PIMCO

Monthly Market Update | April 2019

In Like a Lion, Out Like a Dove

In the World

Global central banks leaned into their dovish stances amid signs of decelerating global growth. The Federal Reserve's patient monetary policy was reflected in a new "dot plot" that revealed the majority of Federal Open Market Committee (FOMC) members expected no hikes in 2019 and one in 2020 – a stark contrast with the Fed's December projection of two hikes in 2019. The Fed topped off this dovish rate outlook with lower growth and inflation forecasts as well as a plan to end the current balance sheet reduction program in September. Striking a similar chord, the European Central Bank (ECB) delivered a cautious policy announcement, issuing downward revisions to economic growth and further extending the hold on policy rates. The ECB also announced its third series of long-term refinancing operations (TLTROs) – a stimulative measure designed to preserve favorable lending conditions. Joining the party, the Reserve Bank of New Zealand, Bank of Canada, Bank of England, and several emerging market central banks also adopted softer policy stances amid concerns of a global slowdown. Of note, the Norges Bank stood as an outlier, raising its policy rate for the second time since September, citing strength in Norway's oil-driven economy.

Global economic data continued to show signs of slowing, with geopolitical developments also weighing on sentiment. Risk sentiment faltered on growing evidence of a weaker global economy: Eurozone manufacturing PMIs sank lower into contractionary territory, U.S. payroll data disappointed markedly and Q4 GDP growth was revised lower, and Chinese industrial production surprised to the downside. The U.S. and China also appeared to remain apart on key terms for a trade deal, pushing out expectations for the timing of a signed agreement. In emerging markets, Turkey enacted de facto capital controls to support the lira, and in Brazil, President Jair Bolsonaro's reform agenda appeared to derail as members of congress were unnerved by ongoing corruption probes. In the U.K., the Brexit deadline was extended until mid-April after parliament failed to decide on a course following the third failure to pass Prime Minister Theresa May's deal. However, there were pockets of optimism, including a strong gain in Germany's business sentiment IFO survey and a boost in U.S. housing activity on the back of lower mortgage rates.

Risk appetites moderated somewhat as global rates fell sharply, even as many risk assets ended the month in positive territory. Growing evidence of a broad-based global slowdown and softer-than-expected stances from central banks contributed to a steep drop in rates across developed markets: The yields on 10-year government bonds in the U.S., U.K., and Canada all fell by 30 basis points or more. Germany's 10-year yield moved into negative territory for the first time since 2016 (and ended the month nearly the same as Japan's). In the U.S., the front end of the yield curve inverted – often seen as a precursor of recession – with the spread between three-month and 10-year U.S. Treasury yields moving negative. Risk assets were more mixed: Global equity markets still ended the month slightly higher, and the S&P 500 rose 1.9% to cap its best quarter since 2009, though the pace of gains moderated. Higher-quality credit spreads ended about unchanged, while lower-quality credit spreads widened slightly. Still, global equities were nearly 13% higher on the year and credit spreads tighter even though sovereign yields were significantly lower – a historically unusual combination. Finally, Brent crude oil rose 1.9% on favorable supply-demand dynamics, including OPEC production cuts and U.S. sanctions against Venezuela's state-run oil company.

MIRROR, MIRROR

For most asset classes, the first three months of 2019 contrasted sharply to the last three of 2018, but there was one notable exception: interest rates. The end of last year was characterized by a traditional risk-off environment as concerns about an impending recession and the future path of interest rates gripped investors. Risk sentiment quickly changed course in 2019, however, when the Federal Reserve pivoted toward less restrictive policy, and trade frictions between the U.S. and China lessened to some extent. Risk markets bounced back from December's steep sell-off: Global equities rallied, credit spreads tightened, and oil prices gained. Yet, global government bond yields broke from the herd as rates continued their decline (counter to traditional "risk-on" behavior). The unusually large move lower in yields has been at least partly driven by investors' expectation of interest rate cuts over the next year (as opposed to hikes) and lingering growth concerns. The U.S. 10-year Treasury yield has rallied a staggering 66 basis points across the past two quarters; meanwhile, risk assets still haven't fully recovered from last quarter's drawdown despite large gains year-to-date.

	4Q18	1Q19	Last 6 months
Equities Return (%)	-13.5%	13.6%	-1.7%
High Yield Change in spread (bps)	210	-135	75
Oil Price Change (%)	-35.0%	27.1%	-17.3%
U.S. Rates Change in 10-yr yield (bps)	-38	-28	-66

As of 31 March 2019. Source: Bloomberg.
Equities represented by S&P 500. High Yield represented by the Bloomberg Barclays US Corporate High Yield Average OAS. Oil represented by Brent crude.

Market snapshot

To view detailed on each asset class, visit pimco.com/monthly-market-update.

BONDS	U.S.				U.K.				EUROZONE				JAPAN				BRAZIL			
	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018
	Level	Change (bps)			Level	Change (bps)			Level	Change (bps)			Level	Change (bps)			Level	Change (bps)		
Target Rate*	2.50				0.75				-0.40				-0.10				6.50			
2 YR	2.26	-25	-23	+60	0.64	-19	-11	+31	-0.60	-8	+1	+2	-0.17	-2	-3	-1	7.27	-2	-9	-69
5 YR	2.23	-28	-28	+30	0.76	-26	-15	+18	-0.45	-17	-14	-11	-0.20	-4	-5	-4	8.59	-3	-26	-120
10 YR	2.41	-31	-28	+28	1.00	-30	-28	+9	-0.07	-25	-31	-19	-0.08	-6	-8	-5				
30 YR	2.81	-27	-20	+27	1.55	-27	-27	+6	0.57	-23	-30	-39	0.51	-10	-21	-9				
5 YR ILBs	0.44	-21	-56	+71	-2.46	-51	-23	-9	1.20	-8	-27	-24					2.76	+12	-27	-85
10 YR Muni[a]	1.89	-25	-43	+31																

CURRENCIES	USD**				GBP/USD				EUR/USD				USD/JPY				USD/BRL			
	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018
	Level	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	97.28	1.2%	1.2%	4.4%	1.30	-1.7%	2.2%	-5.6%	1.12	-1.3%	-2.2%	-4.5%	110.85	0.5%	-1.1%	2.8%	3.92	-4.2%	-1.2%	-14.6%

EQUITIES	S&P 500				FTSE 100				EURO STOXX 50				NIKKEI				BOVESPA			
	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018	Mar '19	MTD	YTD	2018
	Level	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	2,834	1.9%	13.6%	-4.4%	7,279	3.3%	9.5%	-8.7%	3,352	1.8%	12.2%	-12.0%	21,206	-0.2%	6.7%	-10.7%	95,415	-0.2%	8.6%	15.0%

SECTOR SPREADS***	Mar '19	MTD	YTD	2018
	Level	Change (bps)		
MBS[b]	35	-0	-1	+11
IG[c]	115	-1	-26	+54
HIGH YIELD[d]	435	+19	-110	+206
EM EXTERNAL[e]	373	+12	-62	+124

COMMODITIES	Mar '19	MTD	YTD	2018
	Level	Change		
Oil	$60	5.1%	32.4%	-24.8%
Gold	$1,293	-1.8%	0.9%	-2.1%
Copper	$294	-0.5%	11.6%	-20.3%
Grains[f]	$28	-2.8%	-6.3%	-7.4%

*Central Bank Policy Rate
**U.S. Dollar Index (DXY)
***Sector spreads to like-duration government bonds

Source: Bloomberg

[a]Thomson Municipal Market Data (MMD) AAA Curve, [b]Barclays Global Agg MBS Index, [c]Bloomberg Barclays Global Agg Credit Average OAS, [d]Barclays Global Agg High Yield Index, [e]JPMorgan Emerging Markets Bond Index, [f]Dow Jones – UBS Grains Subindex

Outlook

Based on PIMCO's cyclical outlook from March 2019.

PIMCO expects world GDP growth to slow to 2.5%–3% this year from 3.3% in 2018. However, with China increasing stimulus and a trade deal between the U.S. and China in the making, we think there is a good chance that global growth will stabilize or even pick up moderately later this year. We expect **inflation globally to fall to 1.5%–2% from 2.2% in 2018** due to continued below-target inflation in the U.S., Europe and Japan.

In the U.S., we continue to expect growth to slow to 2%–2.5% in 2019 from nearly 3% last year. Factors contributing to the deceleration include fading fiscal stimulus, the lagged effect of tighter monetary policy over the past few years, and headwinds from the China/global slowdown. We estimate that China's easing will not filter through to U.S. growth until late 2019 or early 2020. **Headline inflation looks set to drop to 1.5%–2% this year, while core CPI moves sideways.** With growth slowing and inflation remaining below target, the Fed is likely to keep rates unchanged in 2019.

For the eurozone, we expect growth to slow to a trend-like pace of 0.75%–1.25% in 2019 from close to 2% in 2018, as weak global trade exerts significant downward pressure on the economy and Italy is in recession. An improvement in global trade conditions through this year should contribute to a gradual reacceleration. Reflecting firmer wage growth, **we expect a moderate pickup in core inflation, which has been stuck at 1% for some time.** In line with the European Central Bank's (ECB) forward guidance, we expect policy rates to remain unchanged this year.

In the U.K., we expect real growth in the range of 1%–1.5% in 2019, modestly below trend, and we continue to think that a chaotic no-deal Brexit is a low-probability event. **We see core CPI inflation stable at or close to the 2% target** as import price pressures have faded and domestic price pressures remain subdued. In the event of a soft Brexit by midyear, a rate hike by the Bank of England in the second half of the year would appear likely.

Japan's GDP growth is expected to be modest at 0.5%–1% in 2019, broadly unchanged from 0.7% in 2018. **With core CPI inflation expected to dip into negative territory** (due to temporary factors) around the middle of the year, we expect the Bank of Japan to keep its targets for short rates and the 10-year yield unchanged this year.

In China, we see growth slowing in 2019 to the middle of a 5.5%–6.5% range from 6.6% in 2018, but stabilizing in the second half of the year as fiscal and monetary stimulus find some traction and a likely trade deal between the U.S. and China supports confidence. We expect fiscal stimulus of 1.5% to 2% of GDP. **Inflation remains benign at 1.5%-2.5% in our forecast,** and we look for another rate cut by the People's Bank of China in addition to more reductions in banks' reserve requirement ratios. Yuan stability is well-anchored with a patient Fed and the understanding that this needs to be a component of the China–U.S. trade deal.

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