# Multi-Asset Solutions Weekly Strategy Report

Global markets and multi-asset portfolios

**January 14, 2019**

## IN BRIEF

- Following a year of weak performance, emerging market equities have made a strong start to 2019 as investor sentiment has turned more positive, helped in part by recent stimulus measures from China.
- Nonetheless we remain cautious about whether Chinese stimulus will act as a catalyst for a sustained emerging market equity rally over the near term. Further deceleration in China's economic growth in 1H19 will likely pose challenges to emerging markets and while we expect more stimulus measures from China, they will likely be of a smaller scale than prior rounds, given concerns about leverage in the economy.
- Amid slowing global economic growth momentum and tightening financial conditions in the U.S., we maintain a small underweight in stock-bond in our multi-asset portfolios, a move we initiated at our November Strategy Summit. We have also moved from neutral to underweight emerging market equities.

## WILL CHINA'S COMING STIMULUS LIFT EMERGING MARKETS?

After a ferocious equity market selloff at the end of 2018, investor sentiment has turned more positive recently, helped in part by China's introduction of more stimulus measures as well more dovish rhetoric from the Federal Reserve (Fed). Since the start of 2019, China has announced a 100 basis points (bps) reserve requirement ratio (RRR) cut and lowered the threshold for targeted RRR cuts to boost lending to smaller enterprises. While these liquidity injections have lent support to a positive recent move in emerging market (EM) equities, we remain cautious about whether China will act as a catalyst for a more sustained EM equity rally in the near term.

The flow of data from China continued to disappoint markets, confirming the weakening trend in the underlying growth momentum. In particular, the official and Caixin December manufacturing PMI have dropped to contractionary territory with falling new orders, signaling a more challenging economic environment ahead. The broad-based slowdown in the Chinese economy since the start of 2018 was mainly due to tightening financial conditions, as a result of policymakers' deleveraging efforts. While China shifted to an easing stance in mid-2018, stimulus measures have yet to show a significant impact on growth.

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Looking ahead, we expect weakness in Chinese economic data to continue as growth decelerates further in 1H19 amid stiffer headwinds from tariff shocks and a property market downturn. Despite the Trump Administration's imposition of additional tariffs covering around half of Chinese exports to the U.S., China's export growth held up relatively well in 2018 as exporters front-loaded their shipments to the U.S. to get ahead of expected further increase in tariffs. However, the front-loading activities will likely start to taper in early 2019, whether or not a U.S.-China trade deal is reached, as inventory levels build up. We believe this will act as a drag on overall Chinese export growth for some time. In addition, amid still-tight property market policies, we expect weaker momentum in property sales, especially in lower-tier cities, to present a drag on property investment growth going forward.

Against a backdrop of weakening growth in China in 1H19, it is hard to foresee a re-acceleration of growth momentum elsewhere in emerging markets, as EM economies tend to be highly levered to the global growth and trade environment. In particular, we expect the negative spillovers from China to weigh most on China's Asian neighbors, which are more export oriented and more integrated in China's supply chain. The weaker than expected December Korea export print may be an early sign of the Asian export cycle rolling over. In our view, a more downbeat growth outlook for emerging markets, together with tighter U.S. financial conditions, will likely weigh on the performance of emerging market equities.

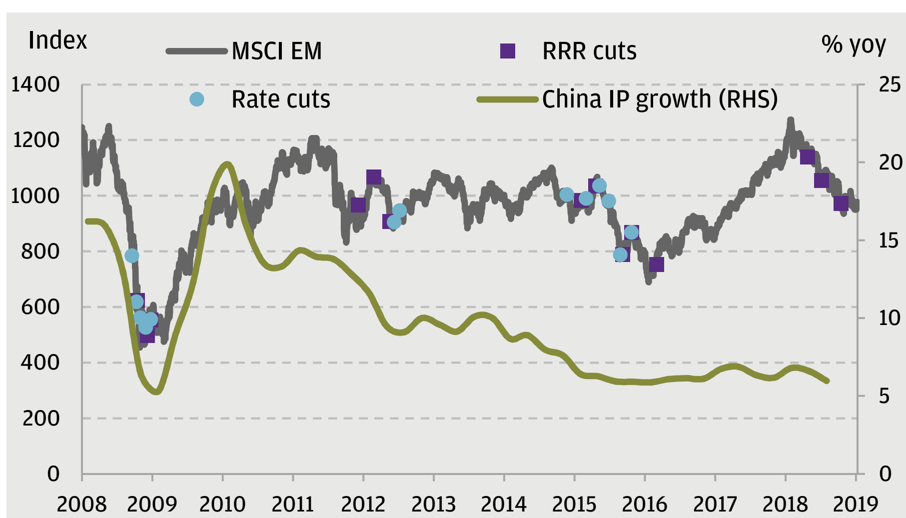
Faced with more disappointing data, we expect Chinese policymakers to roll out more monetary, fiscal and property easing measures, which will likely help to stabilize growth in the second half of the year. What market impact might that have? When we examine the performance of emerging market equities during China's last three easing cycles since 2008, we find there is no simple relationship between stimulus measures and market performance.

**EM equity performance during China's previous easing cycles**

- **2008-09:** To counteract the impact of the global financial crisis, the Chinese government rolled out a large scale stimulus package in 2008. Starting from mid-September, policymakers unveiled 216bps in benchmark lending rate cuts and 200bps in RRR cuts. The monetary easing was complemented by an RMB4 trillion fiscal stimulus package in November 2008 and looser property market policies. The combination of

**EXHIBIT 1: PERFORMANCE OF MSCI EM INDEX DURING PAST EASING CYCLES IN CHINA**

The introduction of stimulus measures during the past three easing cycles in China did not always lead to a rally in emerging market equities. While the equity market rebounded strongly following the easing measures during the 2008-09 cycle, the magnitude of impact was much more muted in 2012. During the 2014-16 episode, a small rally was followed by a big slump before the market stabilized in early 2016.




Source: Bloomberg, CEIC, J.P. Morgan Asset Management Multi-Asset Solutions; data as of January 9, 2019.

stimulus measures drove a significant acceleration in infrastructure investment growth and the economy stabilized around 1Q19. That stability also triggered a strong rebound in the MSCI EM index, which bottomed around March 2009 and more than doubled by the end of the year.

- **2011-12:** China's monetary policy shifted to an easing stance in late 2011 as the European sovereign debt crisis posed downside risks to global growth. Chinese policymakers introduced 56bps in benchmark lending rate cuts and 150bps in RRR cuts, along with easing measures on the fiscal and property fronts. China's economic growth stabilized around mid-2012, which coincided with the bottoming out of the MSCI EM index. It moved up by around 20%; however, the rally fizzled out after six months.
- **2014-16:** In 2014 policymakers embarked on an easing cycle that lasted more than a year as the economy faced multiple growth headwinds ranging from a property market slowdown to capital outflows. Infrastructure investment was accelerated, property market policies were loosened and the benchmark lending rate was lowered by 150bps, with 300bps in RRR cuts. Although the first rate cut came in November 2014, it was not until early 2016 that the real economy showed signs of stabilization. While EM equities experienced a small rally at the beginning of this easing cycle, from its peak in April 2015, the index slumped more than 30% and only bottomed out in early 2016.

When compared with the 2008-09 and 2014-16 easing cycles, the current cycle has been on a smaller scale, with no rate cuts or loosening of property market policies. In our view, the likelihood of a rate cut in the current cycle is low given policymakers' concern about leverage in the economy: Lower rates would likely accelerate the pace of leverage buildup at a time when China's debt-to-GDP ratio has already doubled compared with the 2008 level and household leverage has increased significantly. Policymakers are especially worried about further inflating the property bubble as mortgage rates are benchmarked to the policy rate. Concerns about overheating in the property market have also prevented policymakers from easing property market policies until they see significant slowdown in property investment growth.

Certainly, positive developments on the U.S.-China trade talk front would present upside risks to our growth and market outlooks. A trade deal between the two countries would be positive for market sentiment in the near term. However, if trade tensions ease, policymakers would likely scale back stimulus measures, and this would offset some of the boost to economic growth.

## ASSET CLASS IMPLICATIONS

At our November Strategy Summit we moved from neutral to underweight emerging market equities. Given our view that Chinese economic data will get worse before it gets better, we see a low probability that China will act as a catalyst for a sustained EM equity rally over the near term, as further deceleration in the Chinese economy in 1H19 likely weighs on EM growth and earnings outlooks. If, as expected, the Chinese economy stabilizes with the help of stimulus measures in 2H19, it will likely bolster equity investor sentiment.

More broadly, we maintain a small underweight in stock-bond in our multi-asset portfolios, given moderating economic growth momentum, tightening financial conditions in the U.S. and the slowing of earnings growth that we expect in 2019. Within equities, the U.S. remains our most-favored market while Europe is our least-favored.

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### NEXT STEPS

For more information, contact your J.P. Morgan representative.



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