

# Multi-Asset Solutions Weekly Strategy Report

Global markets and multi-asset portfolios

August 19, 2019

## IN BRIEF

- The tug-of-war between trade tensions and easy monetary policy has been evenly balanced so far this year. However, the balance might be shifting as policy shows signs of fatigue and trade war concerns persist despite a Trump Administration decision to delay the most recent round of tariffs on Chinese goods.
- Bond markets are not merely pricing in a benevolent Federal Reserve prepared to offer a few “insurance” cuts; they’re also discounting some risk of a full scale rate cutting cycle. It will be increasingly difficult to cast any greater urgency in easing as anything other than fears over growth and a shift towards a full scale cutting cycle.
- An uptick in recession risk makes us more cautious on overall risk levels, especially in our credit portfolios. Even though U.S. high yield is still a preferred asset class relative to equities, we are increasingly aware of building liquidity and downside risks.

## FADING SCOPE FOR EASY POLICY ALONE TO SUPPORT RISK MARKETS

Investors are familiar with the idea that the market price of an asset represents the equilibrium across a number of possible future economic paths. Yet there are times when it feels much more like a tug of war than an equilibrium. It feels like such a time today, given the gyrations between the sunny uplands of easy monetary policy and the darker threats of escalating trade tension that continue to hang over sentiment.

“Hang on a minute,” some may say. “We’ve seen this movie before.” This is the movie where asset markets take fright, the Federal Reserve (Fed) rides to the rescue with promises of easy money and cooler heads walk back the trade rhetoric. And yes, some do see the current market environment as simply another sequel in what is now a rather tired franchise. However, if we pause to consider the complexion of the potential new threats around tariffs and the room for maneuver the Fed has left, this latest sequel starts to take on a new, more sinister twist.

Only a few weeks back, at the end of July, equity markets made new highs, boosted by hopes of easy policy from central banks around the world. Bond markets had other ideas, of course. U.S. 10-year Treasury yields hovered around 50 basis points (bps) below their

## AUTHOR



**John Bilton, CFA**  
*Managing Director  
Head of Global Multi-Asset  
Strategy  
Multi-Asset Solutions*

January levels, and yet, despite some nervous glances, this was not enough to quell the apparent enthusiasm for stocks. After all, the promise of easy policy with global growth somewhere around trend meant yields had to be a good deal lower. Didn't it?

We would certainly acknowledge that even as stocks hit new highs, the normal burst of enthusiasm that surrounds such an event was oddly muted. Although equity investors overlooked the dislocation to bond yields, confidence remained fragile. The veneer of the equity rally was, and remains, rather thin.

Bond markets are not merely pricing in a benevolent Fed prepared to offer a few "insurance" cuts; they're also discounting some risk of a full scale rate cutting cycle. Since the global financial crisis, investors have become accustomed to the notion that policy easing is an unalloyed good for asset markets. But in a historical context, when the Fed is cutting, it's usually because growth is sliding and markets are truly vulnerable. History tells us that insurance cuts are not unprecedented but neither are they that common.

When the Fed trimmed rates on July 31, the cut was delivered with the comment that it didn't represent the

start of a cutting cycle. What was likely meant as a signal - that while the Fed was prepared to offer a couple of cuts, the economy remained in good shape - has in fact boxed the Fed into a corner. Should the Fed be called upon to do more than a couple of insurance cuts, it's becoming much harder to dress these up as anything other than a full blown easing cycle.

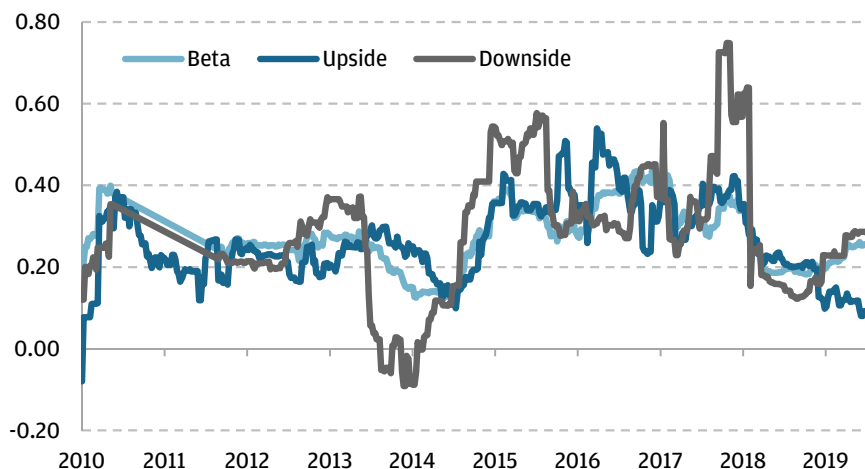
### Potential for greater U.S. economic disruption

Little wonder, then, that the response of bond markets to the latest salvo in the trade war was savage indeed: U.S. 10-year Treasury yields rallying 30bps in just a few sessions and the front of the curve pricing four further cuts by the end of 2020. The issue is that further escalation of threatened tariffs is potentially more disruptive to the U.S. economy than prior rounds have been. Chinese exporters had only a 7% market share in the goods singled out in the first round of tariffs in 2018; allowing importers to find ready substitutes. But the Chinese export share of goods in the latest round (if implemented) is 45% and with a fifth of the products relying on China for more than 80% of supply. Thus, there is an inherent non-linearity in the design on tariffs, in that any subsequent escalation on tariffs has the potential for

#### EXHIBIT 1: BETA OF HIGH YIELD EXCESS RETURNS TO S&P 500 RETURNS

The rolling beta between S&P 500 returns vs. high yield (HY) excess returns (over Treasuries) shows that the overall beta remains relatively low. Downside beta has started to pick up recently, implying that HY returns are more sensitive to days when the SPX is falling. Increased recession risk and the recent price action have prompted a more cautious stance on high yield.

Beta with the S&P 500, weekly HY excess returns, 52 weeks



Source: Bloomberg, J.P. Morgan Asset Management; data as of August 12, 2019.

larger disruption to the domestic U.S. value chain and especially so for the consumer. The non-linear reaction in bond markets in the last few weeks is evidence of the market pricing in this risk.

The Trump Administration offered markets a reprieve on August 13, announcing that tariffs on many of the goods targeted in the latest round would be delayed from Sept. 1 Dec. 15 and some products would be removed from the tariff lists entirely. But the uncertainty around tariffs is likely to persist. The reminder that this threat continues to hang over companies and investment intentions is likely to be an ongoing drag on economic activity and market sentiment.

With stocks on quite full valuations despite rather lackluster earnings growth, there is little cushion to absorb the kind of supply chain shock that an escalation in trade tensions might threaten. The market is also pricing for significant Fed easing, so any incremental support for risk assets from the Fed appears to be reaching a limit. It will be increasingly difficult to dress up any greater urgency in easing as anything other than fears over growth and a shift towards a full scale cutting cycle.

## ASSET CLASS IMPLICATIONS

The tug-of-war between trade tensions and easy policy has been evenly balanced so far this year. However, the balance might be shifting as policy shows signs of fatigue just as we've received another stark reminder that tariff threats continue to impact investor sentiment. This is one of our motivations for our underweight stance on equities vs. bonds.

Any further escalation in trade tensions between the U.S. and China and the potential impact on the U.S. consumer has led to an increase in our odds of a U.S. recession over the next 12 months, from 30% to 40%. This rise in recession risk makes us more cautious on overall risk levels, especially in our credit portfolios. Even though U.S. high yield is still a preferred asset class relative to equities, we are increasingly aware of building liquidity and downside risks, especially within the lowest quality issuers and the energy sector in particular.

## Global Multi-Asset Strategy:

**John Bilton**

*Head of Global Multi-Asset Strategy  
London*

**Michael Hood**

*Global Strategist  
New York*

**Benjamin Mandel**

*Global Strategist  
New York*

**Michael Albrecht**

*Global Strategist  
New York*

**Tim Lintern**

*Global Strategist  
London*

**Patrik Schöwitz**

*Global Strategist, Editor  
Hong Kong*

**Thushka Maharaj**

*Global Strategist  
London*

**Sylvia Sheng**

*Global Strategist  
Hong Kong*

**Diego Gilsanz**

*Global Strategist  
New York*

**Michael Akinyele**

*Global Strategist  
London*

### NEXT STEPS

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

#### Important Disclaimer

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

The views contained herein are not to be taken as advice or a recommendation to buy or sell any investment in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide.

To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our [Company's Privacy Policy](https://www.jpmmorgan.com/global/privacy) (<https://www.jpmmorgan.com/global/privacy>). For further information regarding our local privacy policies, please follow the respective links: [Australia](https://www.jpmmorgan.com/country/AU/EN/privacy) (<https://www.jpmmorgan.com/country/AU/EN/privacy>), EMEA (<https://am.jpmmorgan.com/gb/en/asset-management/gim/adv/legal/external-privacy-policy-site/>), [Japan](https://www.jpmmorganasset.co.jp/wps/portal/Policy/Privacy) (<https://www.jpmmorganasset.co.jp/wps/portal/Policy/Privacy>), [Hong Kong](https://am.jpmmorgan.com/hk/en/asset-management/per/privacy-statement/) (<https://am.jpmmorgan.com/hk/en/asset-management/per/privacy-statement/>), [Singapore](http://www.jpmmorganam.com.sg/privacy) (<http://www.jpmmorganam.com.sg/privacy>) and [Taiwan](https://www.jpmmrich.com.tw/wps/portal/Footer/Privacy) (<https://www.jpmmrich.com.tw/wps/portal/Footer/Privacy>).

This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd (Co. Reg. No. 201120355E), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by J.P. Morgan Institutional Investments, Inc. or JPMorgan Distribution Services, Inc., both are members of FINRA; J.P. Morgan Investment Management, Inc. or J.P. Morgan Alternative Asset Management, Inc.

In APAC, distribution is for Hong Kong, Taiwan, Japan and Singapore. For all other countries in APAC, to intended recipients only.

Copyright 2019 JPMorgan Chase & Co. All rights reserved.

PI-AA-WEEKLY-081919 | 0903c02a81f59f1d