MACRO MONTHLY

REGARDLESS OF RECENT VOLATILITY – 2019 ISN'T A REPEAT OF 2018

MAY 2019

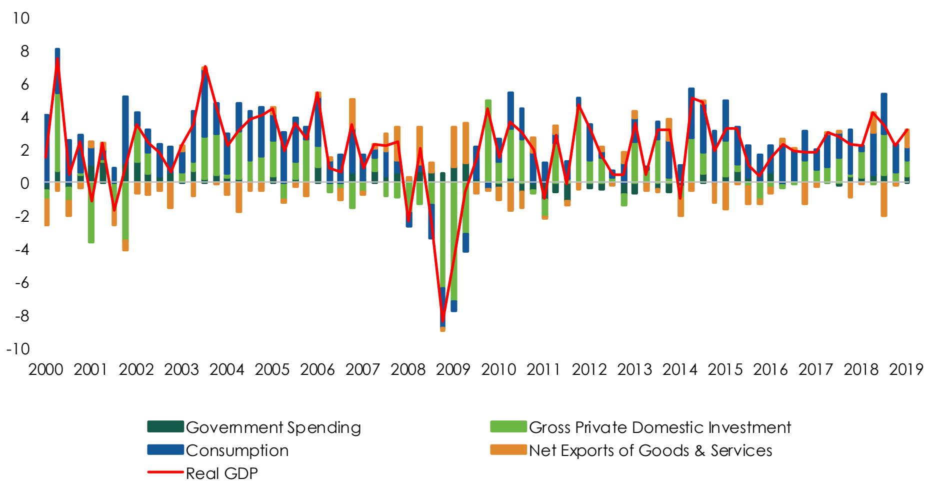
Over the last few weeks we have seen some ghosts of 2018 return and hit markets. We need to put some perspective on this and assess how it affects our long-held thesis.

The US economy has had a decent April (after a weaker Q1 overall), and this has pushed up the dollar as fears of US supremacy rise again. Strong China survey and hard data in early April has not been backed up by the smaller regional data in Taiwan/South Korea, and European PMIs disappointed once again in April after better figures in March. Whilst this may seem to be a 2018 in repeat we think the likelihood of escalation is quite low.

THE US IS SLOWING

The recent US GDP figures show an economy that is slowing from 2018, hit by political and trade uncertainty and as last year's fiscal stimulus ebbs. The headline figure was 3.2% for Q1 GDP, which surprised on the upside versus expectations, but the details were much weaker. Inventory accumulation contributed 0.7% on the quarter as the slowdown saw companies unable to shift stock built up pre tariffs in Q4; this will detract from GDP going forward. Also imports fell as orders were frontloaded in Q4 for the same tariff reasons. Exports were strong, showing decent demand outside the US, which is a clear positive given fears over growth in the rest of the world (ROW). To gauge how strong the US actually is, final sales to domestic producers grew at 1.4%, down from 2.1% in 4Q, and the slowest since 2013. Within that, business investment fell 2.7% from 5.4% prior. Consumer spending fell 1.2% from 2.5% in Q4. Residential real estate contracted again for the fifth straight quarter as higher interest rates continue to bite.

COMPOSITION OF US GDP



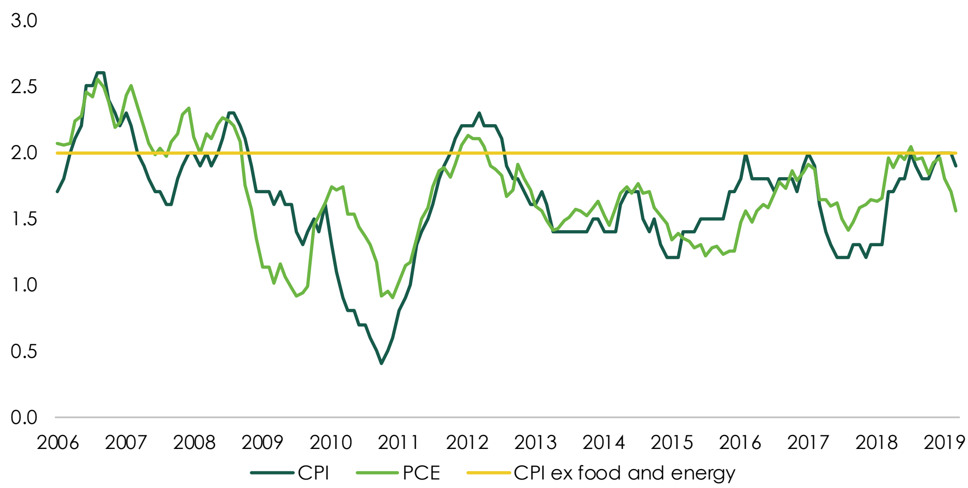
Source: Macrobond, as at 30/4/2019.

NOT A RECESSION

The US economy has shown some vulnerability and while this feels grim, it's good enough to keep recession risk at bay, and data so far in Q2 has shown improvements in retail sales, durable goods (a capex proxy) and housing data. Whilst a strong US is clearly favourable, this isn't strong enough to encourage a big growth divergence between the US and the rest of the world that caused the problems last year.

Given the Federal Reserve's (Fed) new 2019 dovish bias, inflation is also coming in much weaker than expected (GDP deflator over 3 months a very low 1.3% annualised), which should encourage the Fed to stay patient and also calm market fears of more hikes ahead. Any further tightening in US financial conditions from a strong dollar can be erased from lower rate expectations via the `Fed put.'

CORE PCE AND CPI



Source: Macrobond as at 30/04/2019.

CONCERN ABOUT THE DOLLAR

The dollar itself is strengthening and is undoubtedly a renewed concern for markets. Again perspective is needed - the dollar move is partially about the better US data as the US bounces from its weak start to 2019 but primarily about weaker data and dovish central banks elsewhere. Australia, Sweden and Eurozone central banks are talking down rates and currencies in their respective markets. We think these divergences in developed markets (DM) are approaching their limits as very low rate expectations are now priced in ROW markets. The path to a persistent strong dollar would be if GDP in the US was stronger - likely led by an investment surge that would propel the US neutral rate higher (Trump's dream). That is not in evidence in the GDP data. In any case any further tightening in US financial conditions from a stronger dollar can be erased by lower rate expectations via the dovish Fed. This is the 'Fed put,' which is very much alive with the weaker US inflation prints coming into line with weaker inflation prints we have seen in the ROW.

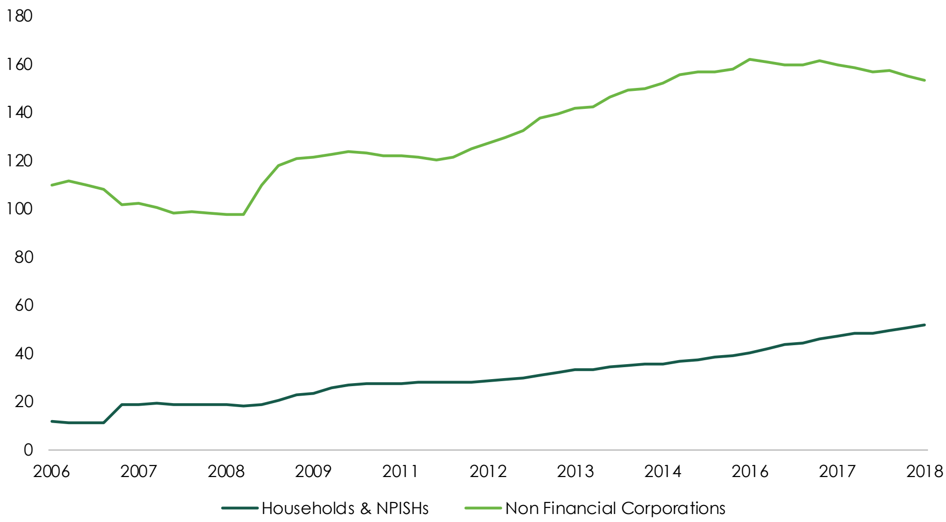
LESS TRADE RISK

So unlike last year, we don't have a hawkish Fed but a US economy that has stumbled, but is in ok shape. There are good reasons for the Fed to be very cautious and longer term prospects for the dollar are looking poor. US trade policy is simply not as aggressive as it was with a US /China deal on the horizon. Other trade policy induced volatility can arise as the US looks to make deals with Japan and Europe but we think the US administration has demonstrated that they want to improve the global trading system - and not destroy it - removing last year's systemic risk concerns over trade.

CHINA IS EASING

Recent news from the China's Politburo has also added some risk aversion to markets amid talk that they are back on the deleveraging path after the country's good growth figures this year. We see this as incorrect. The Chinese were never going to do a credit splurge that markets have become used to due to the imbalances this might create and the risks of poor lending practices. But they have been easing for a year now and are very unlikely to choke this off at the first signs of 'greenshoots,' and the careless reference to deleveraging simply looks to be in line with their long term goals - and should not be a surprise to the market. The Chinese consumer is paramount for the Chinese and global economy, this sector is not levered up and could be very powerful. The debt burden in local governments and large corporates does need to be dealt with, but all efforts should be made by the Chinese to make cheap credit available to consumers to generate the growth and inflation to enable this deleveraging of these sectors to happen. We retain the view that China is bouncing on the back of stimulus efforts that will remain in place and support China and the global economy.

CHINA BIS CREDIT TO NON-FINANCIAL SECTORS (% OF GDP)



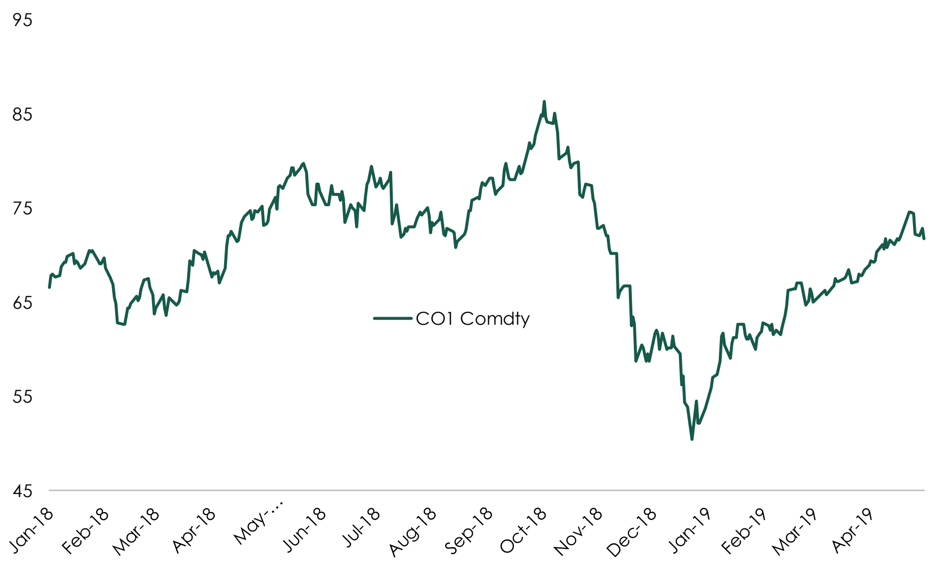
Source: Macrobond as at 30/04/2019.

EUROPE STABILISING, BUT WHAT ABOUT OIL?

Europe has been very disappointing but we believe it'll recover in time as China grows, global trade thaws and Brexit risk is delayed. We do note however that the recent weakness has mainly been in survey data and not the hard data and so believe daily political news flow has played its part in depressing business leaders in their survey responses. Having said this, growth is in poor shape from a myriad of shocks, but unlike last year we do believe it's stabilising rather than falling – a meagre but somewhat improving picture.

Emerging markets have been a favoured asset class this year but the better US data, weaker Asian data, strong dollar and weaker idiosyncratic stories in Turkey and Argentina have contributed to recent volatility. At present we don't see this as a persistent problem as the 2018 factors that were so damaging have lessened considerably as stated above. We are wary on oil however and the recent supply driven spike has clearly also contributed to emerging markets pain and so any weakness in oil prices will be a clear positive.

BRENT CRUDE OIL 1ST FUTURE



Source: Macrobond as at 30/04/2019.

SUPPORT FOR GLOBAL RISK

Which bring us to markets - with the global growth backdrop in better shape and monetary policy easy across the board, global risk appetite should remain supported. A strong dollar is holding back risk markets but given the 'Fed put' this impact should be mitigated. So far any attempt for US risk to sell off has been quickly reversed as rates fall – lower inflation only adds to the strength of the 'put' giving the Fed more leeway to act if needed. The higher yield US bond and strong equity market remain a problem for funding flows overseas and are causing aggressive squeezes across markets, but these moves likely should be faded in our opinion. The reason for this is simple. Last year's destructive increase in global interest rates led by the Fed (and forced upon others) is in full reverse so emerging markets can begin to ease domestic conditions via rate cuts as inflation and stability allow and as such most higher carry sovereigns in all regions continue to appeal to us over the medium to long term.

We recognise that at the recent Fed meeting Jerome Powell pushed back on the idea of cuts being priced into the market. This is a near term concern for volatility on a short term basis (as we talked through in April's Macro Monthly) but given the slowing US economy and inflation, we see this as more of a delay for the inevitable rate cuts than anything else.

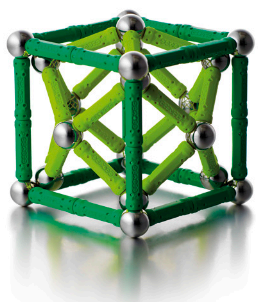
MORE COMFORTABLE ABOUT 2019

As we have said previously, a weaker dollar is needed for the risk trade to accelerate for both US assets and emerging markets (via capital inflows). This is taking some time but given better - and resynchronising- growth this will come eventually. Tempting though it is to add more downside risk hedges we are more comfortable about how 2019 is turning out for more upside in global risk assets even if vicious squeezes remain regular.

Finally, core global rates are looking expensive to us and after the last sell off attempt failed and central banks are only getting more dovish, being short duration overall is too risky at present. However we are close to this manoeuvre and will be quick to engage if we do see more signs of growth / inflation traction.

THE MODEL PORTFOLIO

ALPHA FACTOR	CONVICTION WEIGHTS (PER SECTOR)	DIRECTION	Exposure (weighted duration or %)	Risk Cont. (TE,bps)	Risk Cont. (%)
CREDIT		NET SHORT	-0.15yrs	50	12.6
US / EUR Coco bonds	40%	LONG	0.30yrs	25	6.3
Buy USD CDX HY Protection	30%	SHORT	-0.25yrs	14	3.5
Buy EUR CDS Crossover Protection	30%	SHORT	-0.20yrs	11	2.8
Developed Market Rates		NET SHORT	-2.90yrs	106	26.8
US	5%	SHORT	-0.75yrs	2	0.5
UK	15%	SHORT	-0.90yrs	24	6.1
Germany	10%	SHORT	-1.85yrs	8	2.0
Cyprus	5%	LONG	0.45yrs	6	1.5
France	5%	SHORT	-0.50yrs	2	0.5
Greece	15%	LONG	0.30yrs	19	4.8
Italy	15%	LONG	0.35yrs	11	2.8
Spain	15%	LONG	0.65yrs	18	4.5
Australia	15%	SHORT	-0.65yrs	16	4.0
Hard EM Rates		NET LONG	0.60yrs	48	12.1
Angola	15%	LONG	0.10yrs	6	1.5
Argentina	15%	LONG	0.05yrs	9	2.3
Ghana	10%	LONG	0.05yrs	4	1.0
Nigeria	15%	LONG	0.10yrs	7	1.8
Saudi Arabia	35%	LONG	0.25yrs	18	4.5
South Africa	10%	LONG	0.05yrs	4	1.0
Local EM Rates		NET LONG	1.05yrs	31	7.8
Brazil	15%	LONG	0.15yrs	6	1.5
Indonesia	25%	LONG	0.25yrs	8	2.0
Mexico	40%	LONG	0.45yrs	10	2.5
Russia	10%	LONG	0.10yrs	3	0.8
South Africa	10%	LONG	0.10yrs	4	1.0
FX (vs. USD)		NET LONG	16.50%	98	24.7
Australian Dollar	10%	LONG	2.50%	12	3.0
Brazilian Real	5%	LONG	1.50%	8	2.0
British Pound	5%	LONG	1.50%	7	1.8
Canadian Dollar	5%	LONG	2.50%	8	2.0
Chilean Peso	5%	LONG	1.00%	6	1.5
Chinese Yuan	5%	LONG	3.00%	5	1.3
Colombian Peso	5%	LONG	1.00%	7	1.8
Euro	5%	SHORT	-0.50%	-2	-0.5
Indonesian Rupiah	5%	LONG	1.50%	4	1.0
Japanese Yen	10%	SHORT	-5.00%	6	1.5
Korean Won	5%	LONG	1.00%	2	0.5
Mexican Peso	10%	LONG	2.00%	12	3.0
Norwegian Krone	5%	LONG	1.00%	5	1.3
Polish Zloty	5%	LONG	0.50%	3	0.8
South African Rand	5%	LONG	0.50%	5	1.3
Swedish Krona	10%	LONG	2.50%	10	2.5
Inflation-Linked Bonds		NET LONG	2.90yrs	63	15.9
Japan Breakevens	10%	LONG	0.55yrs	3	0.8
European Breakevens	40%	LONG	1.05yrs	26	6.6
US Breakevens	50%	LONG	1.30yrs	34	8.6
			Total	396	100



Source: Merian Global Investors, as at 18/04/2019.

FUND MANAGERS

Mark Nash and Nicholas Wall have managed the Merian Global Strategic Bond Fund (GSB) since 1 August 2016.

MARK **NASH**

Mark is head of fixed income at Merian Global Investors (MGI). He joined MGI on 27 June 2016 from Invesco, where he had worked since 2001. At Invesco, he was most recently head of global multi-asset portfolios. Mark is a CFA charterholder and has a chemistry degree from the University of Nottingham.

NICHOLAS **WALL**

Nicholas joined MGI as portfolio manager in July 2016. Prior to joining the business Nicholas worked as a fund manager in the global macro team at Invesco, since 2006. He is a CFA charterholder and has an economics degree from the University of York.

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