ECOGNOSIS ADVISORY LTD

From the Greek: ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ (Ekonomiki Gnosis, Knowledge of Economics). **Ecognosis is a global financial, economic advisory and information service, covering economic and financial developments, equities, fixed income, forex, commodities and other assets. Econotes is a research publication available free on our internet site and to the public in Hong Kong. It is not a solicitation for business and neither does it contain investment suggestions on specific and named securities including any buy, sell or hold advice. It is written by Dr. Andrew F. Freris based on 50 years of market experience which includes senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well as senior academic posts with universities in London and in Hong Kong**

Level 20,One IFC,1 Harbour View Street, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com, Website: www.ecognosisadvisory.com, Facebook: @ecognosis

ECONOTE No. 76: Global stock markets: What is going on? 23/9/2018

Summary

If one picture is better than one thousand words, look at the two screen shots below. Nearly all major stock indices, bar US and Japan, are down ytd in USD terms, ditto for nearly all Asian stock markets, led by China which has now one of the worst performing markets in the world while maintaining one of the highest GDP growth rates. The reasons for these very diverse performances are not difficult to explain, starting with the US strong cycle, slowed down by higher interest rates but backed by steep tax cuts which helped the corporates to perform well. China has its own tale of a dysfunctional stock market, not helped by poor policies and concerns over the tariff war with the US. Japan is its own case with a surreal monetary policy, which fosters asset price inflation but not "bread and shoes" inflation. As for the rest of the Asians, ask about country X and will get a different answer for country Z

Investment Conclusions

The trust implied in the S&P 500 performance must be modified by the likelihood that the Fed will stick to hikes and that the tariff war will not help inflation thereby justifying Fed's position. As for the rest of the markets, different strokes for different folks, the usual economists' defense that "it all depends" which, here, happens to be right. Our own market selection criterion will be to focus on economies, which have minimum exposure to trade likely to be affected by the tariffs on China, and which also have flexible monetary policies with strong external balances thus avoiding the impact of higher USD interest rates. That means that Thailand, Malaysia and possibly Taiwan pass these tests but not China or Hong Kong, the latter of course because of the HKD peg to the USD.

The basics first: Nearly all down except US and Japan !

LLP <GO> to Open in Launchpad

News · Settings — World Equity Indices

Standard · Movers · Volatility · Ratios · Futures · Δ AVAT · 10D · %Chg YTD · USD

1) Americas	RMI	2Day	Value	Net Chg	%Chg	Δ AVAT	Time	%Ytd	%YtdCur
11) DOW JONES			26743.50	+86.52	+0.32%	+158.45%	09/21 c	+8.19%	+8.19%
12) S&P 500			2929.67 d	-1.08	-0.04%	+99.64%	09/21 c	+9.58%	+9.58%
13) NASDAQ			7986.96	-41.28	-0.51%	+72.23%	09/21 c	+15.70%	+15.70%
14) S&P/TSX Comp			16224.13 d	+9.38	+0.06%	+64.55%	09/21 c	+0.09%	-2.58%
15) S&P/BMV IPC			49344.29 d	-166.48	-0.34%	+354.11%	09/21 c	-0.02%	+4.39%
16) IBOVESPA			79444.29 d	+1328.28	+1.70%	+36.10%	09/21 c	+3.98%	-14.96%
2) EMEA									
21) Euro Stoxx 50			3430.81 d	+27.69	+0.81%	+143.81%	09/21 c	-2.09%	-4.17%
22) FTSE 100			7490.23 d	+122.91	+1.67%	+81.73%	09/21 c	-2.57%	-5.67%
23) CAC 40			5494.17 d	+42.58	+0.78%	+62.18%	09/21 c	+3.42%	+1.22%
24) DAX			12430.88 d	+104.40	+0.85%	+214.46%	09/21 c	-3.77%	-5.81%
25) IBEX 35			9590.40 d	+6.70	+0.07%	+118.94%	09/21 c	-4.52%	-6.55%
26) FTSE MIB			21536.74 d	+148.36	+0.69%	+83.03%	09/21 c	-1.45%	-3.54%
27) OMX STKH30			1662.32	+16.48	+1.00%	+64.15%	09/21 c	+5.41%	-2.25%
28) SWISS MKT			8995.38 d	-5.43	-0.06%	+149.22%	09/21 c	-4.12%	-2.56%
3) Asia/Pacific									
31) NIKKEI			23869.93 d	+195.00	+0.82%	+49.36%	09/21 c	+4.85%	+4.95%
32) HANG SENG			27953.58 d	+475.91	+1.73%	+45.29%	09/21 c	-6.57%	-6.54%
33) CSI 300			3410.49 d	+100.36	+3.03%	+68.16%	09/21 c	-15.39%	-19.71%
34) S&P/ASX 200			6194.56	+25.06	+0.41%	+82.18%	09/21 c	+2.13%	-4.65%

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2018 Bloomberg Finance L.P.
SN 561743 EDT GMT-4:00 H362-484-2 22-Sep-2018 06:14:36

LLP <GO> to Open in Launchpad, <Back> to Return

News · Settings — Page 1/8 World Equity Indices: Asia/Pacific

Standard · Movers · Volatility · Ratios · Futures · Δ AVAT · 10D · %Chg YTD · USD

Asia/Pacific	RMI	2Day	Value	Net Chg	%Chg	Δ AVAT	Time	%Ytd	%YtdCur
1) TOPIX			1804.02 d	+16.42	+0.92%	+43.39%	09/21 c	-0.74%	-0.66%
2) NIKKEI 225			23869.93 d	+195.00	+0.82%	+49.36%	09/21 c	+4.85%	+4.95%
3) JPX Nikkei 400			15986.77 d	+138.80	+0.88%		09/21 c	-0.54%	-0.45%
4) HANG SENG			27953.58 d	+475.91	+1.73%	+45.29%	09/21 c	-6.57%	-6.54%
5) CSI 300			3410.49 d	+100.36	+3.03%	+68.16%	09/21 c	-15.39%	-19.71%
6) Shanghai Comp			2797.48 d	+68.24	+2.50%		09/21 c	-15.41%	-19.73%
7) Shenzhen Comp			1445.11 d	+25.09	+1.77%		09/21 c	-23.92%	-27.80%
8) HS China Ent			11027.13 d	+234.54	+2.17%		09/21 c	-5.83%	-5.80%
9) Taiwan TAIEX			10972.41	+141.00	+1.30%	+7.47%	09/21 c	+3.10%	-0.06%
10) KOSPI			2339.17	+15.72	+0.68%	-3.70%	09/21 c	-5.20%	-9.30%
11) KOSDAQ			827.84	+6.71	+0.82%		09/21 c	+3.68%	-0.80%
12) S&P/ASX 200			6194.56	+25.06	+0.41%	+82.18%	09/21 c	+2.13%	-4.65%
13) Nifty 50			11143.10 d	-91.25	-0.81%	+174.09%	09/21 c	+5.82%	-6.39%
14) S&P BSE SENSEX 30			36841.60 d	-279.62	-0.75%		09/21 c	+8.18%	-4.31%
15) MCX-SX			21776.67 d	-156.35	-0.71%		09/21 c	+6.44%	-5.84%
16) FTSE Straits Tim			3217.68 d	+37.25	+1.17%		09/21 c	-5.44%	-7.38%
17) FTSE Malay KLCI			1810.64 d	+6.94	+0.38%	+131.04%	09/21 c	+0.77%	-1.28%
18) SE THAI			1756.12 d	+4.01	+0.23%		09/21 c	+0.14%	+0.58%
19) Jakarta Comp			5957.74	+26.48	+0.45%	+38.87%	09/21 c	-6.26%	-14.24%

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2018 Bloomberg Finance L.P.
SN 561743 EDT GMT-4:00 H362-484-0 22-Sep-2018 06:18:04

In the the top screen summarising global equities, of the 3 US indices all are up ytd.Of the non-US indices, in local currency, 4 out of 11 are up ytd, but in USD terms only 2 out of 11 are up.The lower screen shows that of the 19 Asian indices, 9 are up ytd in local currency terms while only 2 are up in USD terms.It can be argued that the strength of the USD explains the weakness of non-US equities, but their performance in local currencies leaves much to be desired vrs the US indices.Data are as per closing on Friday 21 Sept.2018 from Bloomberg screens.

Fig.1: China: GDP growth (blue, yoy) SHCOMP (red, index) 2007-2018

Source: Bloomberg

Asia and China

As Fig. 1 shows there is little correlation after 2014 between **China's** GDP growth and the performance of the Shanghai index. This is hardly surprising as stock prices reflect expectations as opposed to reactions to historical data. Furthermore the prevalence of retail investors in the Chinese markets added an element of short-termism. Concerns over the slow deceleration of the economy, continuous efforts by the authorities to slow down property prices and to deleverage the business sector as well as the recent US-China tariff wars, have added to uncertainty and kept the index falling. Asian stock markets have shown a much more differentiated performance. Combining together local currency and USD terms performance ytd. **Malaysia, Thailand and Taiwan** have done well. **India's** local currency performance was marred by the steepest depreciation of the INR, policy initiatives involving import restrictions to correct the CA deficit and, finally, the RBI starting on a hiking trend. This is perhaps a good place to focus on the forex performance of these markets. Setting their USD forex rates in September 2017 to 100, their current performance shows India and Indonesia with the largest depreciation

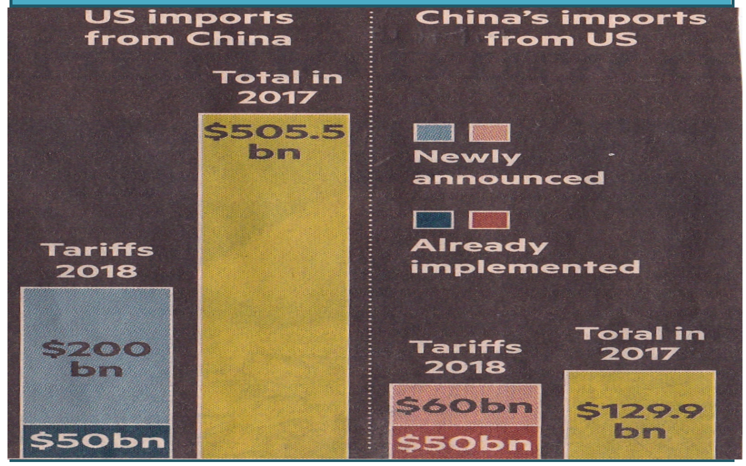
Fact Box: How not to do it: China and stock market regulation

China has been opening up its equities markets to foreign investors through the "qualified investors schemes" and more recently through the Stock Connect launched in Nov.2014.The latter allows the trading of shares quoted in Hong Kong, Shanghai and Shenzhen exchanges by local and international investors but subject to a quota of the sum of shares traded both "north and south bound" and conditions as to the eligible shares which can be traded. Despite optimistic expectations, mainland investors have tended in recent months to be net sellers of Hong Kong stocks. This trend was not helped by the overall poor performance of mainly Chinese companies IPOs in Hong Kong, further confused by the Chinese authorities forbidding Mainland investors to buy "dual class" shares in Hong Kong, and finally withdrawing a CDR scheme which would allow access to mainland investors to key Chinese companies not quoted in China!

With the index level at about 111.0 for both, but with Thailand and Malaysia with an appreciation of 98.0 and 98.2 respectively. Taiwan also did well with a modest depreciation of 101.0. All Asian economies, except Indonesia, India and the Philippines have current account surpluses, which help insulate their forex rates and their interest rate policies from the stronger USD. India, Indonesia, Malaysia, the Philippines, Korea and Hong Kong have all hiked rates in the course of 2018, with Thailand and Malaysia staying put for now, while China has not varied official rates since 2015 preferring to tweak repo rates. Singapore follows a forex and not interest rate policy, the SGD having fallen modestly to an index of 101.

Japan carries her own case with the BoJ persisting and persevering with an extremely loose monetary policy, zero rates and large injections of liquidity despite the fact that inflation remains persistently below the target 2.0% rate. These extreme policies have been successful in sustaining asset but not goods and services inflation. Japan has, so far, also avoided direct confrontation with the US in the tariff war.

Fig.2: The US-China tariff war to September 2018



Source: FT Research

Selection criteria in action

The S&P500 cycle seems advanced enough not to tempt expectations that it will continue against a background of rising rates.The tariff war must also be placed in a strict context.First, the US has imposed tariff on the imports of only one country so far, China, not on "all countries".The cases of Mexico and Canada are still being argued over, but for the sake of completion let us add them too. So three countries in total.Secondly, the US has imposed tariffs on certain goods irrespective of their origin, such as steel, aluminum, washing machines ands solar panels.A raft of exceptions was granted to countries affected, such as Brazil and S.Korea.Thirdly, even in the case of China, not all Chinese imports are impacted, now likely to be about half of all imported in the US, and ditto for the tariffs imposed by China to US imports. (Fig. 2) The sums of trade involved are small percentages of the total exports from both countries about 11.0% for China and about 5.0% for the US. Assuming that these tariffs reduce these sums to even 50%, their macroeconomic impact on GDP growth would be neglibible, except of course for the companies involved.Of the Asian economies, other than China, only S.Korea and India were direclty involved in the list of specific goods carrying now tariffs.For the rest of the economies any impact of the tariffs would be indirect via any impact on their own bilateral trade with China.Using now the simple selection criteria we outlined in the opening paragraphs of this report, namely countries with strong external balances, flexible forex and interest rate policies, absence of any strong China-US trade links and their equities markets performance so far, Thailand, Malaysia and Taiwan stand out for reasons given. China is not our favourite and so is Hong Kong with more interest rate hikes on the way ,as is also India with seemingly restrictive policies on the way.

Andrew Freris (wrting completed 23 Sept.2018)