P I M C O

Monthly Market Update | May 2019

Level Shift or Leveling Off?

In the World

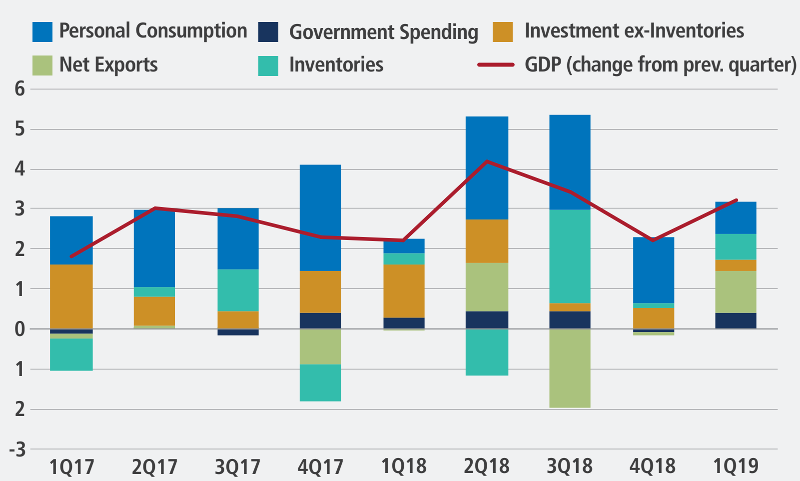
Economic data were better than expected across several major economies, helping alleviate some concern about the global growth trajectory in 2019. In China, first-quarter growth expanded 6.4%, slightly above expectations and steady versus the previous quarter. An acceleration in industrial output and strengthening consumer demand were key drivers, in addition to stimulus measures introduced last summer by the Chinese government. In light of the better-than-expected result, Beijing officials signaled a need to balance economic support with continued deleveraging, sparking investor concern that policymakers may slow stimulus efforts. Like China, the U.S. also grew more than expected, advancing 3.2% in Q1, handily outperforming consensus expectations for 2.2% growth, despite a five-week partial government shutdown. However, the underlying drivers of growth appeared more brittle: Less sustainable factors including a build-up in inventories and slower imports were responsible for most of the increase, while slower consumption growth raised some concern (see chart). Even so, stronger retail sales, a rebound in nonfarm payrolls, and a fall in jobless claims late in the first quarter, all helped paint a better picture of the U.S. consumer. In the eurozone, GDP growth ticked up 1.2% in the first quarter, also surpassing expectations as unemployment fell to a 10-year low and Italy exited recession territory.

Robust risk sentiment helped several equity markets reach fresh all-time highs. Global equities surged over the month – resulting in double-digit returns for many indexes thus far in 2019 – on better-than-expected corporate earnings and economic data, continued accommodation from central banks, and progress on U.S.–China trade talks. The S&P 500 rose 4.0%, with the index constituents on pace to report a smaller-than-expected decrease in profit growth for the first quarter. Of the companies that have reported so far, 78% beat EPS (earnings per share) projections, and 57% announced sales forecasts that exceeded expectations. The S&P 500 index, which is up over 18% so far this year, has now fully retraced the fourth quarter's drawdown, and set a new all-time high. Credit markets also benefited from solid earnings and robust risk appetites: Spreads broadly tightened, with high yield spreads a remarkable 168 basis points (bps) tighter on the year. As risk assets rallied, bond yields across major developed economies broadly rose, and the U.S. dollar strengthened against most of these counterparts. Lastly, Brent crude oil ended the month above $70 per barrel amid OPEC production cuts, U.S. sanctions on Venezuela's oil industry, and concern about the upcoming expiration of Iran sanctions waivers.

Meanwhile, April featured idiosyncratic geopolitical developments with generally localized impact. Elections were in focus in April: Polls opened in India, Spain, and Ukraine, among others. Spain's ruling Spanish Socialist Workers' Party (PSOE) retained control and increased its seats, while the far-right Vox party entered Congress for the first time. In Ukraine, professional comic Volodymyr Zelensky handily defeated incumbent Petro Poroshenko in the second round of the presidential election, running on a strong anti-establishment and anti-corruption platform. In Turkey, tensions with the U.S. intensified as President Recep Tayyip Erdoğan remained committed to buying a missile defense system from Russia despite Turkey's membership in NATO, which provoked the threat of sanctions from the U.S. and pressured the lira nearly 7% lower. In Argentina, continued weak economic data, increasing uncertainty ahead of the October presidential election, and weak liquidity weighed on Argentine assets; the peso continued its fall in April to mark a 15% decline so far in 2019. Finally, in the U.K., the Brexit deadline was postponed once again, this time until 31 October, making it likely the U.K. will partake in European Parliamentary elections in late May.

LOOKING UNDER THE HEADLINE

U.S. economic growth surprised to the upside in the first quarter despite a federal government shutdown and ongoing trade tensions. The initial gross domestic product (GDP) estimate registered 3.2%, far surpassing market estimates of 2.3% and the fourth quarter's 2.2%. However, the composition of growth in the first quarter suggested the headline number may be masking some underlying weakness. A buildup of inventories and fewer imports accounted for much of the increase – both of which are volatile factors that may not be sustainable going forward. At the same time, consumer spending (the biggest part of the U.S. economy) slowed meaningfully versus the past few quarters, though was slightly above estimates. So while the headline growth rate spurred some optimism following growth concerns in the fourth quarter, its durability appeared less clear.



As of 30 April 2019. Source: Bureau of Economic Analysis (BEA).

Market snapshot

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

BONDS	U.S.				U.K.				EUROZONE				JAPAN				BRAZIL			
	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '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	2.27	+1	-22	+60	0.76	+12	+1	+31	-0.58	+2	+3	+2	-0.15	+2	-1	-1	7.37	+11	+1	-69
5 YR	2.28	+5	-23	+30	0.91	+15	+0	+18	-0.41	+4	-10	-11	-0.16	+3	-2	-4	8.58	-1	-27	-120
10 YR	2.50	+10	-18	+28	1.19	+19	-9	+9	0.01	+8	-23	-19	-0.04	+4	-4	-5				
30 YR	2.93	+11	-9	+27	1.69	+14	-13	+6	0.66	+8	-22	-39	0.57	+6	-15	-9				
5 YR ILBs	0.42	-2	-58	+71	-2.27	+19	-3	-9	1.32	+12	-15	-24					2.79	+3	-25	-85
10 YR Muni[a]	1.89	+1	-43	+31																

CURRENCIES	USD**				GBP/USD				EUR/USD				USD/JPY				USD/BRL			
	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018
	Level	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	97.48	0.2%	1.4%	4.4%	1.30	0.0%	2.2%	-5.6%	1.12	0.0%	-2.2%	-4.5%	111.43	-0.5%	-1.6%	2.8%	3.92	0.0%	-1.2%	-14.6%

EQUITIES	S&P 500				FTSE 100				EURO STOXX 50				NIKKEI				BOVESPA			
	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018	Apr '19	MTD	YTD	2018
	Level	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	2,946	4.0%	18.2%	-4.4%	7,418	2.3%	12.0%	-8.7%	3,515	5.3%	18.1%	-12.0%	22,259	5.0%	12.0%	-10.7%	96,353	1.0%	9.6%	15.0%

SECTOR SPREADS***				
	Apr '19	MTD	YTD	2018
	Level	Change (bps)		
MBS[b]	41	+6	+6	+11
IG[c]	105	-10	-36	+54
HIGH YIELD[d]	417	-18	-128	+206
EM EXTERNAL[e]	365	-8	-70	+124

COMMODITIES				
	Apr '19	MTD	YTD	2018
	Level	Change		
Oil	$64	6.3%	40.7%	-24.8%
Gold	$1,286	-0.6%	0.3%	-2.1%
Copper	$290	-1.2%	10.3%	-20.3%
Grains[f]	$27	-4.1%	-10.2%	-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 slipped into 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.

PIMCO

Past performance is not a guarantee or a reliable indicator of future results.

All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise. A low interest rate environment increases this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Commodities contain heightened risk including market, political, regulatory, and natural conditions, and may not be suitable for all investors. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. Investing in **foreign denominated and/or domiciled securities may** involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. High yield, lower-rated securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Inflation-linked bonds (ILBs)** issued by a government are fixed-income securities whose principal value is periodically adjusted according to the rate of inflation; ILBs decline in value when real interest rates rise. Mortgage- and asset-backed securities may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government-agency or private guarantor, there is no assurance that the guarantor will meet its obligations. Sovereign securities are generally backed by the issuing government. Obligations of U.S. government agencies and authorities are supported by varying degrees, but are generally not backed by the full faith of the U.S. government. Portfolios that invest in such securities are not guaranteed and will fluctuate in value. Derivatives may involve certain costs and risks, such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. Outlook and strategies are subject to change without notice. Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fees, and/or other costs. In addition, references to future results should not be construed as an estimate or promise of results that a client portfolio may achieve.

This material contains the current opinions of the manager and such opinions are subject to change without notice. This material is distributed for informational purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed.

PGU001_63930

CMR2019-0507-395235