

Market Brief: A January Ricochet

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Following a dismal December, US markets surged in January on the back of US-China trade talks, strong employment data and dovish talk from Federal Reserve Chairman Powell. Global markets followed suit. Investors had a lot to digest in January, including the global growth slowdown, the US government shutdown and a mixed start to the fourth quarter earnings reporting season. But these negative catalysts failed to stymie a rally that each week seemed to bring another rebound, further supported by dovish global central banks and a largely uneventful reopening to the new issue market within US corporate credit (see next page).

The numbers tell the story. The S&P 500 Index followed a total return of -9.03% in December with a gain of 8.01% in January.¹ The investment grade spread widened 14 bps in December, but tightened 22 bps in January. The high yield spread widened 104 bps in December before tightening 96 bps in January. Finally, the bank loan spread widened 71 bps in December before tightening 46 bps in January.

Just how broad-based was the strength in January? Deutsche Bank has a sample of 38 asset classes across global equities, corporate bonds, government bonds, commodities and currencies.² All 38 were up in January for the first time since 2007 when Deutsche Bank began tracking this sample. Positive performance across all asset classes is rare, as rates typically do not rally with other assets. The rally helped correct much of the December decline, when 36 of 38 assets classes saw negative performance.

January's positive catalysts offset fears of the global growth slowdown and negative ramifications from the US government shutdown. A litany of companies warned about the potential slowdown in China, seeming to confirm recently weak data and

that the protectionist showdown is starting to have an impact on economic activity. Further, continued negative data out of Europe and Brexit developments increased concern in the region. Separately, the latest US government shutdown proved the longest to-date. While the overall economic impacts are expected to be modest, government employees certainly struggled while dysfunction in Washington could soon return to the spotlight given the temporary nature of the recent agreement.

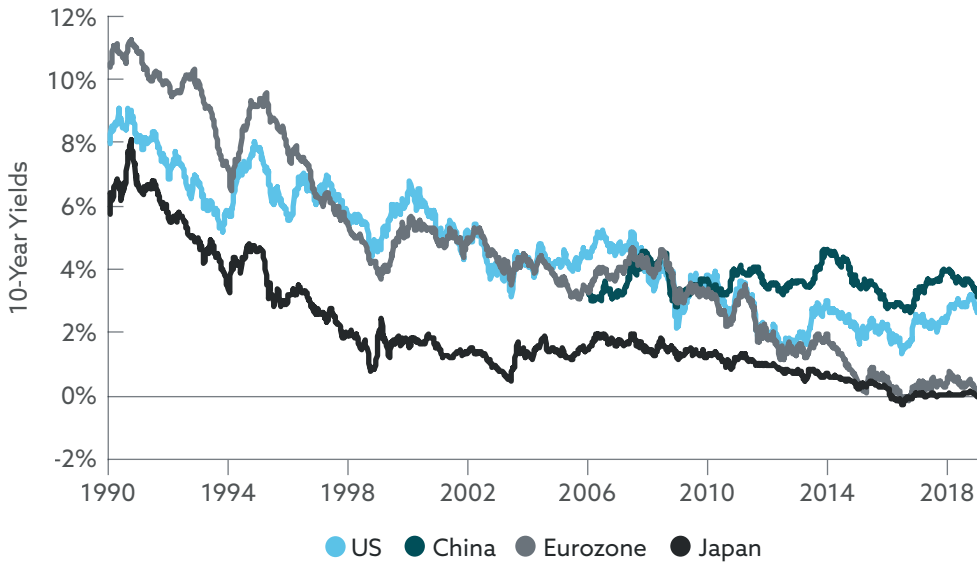
ADJUSTING OUR OUTLOOKS

Our expectations for underlying fundamentals remain constructive. Expectations continue to call for 2019 US GDP growth of around 2.5%.³ While global growth is slowing, China announced several stimulus measures in January (both monetary and fiscal), showing it is serious about buoying the slowdown in its economic growth. Back in the US, a worrying sign has been the steep descent in earnings expectations for 2019, specifically the first three quarters of the year.⁴ Reduced growth expectations have been led by large cap, multinational firms, given the strong US dollar and global growth slowdown.⁵ In addition to Chinese stimulus, however, the US dollar was 1.6% weaker on a trade-weighted basis in January while earnings expectations are stronger for mid and small caps (after an expected weak Q1).⁶ Corporate balance sheets are also healthy, in our view.

Given our fundamental view, valuations have been our focus across equities and corporate credit. The valuation shift in Q4 2018 had been the biggest change to these markets. We entered January seeing more opportunities as the result of the shift, with relative value thresholds being met. However, the January rebound was strong enough and swift enough that we believe opportunities are fewer, although they do remain.

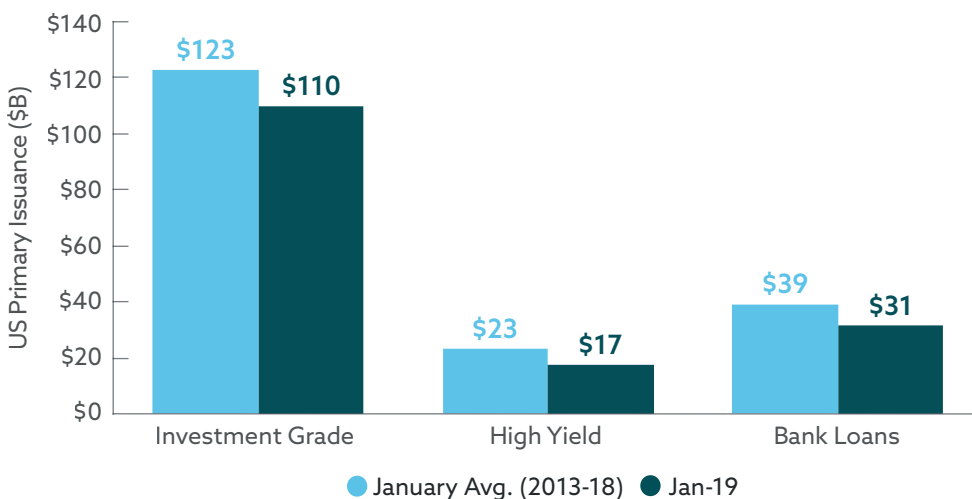
(1) Data in this paragraph from Morningstar, S&P Global Market Intelligence. Indices are the S&P 500, the Bloomberg Barclays US Credit, the ICE BofAML US High Yield and the S&P/LSTA Leveraged Loan. 1 February 2019. (2) Deutsche Bank. 1 February 2019. (3) Bloomberg. 1 February 2019. (4) FactSet. Current estimates are for growth of -0.9% in Q1, 1.5% in Q2, 2.7% in Q3 and 9.8% in Q4. 1 February 2019. (5) Cornerstone Macro. 31 January 2019. (6) FactSet. 5 February 2019.
Past performance is no guarantee of future results.

DOVISH MONETARY POLICY COULD KEEP GLOBAL RATES LOW⁷



It was not just the US Federal Reserve that sounded more dovish in January, as the People's Bank of China provided stimulus through reserve requirement cuts while the European Central Bank signaled no rate hike in 2019. Taken together, these policies have the potential to keep global rates low. The PBOC is outright easing, forward guidance indicates the ECB and Bank of Japan will not hike anytime soon, and expectations are the end of Fed tightening is near. Further, PBOC and BOJ balance sheets continue to grow, the ECB's remains large and the Fed's may shrink less than expected. The US is much further along in normalizing policy, but investors could reach for yield through Treasuries.

LARGELY UNEVENTFUL REOPENING TO NEW ISSUE MARKET⁸



US corporate credit activity was in the spotlight during January, considering the heavy primary market calendar. Participants focused on the investment grade market, where issuance came in below the historical average and significantly below January 2018 (\$145B).⁸ US banks in particular issued less than expected. High yield bond and loan issuance heated up, especially following zero issuance in high yields bonds in December, but both also came in below historical averages. This proved to be a constructive sign, aiding the rebound in US corporate credit. Further, new issues were oftentimes oversubscribed. With the sharp rebound, however, portfolio management decisions will likely become more difficult as valuations are back at richer levels while the heavier issuance calendar will continue in February.

(7) FactSet. China's current 10-year bond began trading in December 2005. 1 February 2019. (8) Credit Suisse. IG and HY figures for January 2019 are estimates. 29 January 2019. S&P Global Market Intelligence. 1 February 2019. Past performance is no guarantee of future results.

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The **Bloomberg Barclays US Credit Index** provides a broad measure of investment grade, USD-denominated credit securities. It includes publicly-issued US and SEC-registered global corporate securities, foreign debt and secured notes.

The **ICE BofAML US High Yield Index** provides a broad measure of below investment grade, USD-denominated fixed rate corporate debt. It includes corporate bonds with risk exposures to countries that are members of the FX-G10, Western Europe or territories of the US and Western Europe.

The **S&P 500 Index** provides a broad, market capitalization-weighted measure of US large cap stocks. It includes approximately 500 publicly-traded stocks of the largest US companies.

The **S&P/LSTA Leveraged Loan Index** provides a broad, market value-weighted measure of US institutional leveraged loans. It includes the institutional tranches of loans syndicated to US loan investors.

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