Cytonn Q3'2019 Markets Review

Global Markets Review

Introduction

According to the World Bank, the global economy has continued to slowdown, with 2019 growth expected at 2.6%, a 0.4% point decline from 3.0% recorded the in 2018. This is as a result of;

i. An escalation in the trade dispute between the US and China,
ii. Country-specific uncertainty such as Britain's exit from the European Union ("Brexit"),
iii. Heightened geopolitical tension between the US and Iran, disrupting the mid-stream and down-stream oil supply channel,
iv. Overall slowing global trade, which, according to World Bank, contracted by 1.4% in June 2019, and,
v. Reduced consumption expenditure in major global economic regions such as Asia, as it has resulted in the reduction in global demand for goods and services, and hence contributed to the slowing global trade.

United States

The US economy grew by 2.0% in Q2'2019, a 2.2% point decline from the 4.2% recorded in Q2'2018. The decline is attributed to a decline in the manufacturing sector with industrial production growing by 0.4% in August 2019, the slowest pace since August 2017. The US economy is expected to grow by 2.5% in 2019, slower than the 2.9% growth recorded in 2018, weighed down by reduced exports to major traditional partners such as China and the Eurozone, owing to uncertainty regarding the trade dispute between the US and China, and the fragile growth in the Eurozone.

The Federal Open Monetary Committee (FOMC) held 2 meetings during Q3'2019, and reduced the Federal Funds Rate by 25 bps at each meeting, to a range of 1.75% - 2.00%, from 2.25%-2.50% previously, citing:

i. Weakened business investment and exports amid falling manufacturing as a result of slower global growth and trade policy tensions, and,
ii. Muted inflationary pressure with the current inflation rate of 1.7%, being below the government's target of 2.0%

The stock market has been on an upward trend, with the S&P 500 gaining by 1.2% in the quarter and 18.7% YTD. The gain was largely supported by improved corporate earnings performance by a majority of counters in the financial services, oil and gas, consumer goods and technology sectors, and the easing stance adopted by the Federal Reserve. US valuations are still higher than their long-term historical average with the Shiller Cyclically Adjusted P/E (CAPE) multiple currently at 29.6x, which is 77.2% above the historical average of 16.7x.

Eurozone

The Eurozone economy grew by 0.2% in Q2'2019, a 0.1% point decline from the 0.3% recorded in Q2'2018. The slow growth is attributed to dampened sentiments in major economies such as

Germany, which contracted by 0.3% during the quarter as a result of falling exports, and could be on path for a recession this year. The slow growth is also attributed to a fall of 1.8% in industrial production as a result of collapsing production of motor vehicles and capital goods. In addition, uncertainty over Britain's exit from the European Union ("Brexit") has also led to increased uncertainty in the Eurozone regarding its impact, and the type of exit deal to be adopted by the UK.

The European Central Bank (ECB) maintained the base lending rate at 0.0%, and the rates on the marginal lending facility at 0.25%, while it reduced its deposit rates by 10 bps to (0.5%) from (0.4%), and introduced a fresh stimulus package by restarting its bond purchases of EUR 20.0 bn a month from November. The stimulus packages were in a bid to revive growth amid the fragile economic growth in the Eurozone, and the muted inflationary pressures, as the inflation rate for the region came in at 1.0% in September, lower than the ECB target of 2.0%.

The Stoxx 600 index rose by 2.2% in Q3'2019 and by 16.4% YTD. The P/E ratio currently at 16.0x, is 17.9% below the historical average of 19.5x, indicating markets are currently trading at relatively cheaper valuations.

China

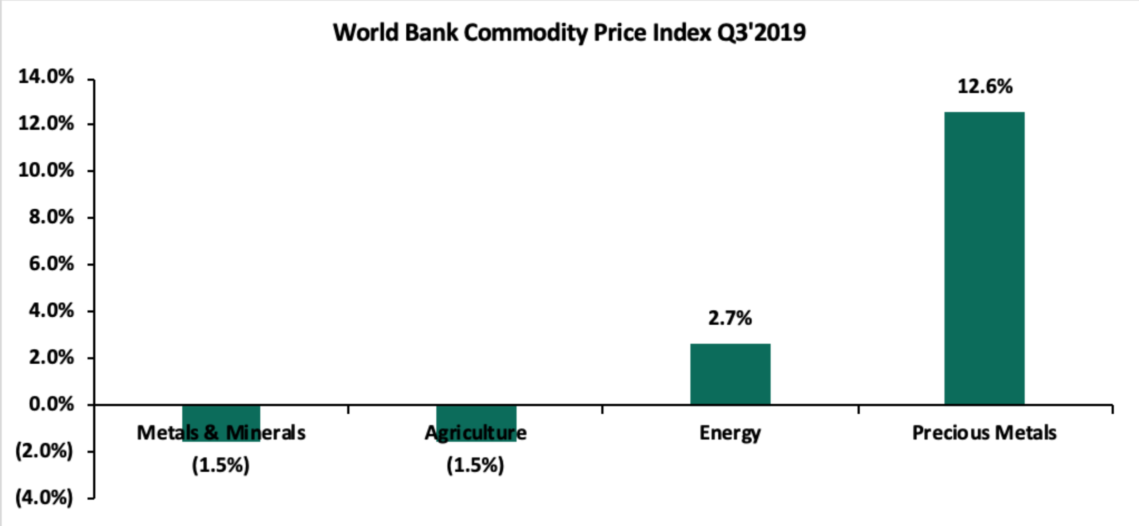
The Chinese economy grew by 6.2% in Q2'2019, a 0.5% point decline from the 6.7% recorded in Q2'2018. The decline is attributed to trade flows remaining weak amid softening global demand and higher tariffs on bilateral trade with the U.S, coupled with a decline in manufacturing activity. The government is however providing additional fiscal support through fixed investments that grew by 5.5% in August 2019. During the quarter, the Manufacturing PMI closed at 49.8 in September 2019, marking the fifth consecutive month the manufacturing sector contracted during the year since the last recorded expansion in April at 50.1.

The Chinese government has adopted a more accommodative stance, with the aim of attaining the target GDP growth of "around 6.5%" by injecting liquidity in the economy by reducing the reserve requirements for banks, and resuming public investment, which should result in increased liquidity and consequently higher domestic consumption.

The Shanghai Composite index declined by 2.5% in Q3'2019, for a gain of 16.4% YTD. The year to date gain is supported by expectations of a positive outcome following resumption of trade talks with the United States, coupled with increased capital injection by the government, which improved investor confidence. The P/E ratio currently at 11.8x, is 18.6% below the historical average of 14.5x, indicating markets are currently trading at relatively cheaper valuations.

Commodity Prices

According to the World Bank Commodity Prices Index, energy, metals, precious metals and agriculture segments gained/(declined) by 2.7%, (1.5%), 12.5% and (1.5%), respectively, in Q3'2019. Below is a chart showing the performance of select commodity groups for Q3'2019;



As per the chart above:

i. The increase in precious metals was largely influenced by the rise in gold prices, which has benefitted as a store of value following the expansionary monetary policy adopted in advanced economies leading to lower interest rates, and
ii. The decline in agriculture was largely driven by the declines in oils & meals and food, which both recorded declines of 1.0% points.