

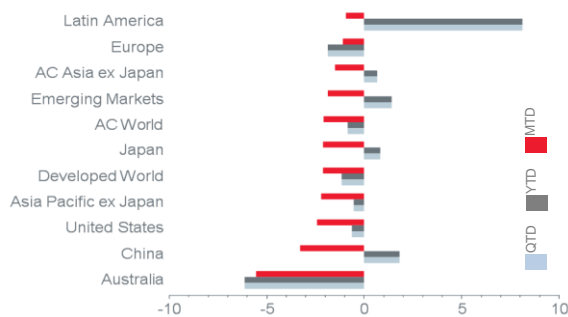
MONTHLY REVIEW: Trading Places

March 2018

The World in five bullet points

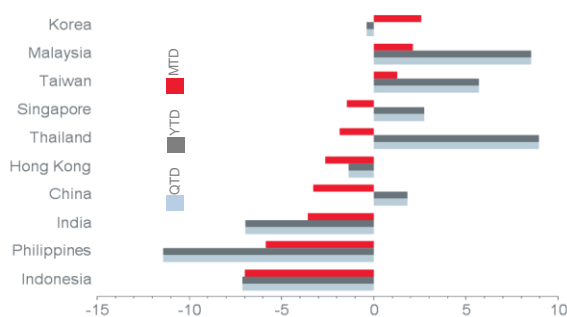
- ▶ March was all about Tariffs and Trade. President Trump imposed a 25% tariff on steel, and a 10% ticket on aluminium imports, then readied \$50bn worth of tariffs on China's technology sector. China responded with counter tariffs on \$3bn worth of US exports, and the EU and Japan also examined retaliatory measures. Although the headline numbers were big, the escalation in trade tensions appeared contained, not least because of restraint from China but also as the US watered down the tariffs almost immediately after announcing them. But it's what will happen next that is causing the markets to wobble.
- ▶ The initial tariffs on steel met resistance in the **US**, with economic advisor Gary Cohn promptly resigning while key members of his own Republican Party raised eyebrows in alarm. And the political changes in the US didn't end there: Rex Tillerson and H.R McMaster also left the Trump cabinet, causing worries in the markets that political instability could engulf Washington.
- ▶ Geo-politics also traded places in March. President Trump accepted an invitation from **North Korea's** President Kim Jong Un for a summit in May, easing tensions on the Korean peninsula. But also in March the **UK** - quickly followed by other western countries - expelled dozens of Russian diplomats in retaliation for the alleged attempt to kill a former spy in the UK.
- ▶ In **China**, the National People's Congress approved a government overhaul that consolidated power in the centre and effectively gave President Xi a term for as long as he wants. China also said it aims to expand its economy by around 6.5% this year, the same as in 2017, while pressing ahead with its campaign to reduce risks in the financial system including the de-leveraging of its economy; with that, the appointment of Liu He as Vice Premier may lead to an acceleration of this policy.
- ▶ In Europe, **Italy's** election saw the populist/anti-establishment parties lose ground and the worst-case scenario of an extreme right-wing party winning averted. **Germany** got a new government after months of discussions between various coalition parties with Angela Merkel staying as Chancellor. The **UK** conceded ground to the EU in Brexit negotiations and in return gained a 21-month extension after the formal exit next year to aid the transition.

Fig.1. Regional Equity Indices Performance, US\$ %



Source: Thomson Reuters Datastream, MSCI

Fig.2. Asia Equity Indices Performance, US\$ %



Source: Thomson Reuters Datastream, MSCI (in USD)

Equity Markets

- ▶ Equity markets were volatile in March and in general ended lower with only small pockets of positive returns. The volatility came amid worries the trade tariffs on US steel and aluminium imports would escalate into a full-blown trade war, with markets sent lower on the announcement only for them to recover as the headline figures were watered down.
- ▶ MSCI World fell 2.1% in US dollar terms with Emerging Markets marginally outperforming Developed Markets, while Latin America outperformed Asia as the tech sell off weighed on several Asian markets. But even here, Asia markets were mixed with Korea posting a small positive return as tensions with the North eased, and Taiwan recording a small gain as semiconductor names bucked the negative sentiment in technology stocks.
- ▶ Underperforming markets included Australia, dragged lower by the Aussie dollar falling against the US dollar, and the EMEA region, which saw South Africa give up much of its recent gain. Back in Asia, Indonesia and the Philippines were substantially lower than their continental neighbours largely on currency pressures as well as net fund outflows.

Source: Eastspring Investments. Chart data from Thomson Reuters Datastream as at 31 March 2018. For representative indices and acronym details please refer to notes in the appendix.



- ▶ Almost everywhere, corporate earnings took a back seat to politics and trade news. Italy enjoyed a modest relief rally as the worst-case scenario was avoided in its elections while Germany's large-cap exports suffered amid the tariff concerns as speculation swirled that its auto industry could be hit next, while the strong euro also hit exporters.
- ▶ Technology stocks everywhere came under pressure after one round of US sanctions threatened the Chinese technology sector. Then, after a UK-based political consultancy was alleged to have been given personal data from Facebook users without consent, internet stocks including FB, Twitter and Alphabet fell sharply on fears regulation could be on its way. Amazon also fell after President Trump hinted he may rebase the company's tax standing.

Fig 3. Currencies Performance versus USD (%)

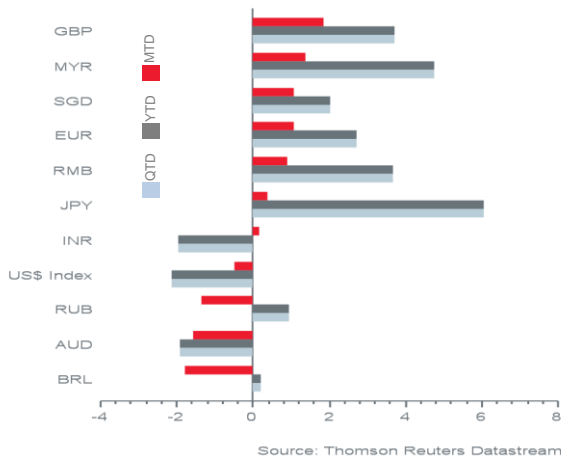
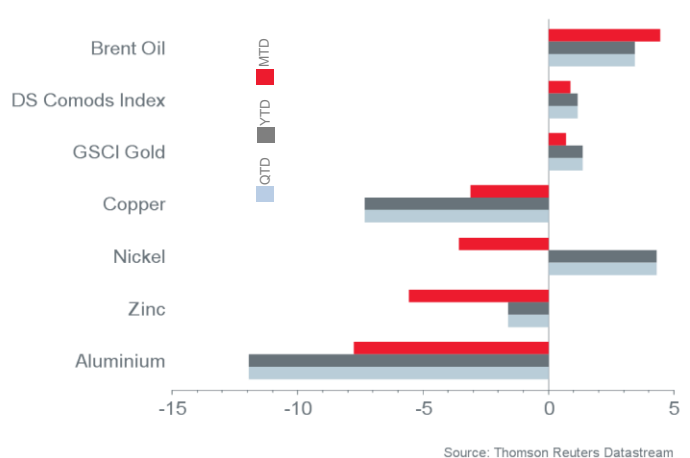


Fig 4. Commodities Performance in USD (%)



Currencies

- ▶ The US dollar fell over the month but was well off its lows by month end despite a bout of volatility toward the end. Downward pressure came from Gary Cohn's resignation as well as the initial headlines from President Trump on his tariff plans however support arrived in the form of exemptions for steel imports from Mexico and Canada, then from positive jobs and economic data. Finally, hints that the US and China were working behind the scenes on a trade deal gave the dollar a boost in the final week. The interest rate rise, normally a key pillar of support for the dollar, was brushed aside.
- ▶ The yen was the strongest of the major global currencies in the first month mainly because of strengthening late in March on reports of exporters selling dollars to cover dollar-yen hedging strategies. The yen's long-held 'safe haven' status also helped.
- ▶ The euro was steady during the month and traded within its quarter-long trading band for most of the month. ECB's president Mario Draghi surprised investors by first dropping the central bank's pledge to increase its large-scale bond purchases in another step toward exiting the process altogether, and then countered his dovish comments by saying policy would be "reactive" and that underlying inflation was still subdued. Investors paired off the comments and the euro traded sideways as a result.
- ▶ The pound gained during March as Brexit negotiations progressed and the Bank of England hinted at a further rate increase in May. The market is now pricing in around a 50% chance of a further rate increase by year end.

Commodities

- ▶ Crude rallied over the month to decouple a little from the recent trend of following equity markets as increased tensions in the middle east, then worries the Iran nuclear deal could collapse boosted prices. But a surprise US inventory build at the end of the month saw WTI and Brent come off their highs. Meanwhile in Shanghai, yuan-denominated oil contracts got off the ground and, for a brief time on the first day, out-traded Brent contracts in terms of volume.
- ▶ But ex oil, commodity prices struggled through the month with concerns on global trade weighing on metal and raw material prices. The exception was gold which took on its traditional role of a "port-in-the-storm" amid the equities turmoil to end higher.
- ▶ Iron ore fell again but prices gyrated with the newsflow on steel tariffs. Traders struggled to get a firm grip on tariff implications but prices continued on the downward trajectory they've been on since late February, and are now 20% down from their peak.
- ▶ Copper and zinc fell, as did aluminium that slid 7% on the US tariff news. Coal prices, meanwhile, were steady.
- ▶ The Baltic Dry Index, a key indicator of the health of the commodity market, continued its decline although losses in March were more modest than those seen in December and January, supported by encouraging industrial data points out of China that first gave the index some grounding in February.



Fixed Income

- ▶ The Federal Reserve raised interest rates by 25bps to 1.5-1.75%, the sixth in the current rate-hiking cycle and the first with Jerome Powell as chair. The widely expected move was followed by an upgrade of 2018's economic growth forecast to 2.7% from 2.5%, and a rise in federal funds projections of a terminal rate of 3.4% from 3.1% in 2020.
- ▶ The rate rise was largely expected so the market reaction was muted per se. But in his first accompanying comments, Mr Powell indicated he favoured two further increases this year and a steeper path of tightening in 2019 and 2020. Some investors had begun to speculate that three more rate rises were possible in 2018 and although Fed Fund Futures have since largely discounted this, there still exists the possibility of surprise towards the year end as 2019 looms into view.
- ▶ Ten-year treasuries spent a fretful month in a trading range before moving decisively down to 2.74% at month-end, as the Federal Reserve rate hike with hawkish overtones and trade tensions tugged the benchmark bond in opposite directions. Several short-duration auctions during the month were met with muted response from investors as more benign inflation-related data points were posted.
- ▶ Elsewhere, the ECB, the Bank of England and Bank of Japan all kept rates on hold but the BoE signaled it would look to raise rates in May.

Fig 5. Bond Indices Performance, USD %

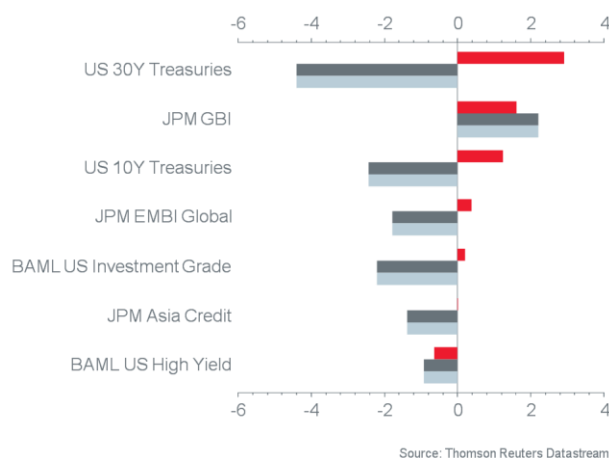
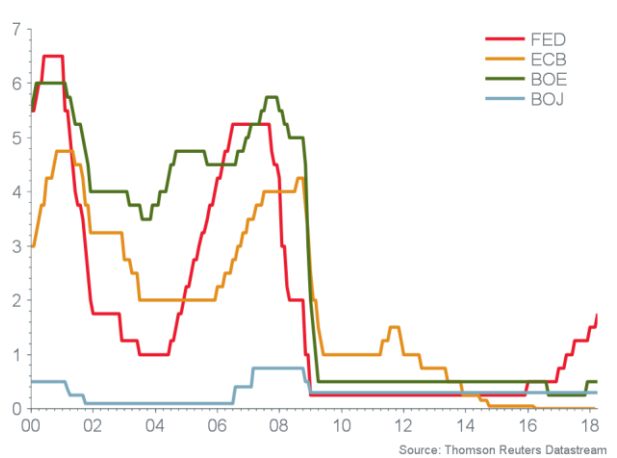


Fig 6. Central Banks Interest Rate, %



Economics

- ▶ Data out in March showed **US** Retail sales fell for a third straight month in February as sales of big-ticket items such as autos and building materials unexpectedly fell. The numbers were below expectations but economists pointed to a consumer spending surge in December ahead of expected tax breaks as reasons for the weakness. Producer Prices were higher in February, fueling expectations this would feed through to consumer inflation through the year while Industrial output was also surprisingly robust, rising 1.1% for the strongest return in four months.
- ▶ **German** unemployment fell to 5.3%, the lowest level since the country was united in 1990, and inflation came in at 1.5%, lower than expected but still the highest level since December 2017. Meanwhile in the **UK**, inflation fell from 3.1% to 2.7% while wages grew to 2.8% finally giving a month of real wage inflation – the first in about a year.
- ▶ **China's** industrial output figures grew at 7.2% in January and February, faster than expected and suggesting the economy was on a faster growth trajectory than previously thought. The value of 'higher value' products such as computers and telecom equipment rose 12.1%.
- ▶ Elsewhere in Asia, **Taiwan** PMI fell in March but is still above the key 50 level, while the central bank held rates. PMI in India also fell but so too did inflation and will probably undershoot the RBI's 5.1% forecast for the first quarter. **Korea** and the US signed a new trade deal while consumer and business sentiment softened but all eyes were on the potential for a Trump-Kim summit in May. Interestingly, trade flow from China into North Korea, particularly in the pivotal oil sector, plunged.
- ▶ Although **South African's** equity market suffered in March, its economy received a boost when Moody's raised its credit rating one notch above junk and also raised its outlook. S&P also doubled its growth outlook for the country to 2%. The rand rose more than 1% and yields on the country's benchmark bonds fell to their lowest level in three years after the central bank cut rates by 25bps to 6.5%.
- ▶ **Brazil** saw another 25bps cut to its key Selic interest rate and left the door open for another cut later this year; the markets had all but discarded the possibility of such a cut again this cycle but benign inflation figures of 2.8% for March has helped sentiment.

Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 31 March 2018. For representative indices and acronym details please refer to notes in the appendix.

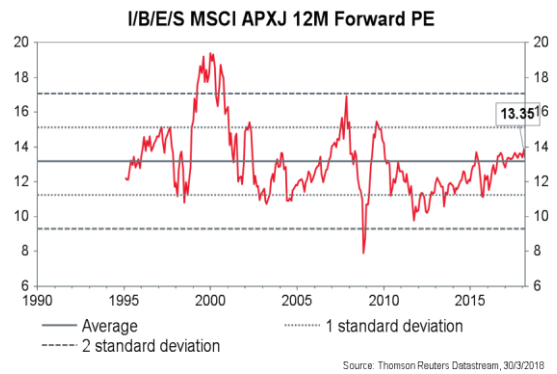
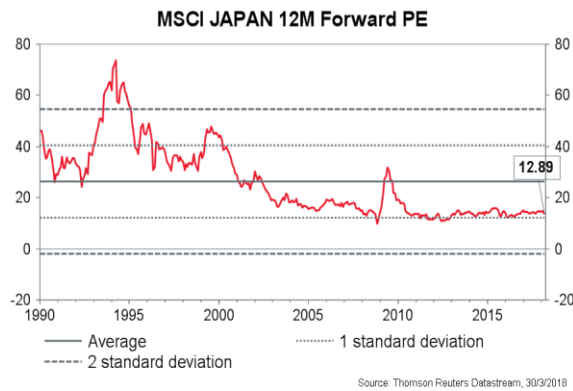
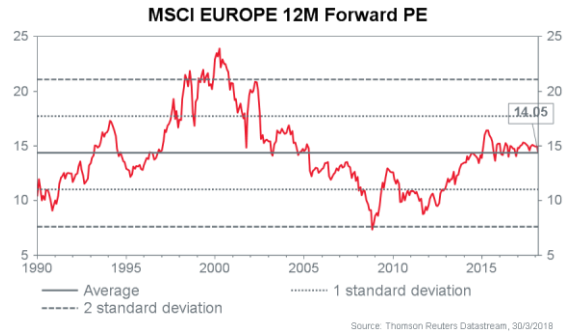
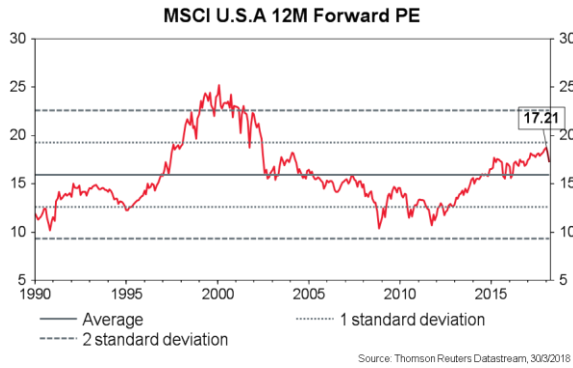
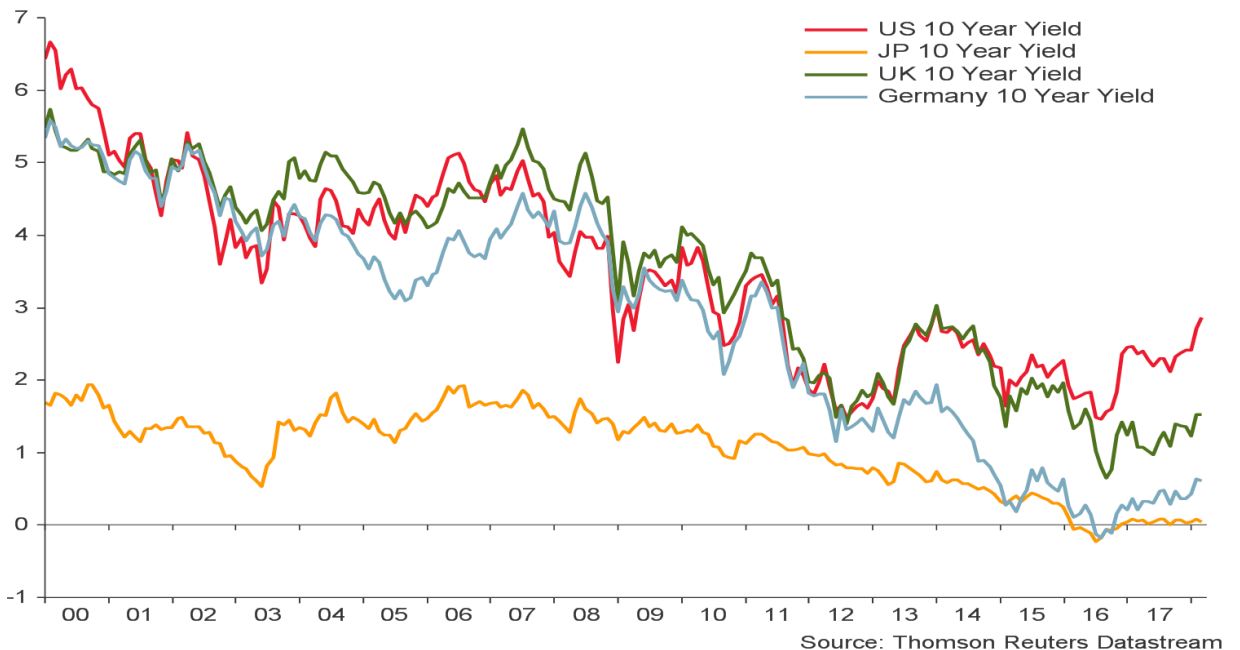


Fig 8. Key Bond Yields (%)



Source: Eastspring Investments. Chart data from Thomson Reuters DataStream as at 31 March 2018. For representative indices and acronym details please refer to notes in the appendix.



MSCI monthly, quarterly and year-to-date data

	MTD	QTD	YTD	2017	2016	Mar-18	Feb 18	Jan-18
World	-2.1	-0.8	-0.8	24.6	8.5	-2.1	-4.2	5.7
Developed World	-2.1	-1.2	-1.2	23.1	8.2	-2.1	-4.1	5.3
United States	-2.4	-0.6	-0.6	21.9	11.6	-2.4	-3.7	5.7
Europe	-1.1	-1.9	-1.9	26.2	0.2	-1.1	-5.9	5.4
Japan	-2.0	1.0	1.0	24.4	2.7	-2.0	-1.5	4.6
Emerging Markets	-1.8	1.5	1.5	37.8	11.6	-1.8	-4.6	8.3
Asia Pac Ex Japan	-2.2	-0.6	-0.6	37.3	7.1	-2.2	-4.7	6.7
Asia Ex Japan	-1.5	0.7	0.7	42.1	5.8	-1.5	-5.0	7.6
Latin America	-0.9	8.1	8.1	24.2	31.5	-0.9	-3.6	13.2
Brazil	-1.8	12.5	12.5	24.5	66.7	-1.8	-2.0	16.8
EMEA	-4.9	-0.9	-0.9	25.2	20.5	-4.9	-1.8	3.0
	MTD	QTD	YTD	2017	2016	Mar-18	Feb 18	Jan-18
Australia	-5.6	-6.1	-6.1	20.2	11.7	-5.6	-3.2	3.0
New Zealand	-1.3	-4.9	-4.9	12.7	19.3	-1.3	-7.1	3.7
Hong Kong	-2.6	-1.4	-1.4	36.2	2.3	-2.6	-3.2	4.7
China	-3.3	1.8	1.8	54.3	1.1	-3.3	-6.4	12.5
Korea	2.6	-0.4	-0.4	47.8	9.2	2.6	-6.3	3.7
Taiwan	1.3	5.7	5.7	28.5	19.6	1.3	-3.0	7.6
Thailand	-1.8	9.0	9.0	34.9	27.0	-1.8	2.3	8.5
Malaysia	2.1	8.5	8.5	25.1	-3.9	2.1	-1.4	7.8
Singapore	-1.5	2.8	2.8	35.6	1.5	-1.5	-2.0	6.4
Indonesia	-7.0	-7.1	-7.1	24.8	17.5	-7.0	-3.0	3.0
India	-3.6	-7.0	-7.0	38.8	-1.4	-3.6	-6.7	3.4
Philippines	-5.9	-11.4	-11.4	25.2	-6.1	-5.9	-4.6	-1.3
	MTD	QTD	YTD	2017	2016	Mar-18	Feb 18	Jan-18
Mexico	0.8	0.9	0.9	16.3	-9.0	0.8	-7.1	7.9
Chile	-1.6	1.6	1.6	43.6	16.8	-1.6	-3.8	7.3
Hungary	-0.5	-1.0	-1.0	39.9	35.4	-0.5	-7.7	7.8
Poland	-6.3	-8.2	-8.2	55.3	0.7	-6.3	-9.9	8.8
Czech Republic	2.9	6.4	6.4	38.9	-2.5	2.9	-4.6	8.4
Russia	-3.7	9.4	9.4	6.1	55.9	-3.7	0.9	12.6
Turkey	-7.3	-4.8	-4.8	39.1	-8.1	-7.3	-2.1	4.9
South Africa	-6.4	-4.0	-4.0	36.8	18.4	-6.4	-0.2	2.8
United Kingdom	-0.3	-3.9	-3.9	22.4	-0.0	-4.9	-1.8	3.0
Germany	-1.9	-3.5	-3.5	28.5	3.5	-1.9	-7.2	5.9
France	-1.4	0.4	0.4	29.9	6.0	-1.4	-4.8	7.0
Netherlands	0.0	1.0	1.0	32.7	5.3	0.0	-5.0	6.3
Austria	-0.5	2.7	2.7	52.1	8.1	-0.5	-5.3	9.0
Italy	0.3	5.4	5.4	29.6	-9.5	0.3	-5.9	11.7
Spain	-1.9	-1.6	-1.6	27.7	-0.5	-1.9	-8.0	9.0
Greece	-9.1	-6.7	-6.7	29.1	-11.9	-9.1	-8.2	11.8
Portugal	3.3	3.1	3.1	25.2	4.6	3.3	-4.5	4.5
Switzerland	-1.6	-3.9	-3.9	23.6	-4.0	-1.6	-6.3	4.3
Sweden	-2.3	-1.9	-1.9	21.8	1.9	-2.3	-5.4	6.1
Norway	-1.6	2.4	2.4	29.6	14.6	-1.6	-1.8	6.0

**KEY TERMS**

CA	Current Account
CBR	Central Bank of Russia
COPOM	Central Bank of Brazil
CPI	Consumer Price Index
DM	Developed Markets
ECI	Employment Cost Index
EM	Emerging Markets
EM Currencies	MSCI Emerging Markets Currency Index
EM Equities	MSCI Emerging Markets Index
EM Local Currency Bonds	JP Morgan Emerging Local Currency Bond Index
EM USD Bonds	JP Morgan Emerging Market Bond Index
EMU	European Monetary Union
EU	European Union
Fed	The Federal Reserve Board of the United States
FOMC	Federal Open Market Committee
GDP	Gross Domestic Product
Global Developed Equities	MSCI Developed Markets Index
Global Equities	MSCI All Country World Index
Global Government Bonds	Citigroup World Government Bond Index
IP	Industrial Production
M2	M2 Money
mom	Month on month
PBoC	Peoples Bank of China
qoq	Quarter on quarter
Repo	Repossession
SDRs	Special Drawing Rights
SELIC	Sistema Especial de Liquidação e C.U.S.todia (SELIC) (Special Clearance and Escrow System)
Tankan	Japan Large Business Sentiment Survey
TSF	Total Social Financing
UK	United Kingdom
y/y	Year on year

REPRESENTATIVE INDICIES

Aluminum	S&P GSCI Aluminum Index
Asia Local Bond (ALBI)	HSBC Asia Local Bond Index
Brent Oil	Cash settlement price for the InterContinental Exchange (ICE) Brent Future based on ICE Futures Brent index
Commodities	Datastream Commodities Index
Copper	S&P GSCI Copper Index
EMU 10 Year	Datastream EMU 10 Year
Global Emerging Bond	JPM Global Emerging Bond Index
Gold	S&P GSCI Gold Index
Japan 10 Year	Datastream Japan 10 Year
JACI	JP Morgan Asia Credit Index
MSCI Dev World	MSCI Developed Markets Index
MSCI EM	MSCI Emerging Markets Index
MSCI Europe	MSCI Europe Index
MSCI Japan	MSCI Japan Index
MSCI Latam	MSCI Latin America Index
MSCI Russia	MSCI Russia Index
MSCI U.S.	MSCI U.S. Index
MSCI World	MSCI All Country World Index
Steel (HRC)	TSI Hot Rolled Coil Index
UK 10 Year	Datastream UK 10 Year
U.S. 10 Year Treasuries	Datastream U.S. 10 Year Treasuries
U.S. 30 Year Treasuries	Datastream U.S. 30 Year Treasuries
U.S. High Yield	BAML U.S. High Yield Constrained II
U.S. Investment Grade	BAML Corporate Master
DXY	U.S. Dollar Index
Zinc	S&P GSCI Zinc Index



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