Cytonn 2019 Markets Outlook

Global Markets Outlook

2018 was characterized by a moderate decline in global economic growth, which was weighed down by the negative effects of the trade conflicts between the US, China and Eurozone, as well as weaker growth in key emerging markets such as China and Brazil, arising from country-specific factors such as (i) country-wide industrial action in Brazil, (ii) political uncertainty in Britain due to Brexit, and (iii) country-wide protests in France. According to the World Bank, global GDP growth in 2019 is expected to come in at 2.9%, a decline from the 3.0% recorded in 2018, as a result of softened international trade and investments, trade tensions and substantial financial markets pressure in emerging markets and developing economies.

Following the flat economic growth in 2018, we look at the three key themes that we believe will shape the global markets in 2019:

i. ***Monetary Policy Tightening…***

Monetary policy stances are expected to tighten in advanced economies. The US Federal Open Market Committee (FOMC) is expected to continue on the path towards interest rate normalization through the tightening of monetary policy, with expectation of two further rate hikes in 2019. The European Central Bank (ECB) is expected to maintain its benchmark interest rates through the first half of 2019, having announced that it would stop its asset-bond buying program in December 2018. This stance to gradually remove accommodative policies by Central Banks highlights the stronger growth in their specific regions. However, a benign inflationary environment and increased possibility of a recession in Germany and the US in 2019 are key downside risks to further tightening monetary policy.

ii. ***Global Trade to Slow Down…***

Escalating trade tensions between major trade partners and the potential shift away from a multilateral, rule-based trading system are key threats to the global economy in 2019. The US has been imposing tariffs on a variety of imports with major trade partners, including on USD 200.0 bn worth of imports from China, and trading partners undertaking or promising retaliatory and other protective measures. An intensification of trade tensions, and the associated rise in policy uncertainty, could dent business and financial market sentiment, trigger financial market volatility, and slow investment and trade. Higher trade barriers would also disrupt global supply chains and slow the spread of new technologies, ultimately lowering global productivity. More import restrictions would also make tradable consumer goods less affordable.

iii. ***Falling Commodity Prices…***

Global commodities registered declines in 2018, with agriculture, non-energy commodities, Brent Crude and metals & minerals registering declines of 3.0%, 3.7%, 5.5%, and 7.9%, respectively, while energy gained by 4.9%, according to the World Bank Commodity Prices Index. Oil prices closed 2018 at USD 53.8 per barrel, having averaged USD 68.0 per barrel during 2018. According to the World Bank, oil prices are forecasted to decline marginally to an average of USD 67.0 per barrel in 2019.

This is owing to an expected decline in demand following the slowdown in the global economy, an oversupply of oil in the market, and an expected rise in shale oil output from the US. However, efforts by the OPEC organization, namely capping of oil output in the first half of 2019, should help rebalance the market in terms of supply and demand.

Having considered the three key factors that will drive Global Markets in 2019, we now look at specific economic regions and expectations for their GDP performance in 2019:

World GDP Growth Rates

	Region	2015a	2016a	2017a	2018e	2019f
1.	India	8.2%	7.1%	6.7%	7.3%	**7.5%**
2.	China	6.9%	6.7%	6.9%	6.5%	**6.2%**
3.	Sub-Saharan Africa*	3.1%	1.3%	2.6%	2.7%	**3.4%**
4.	United States	2.9%	1.6%	2.2%	2.9%	**2.5%**
5.	Brazil	(3.5%)	(3.3%)	1.1%	1.2%	**2.2%**
6.	Middle East, North Africa	2.8%	5.1%	1.2%	1.7%	**1.9%**
7.	Euro Area	2.1%	1.9%	2.4%	1.9%	**1.6%**
8.	United Kingdom	2.3%	1.8%	1.7%	1.3%	**1.4%**
9.	South Africa (SA)	1.3%	0.6%	1.3%	0.9%	**1.3%**
10.	Japan	1.4%	0.6%	1.9%	0.8%	**0.9%**
	Global Growth Rate	**2.8%**	**2.4%**	**3.1%**	**3.0%**	**2.9%**
Including South Africa						

Source: World Bank

United States:

The US economy is expected to grow by 2.5% in 2019, 0.4% points lower than the 2.9% growth expected in 2018, owing to the trade tensions with major trading partners, tighter financial conditions, and as the fiscal stimulus from the tax cut package fades. The Federal Reserve has continued implementing its tighter monetary policy, with four rate hikes in 2018, of 25 bps each, in March, June, October and December, with the Federal Funds rate ending the year at a band of 2.25% - 2.50%, from a range of 1.25% - 1.50% at the beginning of 2018. The Federal Reserve has signaled the possibility for two additional rate hikes in 2019, with the key downside risk being a benign inflationary environment, with inflation currently at 1.9%, 10 bps below the Fed's targeted 2.0% inflation rate, and increased possibility of a recession in the US in 2019 owing to an intensified trade war and tighter financial conditions.

In 2018, the US Government raised tariffs on about USD 300.0 bn worth of imports, mostly from China. Other countries have retaliated with tariffs on about USD 150.0 bn worth of US exports. The tariffs may expand further in 2019 as the Trump Administration has threatened additional tariffs for some of its major trading partners, including China, if current negotiations do not yield intended results. This will result in higher prices, which will weigh down on activity, especially exports and investments.

The stock market declined in 2018, with the S&P 500 losing 6.2%. In terms of valuations, the

Cyclically Adjusted Price/Earnings (CAPE) ratio is currently at 29.0x, 72.6% above the historical average of 16.8x, indicating the market, despite being on a declining trend, remains overvalued relative to historical levels. In 2019, the stock market is expected to be bearish weighed down by negative investor sentiments owing to increased concerns of a slower global economic growth, tighter monetary conditions, increased trade and geopolitical tensions and expected lower corporate earnings with major technology companies revising downwards their earnings expectations.

Eurozone:

The Eurozone is expected to grow by 1.6% in 2019, 0.3% points lower than the 1.9% growth expected in 2018. This is as a result of continued country wide specific factors such as; (i) political uncertainty in Britain due to the Brexit vote, (ii) country-wide protests in France, and (iii) a looming recession in Germany, all of which are likely to continue to suppress economic activity in the region in 2019. The European Central Bank (ECB) is expected to maintain its benchmark interest rates through the first half of 2019. The ECB also announced that it would stop its asset-bond buying program in December 2018. We therefore expect growth to decelerate in 2019 as monetary stimulus is withdrawn, declining global trade results in reduced exports from the region, geopolitical tensions persist, and business activity slows down as evidenced by a Eurozone composite PMI of 51.1 in December, which was at the weakest level in four-years.

Eurozone stock markets were on a declining trend in 2018, with the EuroStoxx 600 index declining by 17.4% during the year. In terms of valuations, the EuroStoxx 600 Index is currently trading at a P/E of 14.8x, 27.1% below its historical average of 20.3x, indicating markets are undervalued and are trading at cheap valuations relative to historical levels. In 2019, the stock market is expected to be bearish weighed down by negative investor sentiments owing to the reduced global economic growth, and heightened geopolitical tensions, following civil unrest in France and increased uncertainty on Britain's withdrawal from the EU ("Brexit").

China:

The Chinese economy is expected to grow by 6.2% in 2019, slower than the 6.6% expected growth in 2018, owing to persistent trade tensions with the US and a deceleration of industrial production and export growth. China and the US have been caught up in a trade war, with the US imposing a 10.0% tariff on Chinese goods worth USD 200.0 bn, and China imposing a further retaliatory 10.0% tariff on goods worth USD 60.0 bn. This will however be offset by robust domestic demand aided by policies to boost consumption. Supportive fiscal policies that have been undertaken or announced are also expected to largely offset the negative impact of higher tariffs.

The Chinese Government has adopted a more accommodative monetary policy amid concerns about the slowdown in investment, and negative impact of the trade war with the US. The Chinese Central Government is focusing on encouraging local governments to speed up spending of unused revenues and banks to ensure adequate financing for local government projects. The Chinese Government announced CNY 1.2 tn (USD 180.0 bn) in business tax cuts in addition to policies aimed at boosting infrastructure expenditure. The People's Bank of China also announced that it would cut the required reserve ratio (RRR) by 1.0% point to free up bank reserves and inject money in the banking system to be lent out to stimulate the economy.

The stock market recorded a negative return in 2018, with the Shanghai Composite declining by 28.7% in 2018. In terms of valuations, the Shanghai Composite index is currently trading at a P/E of 11.6x, 24.7% lower than the historical average P/E of 15.4x, indicating the market is currently undervalued, and is currently trading at cheap valuations relative to historical levels. In 2019, the stock market is expected to be bearish weighed down by negative investor sentiments owing to the prolonged trade tensions with the US, heightened geopolitical tensions, and an overall slower economic growth.