Manulife Asset Management

# Monthly Macro View

October 2017

For retail use, October 2017

## September – An "Indian Summer" for global markets!


Global markets posted strong performance in September driven primarily by economic fundamentals, with developed markets (DM) taking the lead. China's markets have performed well ahead of the upcoming 19th Communist Party Congress in October, with low levels of volatility. In this month's Monthly Macro View, Geoff Lewis leads investors through the latest market developments.

### Review of markets in September[1]

In what is usually one of the seasonally weaker months, global stock markets put on another strong performance in September, chalking up new heights.

The MSCI World equity index rose 2.3% in September, the eleventh successive month of positive returns. This marked the second longest string of increases since the index began in 1969.[2] Since mid-August the rally has broadened out to include some of the previously lagging sectors, supported by strong economic data and renewed hopes of tax cuts in America.

#### Developed markets lead the way

Developed markets (DM) took the lead in September, as MSCI US rose 2.0%, MSCI Europe 3.3% and MSCI Japan 2.1%. Emerging markets (EM) slipped a little, with a negative 0.4% return. But they remained firmly in the lead for the third quarter overall, with a gain of 8.0% for EM versus 5.0% for DM. A stronger world economy is being reflected in more optimistic consensus forecasts of the medium-term earnings outlook for companies, which we see as having played a large role in the current rally.

The near-term earnings outlook is also promising, as 43 S&P 500 companies have issued positive earnings guidance well above the 5-year average of 27, and the third highest number for a quarter since FactSet began tracking earnings-per-share (EPS) guidance in 2006. At the sector level, companies in the information technology, healthcare, and consumer discretionary sectors account for 39 of the 43 companies issuing positive EPS guidance for the third quarter.

#### Hong Kong and China equities shine in the third quarter

Turning to Asia, Hong Kong stocks rose another 8.6% in the third quarter of 2017 and are up 30% year-to-date, making Hong Kong's Hang Seng the world's top performing major index,[3] beating Asia ex-Japan, the US, Europe and EM. A Chinese internet giant accounts for 30% of the Hang Seng's rise this year. The Boston Consulting Group estimates that China's 710 million internet users spent almost US$1 trillion online last year, with no sign of growth slowing.[4] With internet penetration only 52% in China,

[1] Manulife Asset Management, FactSet, as of 29 September 2017. Equity indices are calculated in total returns in US dollar.
[2] See Societe Generale, Global Equity Market Arithmetic, 2 October 2017.
[3] See SCMP, 'Hang Seng Index Cuts Above Rivals in Nine Months,' 30 September 2017.
[4] SCMP, page B4, 30 September 2017.

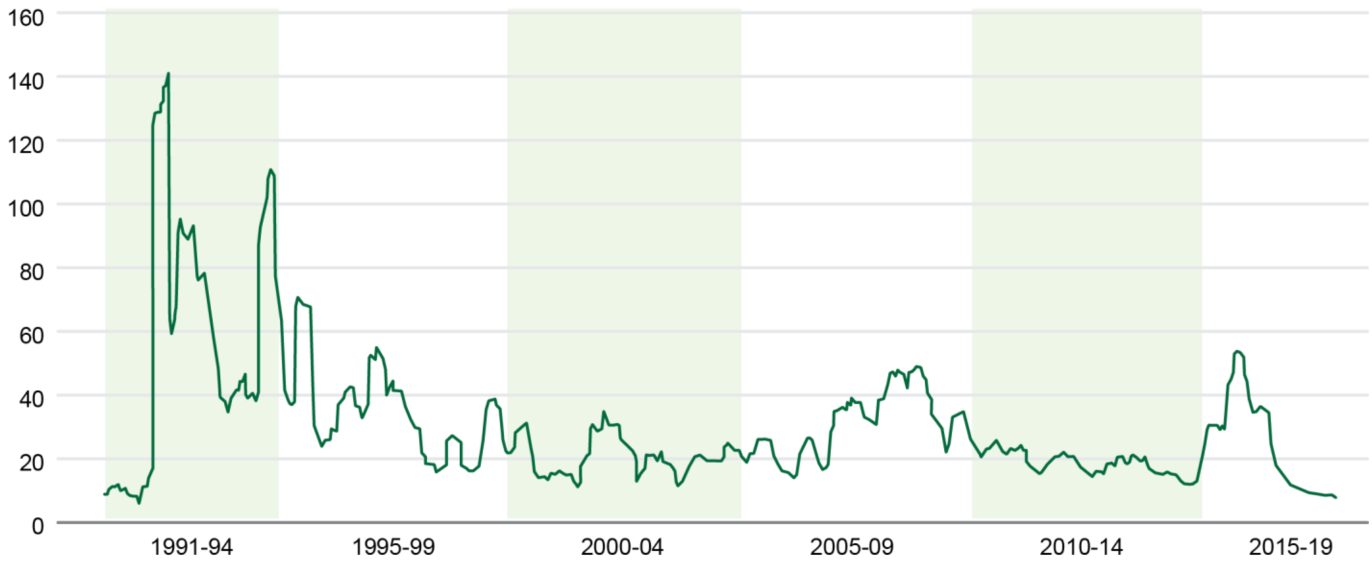
there is still plenty of room for the market to grow. Chinese IT giants have established network advantages that will make it difficult for foreign competitors to make significant inroads in the near term.

In Mainland China, the Shanghai Composite Index rose 6.2% in the third quarter, its strongest rise since the fourth quarter of 2015. Consumer stocks performed well in the third quarter. Mainland stock markets are closed for the Golden Week public holiday (2 to 6 October) and on re-opening are expected to be in a 'wait-and-see' mode ahead of the Chinese Communist Party's 19th National Congress which begins on 18 October. The relative tranquillity of China A-shares is a notable trend.

## China A-shares share in the tranquillity

An unusual degree of tranquillity has been a much discussed feature of DM equities in 2017. Perhaps less commented on is that Mainland China equities – regarded by most western investors as inherently volatile – has also been enjoying a period of unusually low volatility (Figure 1). Look at the chart and visually exclude or "take out" the peak in volatility in mid-2015 that accompanied the sharp "patriotic" rally in stocks. What you see then is a broadly flat volatility trend in Chinese A-shares (SH Composite Index) for almost 20 years (from 1996 to 2015) averaging around 20% 3-month annualised. Most recently there has been a move lower to levels not seen since 1992.

**Figure 1: Shanghai Composite Index 90-day Volatility[5]**




One explanation is that the current exceptionally low volatility in Chinese equities reflects the efforts of Chinese regulators ahead of the key Communist Party congress in mid-October when there will be a reshuffle of the top leadership. The China Securities Regulatory Commission (CSRC) stated that they will strive to ensure "stable operations of the capital market" and create a congenial, sound atmosphere for the meeting. Wild swings in Chinese share prices are clearly unacceptable to the regulator. We prefer to attribute the low volatility in A-shares to the same benign economic prospects facing non-China stock markets.

[5] Bloomberg, SCMP, 30 September 2017.

Overall we remain positive and overweight China in our Asia and global emerging market (GEM) portfolios, which is a view that a growing number of foreign investors have begun to share with us since 2016. Finally, regarding the Congress itself, we have very little to say. With China equities, we believe it is a case of *"WYSYWYG*", or "what-you-see-is-what-you-get." Post-Congress, we expect to see few major changes to the economic and financial policies that China has been employing with some considerable success throughout 2017.