BARINGS INVESTMENT INSTITUTE

WEEKLY UPDATE

11 October 2019

Overview

Just Don't Call it QE: *The Federal Reserve will resume buying U.S. Treasury bills to offset recent turmoil in money markets. Fed Chairman Jerome Powell stressed that "growth of our balance sheet for reserve management purposes should in no way be confused with the large-scale asset purchase programs that we deployed after the financial crisis." Money market volatility spiked last month as corporate tax payments and settlement for Treasury security purchases created a scarcity of liquidity that sent short rates surging. The Fed announced last week it will extend operations for overnight repurchase agreements through November 4 to improve liquidity for funding markets.*

FOMC Minutes: *Minutes of the September meeting show most participants supported the rate cut but are divided on the path for monetary policy. There seemed to be a focus on inflation during the discussions, which has elevated the odds of another rate cut in October, as recent inflation data has been soft. All were more concerned about the escalation of the trade war with China and Brexit uncertainty slowing global growth, but the impact on the U.S. economy was less certain. Participants also discussed developments in money markets and the appropriate level of balance sheet reserves, as well as the merits of a standing repurchase agreement facility.*

ECB Minutes: *The September meeting minutes show that although there was a clear majority in favor of restarting QE, several members were not convinced the case was strong enough. Some participants preferred a larger rate cut instead of new asset purchases. The next big debate will likely center on limits to the asset purchase program, which was approved on an open-ended basis. The discussion will focus on the size, length and mix of QE.*

Key Financial Indicators						As of:	10/9/2019
Rates	**Yield**	**1 W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
Fed Funds	2.00%	0 bps	-25 bps	-50 bps	-50 bps	-25 bps	-50 bps
3 Month USD Libor	1.98%	-7 bps	-15 bps	-36 bps	-60 bps	-44 bps	-82 bps
3 Month Euribor	-0.42%	1 bps	2 bps	-6 bps	-11 bps	-10 bps	-11 bps
3 Month U.S. T-Bill	1.69%	-9 bps	-27 bps	-52 bps	-68 bps	-52 bps	-71 bps
2-Year U.S. Treasury	1.46%	-2 bps	-10 bps	-44 bps	-88 bps	-143 bps	-104 bps
10-Year U.S. Treasury	1.58%	-1 bps	-4 bps	-47 bps	-91 bps	-162 bps	-110 bps
10-Year German Bund	-0.56%	-3 bps	1 bps	-24 bps	-56 bps	-112 bps	-80 bps
10-Year U.K. Gilt	0.45%	-7 bps	-16 bps	-37 bps	-73 bps	-122 bps	-89 bps
10-Year JGB	-0.22%	-6 bps	5 bps	-7 bps	-17 bps	-37 bps	-21 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	1.60%	N/A	0.1%	0.4%	3.3%	12.0%	8.3%
Barclays Capital U.S. TIPS	1.78%	N/A	-0.2%	-0.4%	1.7%	8.4%	7.9%
Barclays Capital U.S. Aggregate	2.18%	49	0.1%	0.4%	2.9%	11.6%	9.0%
Barclays Capital Global Aggregate	1.27%	45	0.2%	-0.2%	1.7%	9.1%	6.7%
Barclays Capital U.S. ABS	1.91%	39	0.1%	0.2%	1.4%	5.8%	4.4%
Barclays Capital U.S. MBS	2.39%	50	0.1%	0.4%	1.6%	8.9%	5.8%
Barclays Capital U.S. Corporate Investment Grade	2.85%	120	0.0%	0.3%	3.5%	14.4%	13.5%
BAML Euro Corporate Investment Grade	0.42%	113	-0.1%	-0.5%	1.0%	6.2%	6.6%
Barclays Capital U.S. Corporate High Yield	5.90%	413	0.0%	-0.5%	0.8%	6.6%	10.9%
BAML European Currency High Yield Non-Financial	3.60%	416	-0.5%	-0.9%	-0.1%	3.7%	7.7%
CS U.S. Leveraged Loans	6.46%	504	-0.4%	-0.3%	0.1%	2.3%	5.8%
CS Western European Leveraged Loans Non-USD	4.68%	427	-0.1%	0.2%	0.8%	2.4%	3.6%
JPM CEMBI Broad Diversified	5.06%	354	0.3%	0.6%	1.7%	11.5%	11.1%
JPM EMBI Global Diversified	5.16%	346	0.4%	-1.0%	1.4%	13.4%	13.2%
JPM GBI-EM Global Diversified	5.15%	N/A	1.0%	0.4%	-0.1%	13.0%	8.9%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	2,919.40	1.91%	1.2%	-1.8%	-1.5%	3.4%	18.3%
Euro STOXX 600 (Local)	380.30	2.97%	0.7%	-1.5%	-2.0%	2.0%	12.6%
U.K. FTSE 100 (Local)	7,166.50	4.56%	0.6%	-1.0%	-4.9%	-1.0%	6.5%
Japan Nikkei 225 (Local)	21,456.38	2.04%	-1.5%	0.6%	-0.5%	-8.6%	7.2%
China Shanghai Composite (Local)	2,924.86	2.37%	0.7%	-3.3%	-0.1%	7.5%	17.3%
MSCI AC World (Local)	511.21	2.59%	0.7%	-1.4%	-1.9%	3.4%	15.5%
MSCI Emerging Markets (Local)	993.01	2.99%	0.0%	-1.2%	-2.8%	3.7%	7.1%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	400.18	0.8%	-2.3%	-5.2%	-11.0%	-19.4%	6.9%
WTI Crude ($/bbl)	52.63	-0.1%	-9.1%	-8.6%	-17.8%	-29.8%	16.6%
Copper ($/lb)	2.56	0.0%	-1.9%	-2.4%	-12.6%	-8.3%	-2.5%
Gold ($/oz)	1,507.25	1.0%	-0.1%	8.3%	15.7%	27.1%	17.8%
U.S. Dollar Index	99.12	0.1%	0.9%	1.7%	2.2%	3.6%	3.1%
Euro (USD/EUR)	1.10	0.3%	-0.7%	-2.0%	-2.6%	-4.3%	-3.9%
British Pound (USD/GBP)	1.22	-0.7%	-1.0%	-2.0%	-6.4%	-6.7%	-4.1%
Japanese Yen (Yen/USD)	107.39	0.0%	0.2%	-1.3%	-3.4%	-5.1%	-2.1%
Chinese Yuan (CNY/USD)	7.13	-0.1%	0.1%	3.6%	6.3%	3.0%	3.9%

Source: FactSet and Bloomberg

Economics

UNITED STATES

Employment: The September employment report showed nonfarm payrolls grew 136,000, just below the 145,000 consensus estimate. The previous two months were revised higher by a net 45,000. The unemployment rate hit a new low of 3.5% as employment increased and the labor force expanded. Wage growth disappointed, remaining flat M/M and slowing to 2.9% Y/Y. The report showed a slowing trend in job growth, but is likely adequate to give the Fed flexibility on policy decisions.

Inflation: September inflation measures were weaker than expected. Headline consumer inflation was unchanged M/M and slowed to 1.7% Y/Y as energy prices fell for the fourth time in five months. Core CPI rose .1% M/M as the Y/Y rate remained steady at 2.4%. Headline and core producer prices unexpectedly declined .3% M/M, pulling the Y/Y rate down to 1.4% and 2.0%, respectively. Subdued inflation measures gives the Fed more latitude to lower interest rates.

Trade: The trade deficit widened more than expected in August to $54.9 billion from $54 billion the previous month. Exports increased 0.2% to $207.9 billion and imports rose 0.5% to $262.8 billion. Exports and imports fell 2.2% M/M. The narrower deficit will add to economic growth. Goods exports to China are down 16% YTD, while imports have fallen 12.5%.

EUROPE

EZ Confidence: The Sentix economic confidence index fell in October to its lowest level since April 2013 as both the current situation and expectations measures declined. Despite recent ECB easing, investors are worried about a recession.

U.K. Trade: The August trade deficit widened to £9.8 billion from £9.6 billion in July. Exports fell .5% M/M to £30.3 billion while imports rose .1% M/M to £40.1 billion. The oil trade deficit oil widened to -£841 million from -£750 million.

U.K. Industrial Production: August industrial production unexpectedly declined .6% M/M, pulling the Y/Y rate down to -1.8%. Weakness was broad-based as manufacturing, mining, power generation and oil exploration activity fell in August.

ASIA - PAC

China FX Reserves: China's foreign exchange reserves fell to $3.09 trillion in September from $3.11 trillion in August, more than expected. Reserve holdings have been relatively stable despite valuation effects from a stronger U.S. dollar.

Japan Machine Orders: Core machine orders fell 2.4% M/M in August, more than expected, following a 6.6% drop in July. The drop in orders extended to the service sector, indicating weak capital investment may lead to a broader slowdown.

Japan Producer Prices: Producer prices were unchanged in September (-1.1% Y/Y), matching estimates. The Y/Y decline in PPI was driven by an 11.9% M/M drop in petroleum and coal product prices. Beverages and food (+0.7%), and utilities (+0.3%) prices were higher over the past year, while transportation equipment (-0.5%) and chemicals (-4.8%) were lower.

Policy

UNITED STATES

China Trade: The administration is reportedly considering rolling out a previously agreed currency accord with China as part of an early harvest deal that could see tariff increases, planned for October 15, suspended. The accord, which was seen as a first-phase agreement by the administration, had been agreed upon by the U.S. and China before talks broke down earlier this year. This comes amid eight Chinese technology giants having been blacklisted by the U.S. administration, accusing the companies of being implicated in human rights violations against Muslim minorities in the country's Xinjiang region. Similarly, the U.S. will also begin restricting visas for Chinese government and Communist Party officials linked to these abuses.

Tax Reform: The Treasury Department is considering relaxing regulations intended to prevent U.S. firms from lowering their tax liability by shifting income to their offshore branches, also referred to as "inversions." The Treasury is also allegedly considering repealing them entirely and replacing them with something more business-friendly.

Financial Regulation: Under a new framework, which is set to be finalized this week, domestic and foreign banks with $100 billion and $250 billion in assets are freed from enhanced capital and liquidity rules, now requiring them to participate in the Fed's annual stress testing exercise only every two years, rather than annually. The Federal Reserve has also signed off on proposed changes to the "Volker Rule," which makes it easier to banks to conduct proprietary trading. The new rule will take effect on January 1.

GLOBAL

Middle East: Turkish forces have launched an offensive in Northern Syria to seize border areas from the U.S.-backed Syrian Democratic Forces, a Kurdish-led group. The developments come amid a deterioration of talks between the U.S. and Turkey on creating a kind of buffer zone along the Turkey-Syria border. Elsewhere in the region, potential flashpoints are building as protests continue in Iraq amid allegations of government corruption and economic mismanagement.

Portugal: As widely expected, Prime Minister Antonio Costa won a parliamentary election this week, with Costa's Socialists boosting its number of seats but falling short of an outright majority, capturing about 37% of the vote. The opposition PSD party won 28% of the vote. These developments have become somewhat of a rare occurrence in Europe's left, which has seen the rise of Green or the far right lead elections elsewhere.

Ecuador: President Lenin Moreno has announced that he is moving the administrative center of his government away from the nation's capital as protests and instability against recently implemented austerity measures, including a decision to scrap a fuel subsidy that costs the state about $1.4 billion a year. The measure is part of an economic reform package that officials are implementing under a $4.2 billion financing deal that the government signed with the IMF.

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