond yields to rise significantly unless inflation surges. Secondly, there is a lower threat of rising defaults, given the reduced probability of a US recession in the near term.US high-yield bonds offer an attractive spread compared to Treasuries, their fundamentals remain resilient, and issuance remains low.

Key risk factors: US-China trade negotiations, Fed policy, and US consumer conditions

As US-China trade negotiations continue, any unexpected rhetoric or moves from either country will impact markets. Meanwhile, if the US economy picks up faster than expected and the Fed changes its policy direction, fixed-income bonds may come under pressure. Signs of deterioration in consumer conditions would pose risks to the performance of US securitised credit.

Investment implications: Flexibility in bond investing remains key to capturing income potential

In this late-cycle environment, a flexible bond strategy spanning geographies and sectors can help investors to capture potential opportunities across the entire fixed-income spectrum, from US securitised credit to global high-yield and emerging-market bonds.

B) Market Update

United States

The Fed maintained federal funds rate target at 2.25%-2.50% at the policy meeting on June 18 to 19th as expected and adopted a more dovish stance on interest rates. Housing starts in May dropped 0.9% month-on-month, while market expected a 0.3% growth. As uncertainties about the economic outlook mount, it is expected that the federal funds rate may be lowered by 25 basis points during the year.

Canada

The year-on-year growth of CPI in May accelerated to 2.4% from 2.0% in April, exceeding market expectation of 2.1%. The common measure of core CPI stayed stable, with a year-of-year growth of 1.8% which was the same as the previous month. Retail sales edged up 0.1% month-on-month in April, meeting market expectation. This was largely boosted by food and drink sales, as well as higher prices for gasoline. The market generally expected that the Bank of Canada would keep the interest rate at the current level of 1.75% in the short term.

Eurozone

The advance reading of consumer confidence in June edged down to -7.2 from the -6.5 in the previous month. The preliminary reading of composite PMI in June edged up to 52.1 from the 51.8 in previous month. Meanwhile, preliminary reading of manufacturing PMI edged up to 47.8 from 47.7 in previous month, whereas services PMI edged up to 53.4 from 52.9 in previous month. The final reading for Eurozone's CPI growth rate in May stayed at 1.2%, while the core CPI growth also stayed at 0.8%. It is expected that ECB will hold the interest rate at 0.00% during the year.

United Kingdom

The Bank of England kept the benchmark interest rate unchanged at 0.75% and maintained the size of its asset-buying program at 435 billion pounds after the MPC meeting as expected on June 20th. CPI registered a year-on-year growth at 2.0% in May, lower than 2.1% in April, while the core-CPI rose at 1.7%. Retail sales (excluding auto fuel) rose 2.2% annually in the same month, lower than both the 2.5% growth of the market expectation and the 4.9% growth in the preceding month. The market generally expects interest rates will stay unchanged in the near term.

Australia

Australia's unemployment rate in May stood at 5.2%, above the market expectation of 5.1%. It is expected that the cash target rate will be further reduced by 0.25 basis points to 1.00% in the coming quarter.

Japan

The Bank of Japan held its monetary policy meeting on June 19-20th. It announced that it will maintain a benchmark rate of -0.1% for excess reserves, and will continue to guide the 10-year government bond yield at around 0%. The inflationary environment in Japan remains stable. Year-on-year growth in CPI decelerated from 0.9% in April to 0.7% in May, meeting market expectation. However, external trade remains a concern. Exports slumped 7.8% year on year in May, the sixth straight month of decline. It is expected that the BOJ will maintain its loose monetary policy for the time being, keeping a benchmark rate of -0.1% for excess reserves.

China

According to the Government Work Report 2019, China will continue to implement a prudent monetary policy. The Chinese government is expected to keep interest rates on hold in the future.

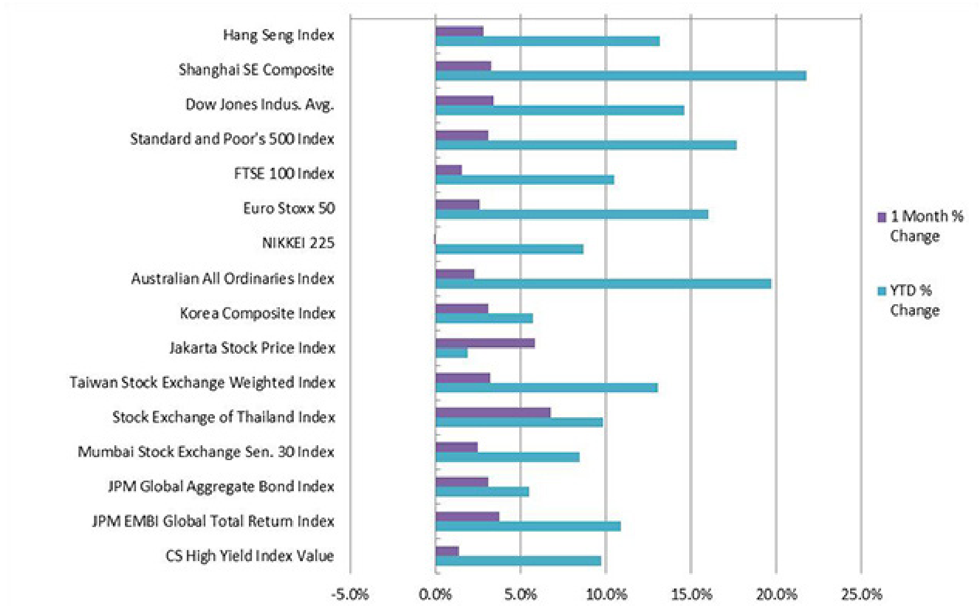
Hong Kong

Average 3-month Libor fell from 2.43% to 2.39% during June 14th to 20th while average 3-month Hibor rose from 2.32% to 2.40%. As the Fed has turned to a more dovish stance, the HKD prime rate is believed to stay unchanged at the moment.

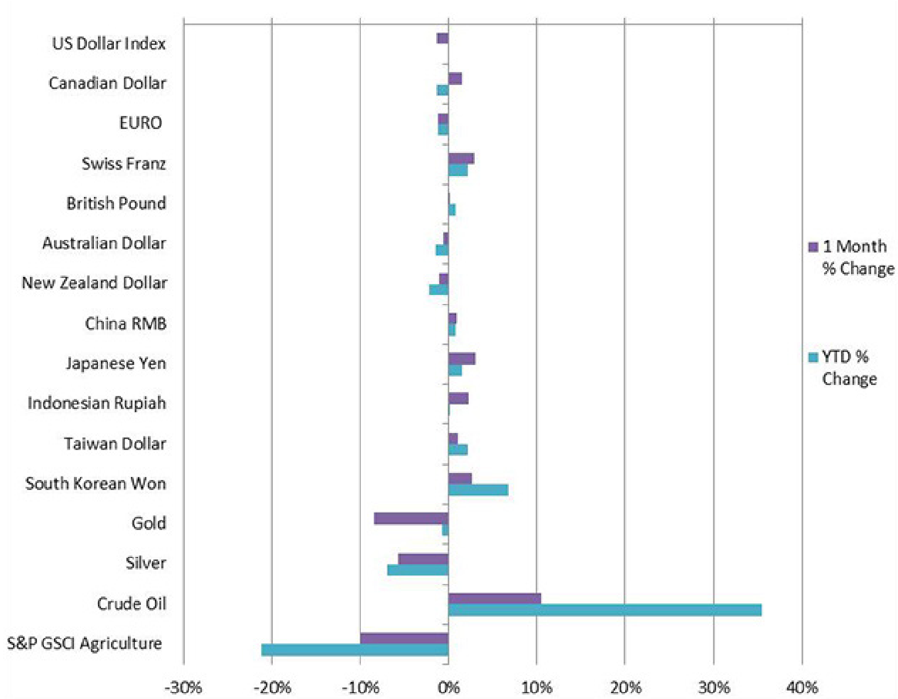
Source: BEA Economic Research Department

C) Major Indices

Major Equity and Bond Index



Major Currency and Commodity Index



Data as of 21st June, 2019.
Source: Bloomberg

Important Notes:

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