

# VanEck<sup>®</sup>

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## VanEck ViewPoint<sup>™</sup>

Global economic perspectives

October 2019





## Market summary

Despite the deterioration in manufacturing and global trade, all major asset classes except emerging markets posted positive returns for the quarter to 30 September 2019. Gold bullion led the charge as recessionary fears drove investors to the “safe haven” asset. Further reflecting this sentiment, defensive sectors including utilities and consumer staples were the best performing in the global equities market.

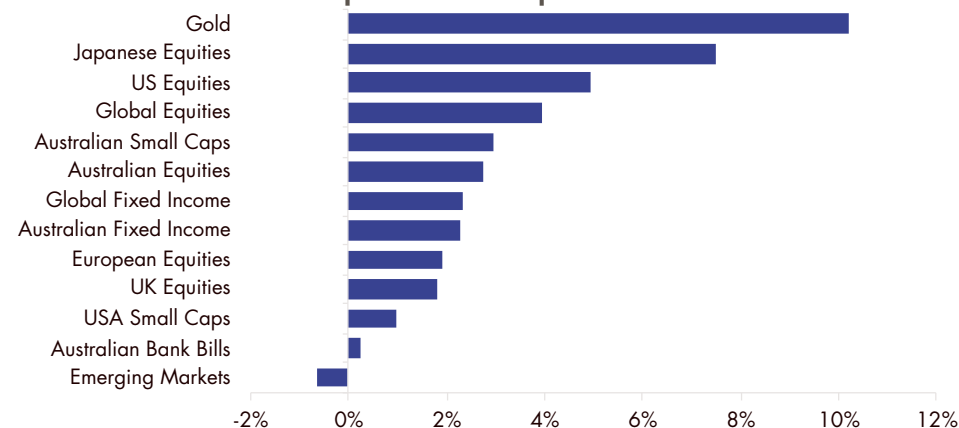
The US Federal Reserve initiated monetary easing measures for the first time since the GFC with successive rate cuts in July and September amid the backdrop of the US-China trade war and concerns over global oil supply following the drone attack in Saudi Arabia. Australia, NZ and the European Union followed suit with the RBA cutting rates a further 25 basis points at their October meeting.

Argentina spooked global markets with its domestic S&P Merval Index plummeting 48% in a single day following the increasing likelihood of Alberto Fernández defeating President Mauricio Macri in the upcoming election and derailing the country’s US\$57 billion IMF program. Investors fear a repeat of the country’s 2001 currency and debt crisis. Such a crisis would inhibit the IMF’s ability to service other emerging market economies.

Brexit woes hit new highs (or lows) during the quarter with new Prime Minister Boris Johnson suspending British parliament. The move was ruled to have had no legal justification by the Supreme Court but the aggressive tactic aims to force the European Union back to the negotiation table. With the greater Eurozone already suffering a sharp slowdown, it’s already in the grips of a manufacturing recession, a chaotic Brexit would be the final stroke potentially driving the entire region into recession.

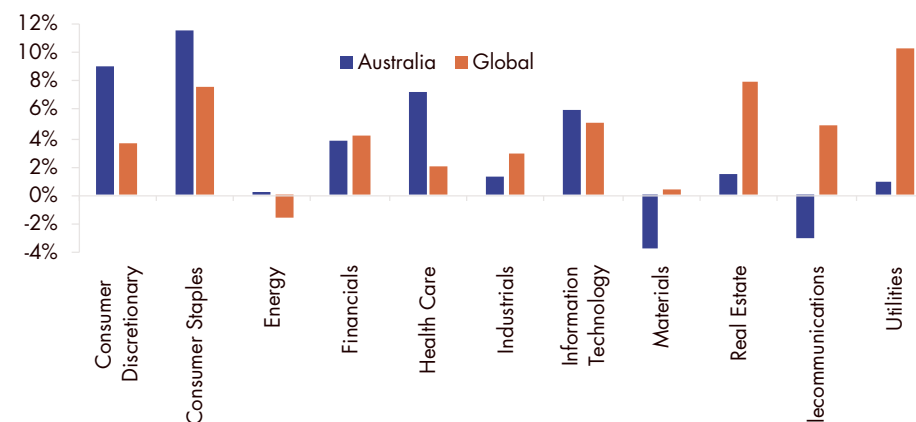
Global markets tread cautiously. Trump appears no closer to resolving the trade dispute with China while he now faces an impeachment inquiry which has been ordered by House Speaker Nancy Pelosi. These are truly uncharted waters and as central banks point to a sustained period of lower interest rates, it will be interesting to see what quantitative easing measures may be on the horizon.

**Exhibit 1: Index returns in September 2019 quarter**



Source: Bloomberg, 1 June 2019 to 30 September 2019, returns in Australian Dollars. International Equities is MSCI World ex Australia Index, Australian Equities is S&P/ASX 200 Accumulation Index, Australian Fixed Income is Bloomberg AusBond Composite 0+ yrs Index, Global Fixed Income is Bloomberg Global Aggregate Bond Hedged AUD Index, Australian Bank Bills is Bloomberg AusBond Bank Bill Index, Emerging Markets is MSCI Emerging Markets Index, Gold is Gold Spot US\$/oz, Australian Small Caps is S&P/ASX Small Ordinaries Index, US Small Caps is Russell 2000 Index, US Equities is S&P 500 Index, UK Equities is FTSE 100 Index, Japanese Equities is Nikkei 225 Index, European Equities is MSCI Europe Index, China equities is CSI300 Index.

**Exhibit 2: Global and Australian equity sectors September 2019 quarter performance**



Source: Bloomberg, 1 June 2019 to 30 September 2019, returns in Australian Dollars. Consumer discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ASX 200 Financials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Healthcare is MSCI World Health care Index / S&P/ASX 200 Health care Index, Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Property is MSCI World REIT Index / S&P/ASX 200 AREIT Index, Consumer staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Information technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Communications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index.

## The Wall of “No Worries”!

Seasoned investors talk of markets “climbing the wall of worry.” That is, far from potential problems pushing markets down, fear is leaving players under-invested and markets despite the uncertainty trend upwards. You could say that in 2019 the market has been vulnerable to relief rallies!

Over the course of 2019, global growth prospects have dimmed, driven in good part by trade war tensions undermining supply chains and corporate confidence. Global manufacturing is already in recession, as indicated by PMIs (Purchasing Managers’ Index).

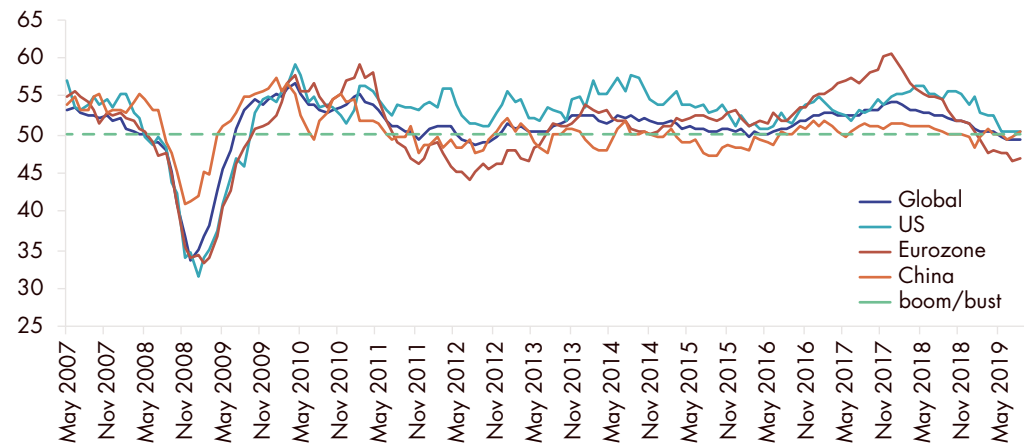
Trade progress is three steps backward, followed by one step forward. At the start of the year, the consensus was that the Trade War between China and the US would be resolved long before now. We appear no closer to a solution, with tariffs and non-tariff squabbles, such as the Huawei bans and farm product purchases, at depths that would have been deemed catastrophic in January.

And yet equity markets remain at near highs.

The “wall of worry” explanation is shown by market reaction to tweets from President Trump, reports and rumours of deals. Depending on the tone of each tweet, the market ‘overreacts’ immediately, before trending back to growth.

## Chart 3: Global Manufacturing PMIs deteriorated in Q2 and Q3

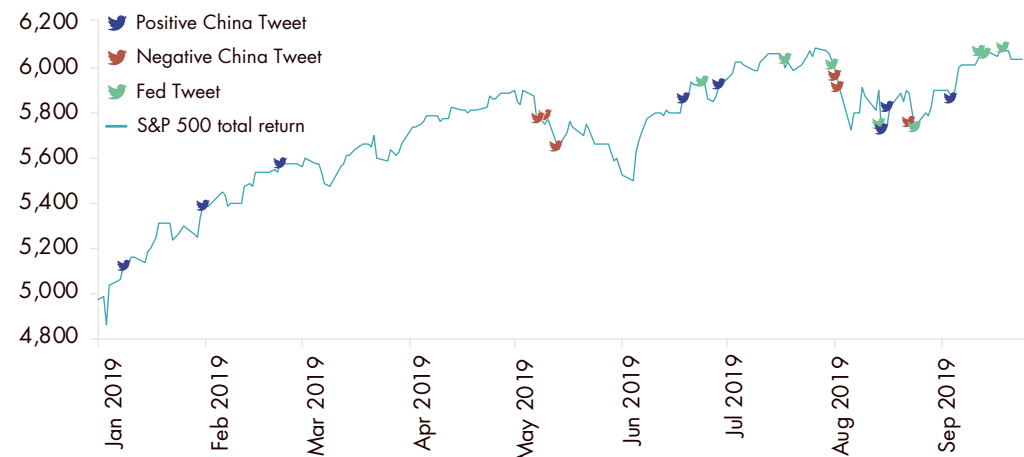
Global PMIs (Purchasing Managers’ Index)



Source: Institute for Supply Management, JP Morgan/Markit, National Bureau of Economic Research. PMI above 50 is considered expansionary.

## Chart 4: Market overreacts, before trending back to growth

S&P 500 Index Total Return Index in 2019



Source: Bloomberg, VanEck, Index values in local currency, 1 Jan 2019 to 24 September 2019. Positive China tweets are days when two or more tweets are sent indicating a meeting or breakthrough in the trade war is imminent. Negative China tweets are days when two or more tweets are sent criticising China’s response to the trade war. Fed Tweets days when two or more tweets are sent criticising the Fed and Chairman. Does not include retweets. Past performance is not a reliable indicator of future performance

## Yield curve inversion

Another explanation of the equity market growth is that markets are soothed by the prospect of a renewed cycle of central bank easing. After years of being conditioned to respond positively to liquidity this is unsurprising.

The extent of easing hopes has resulted in an inversion of the US (and other) yield curves.

There are two problems with this:

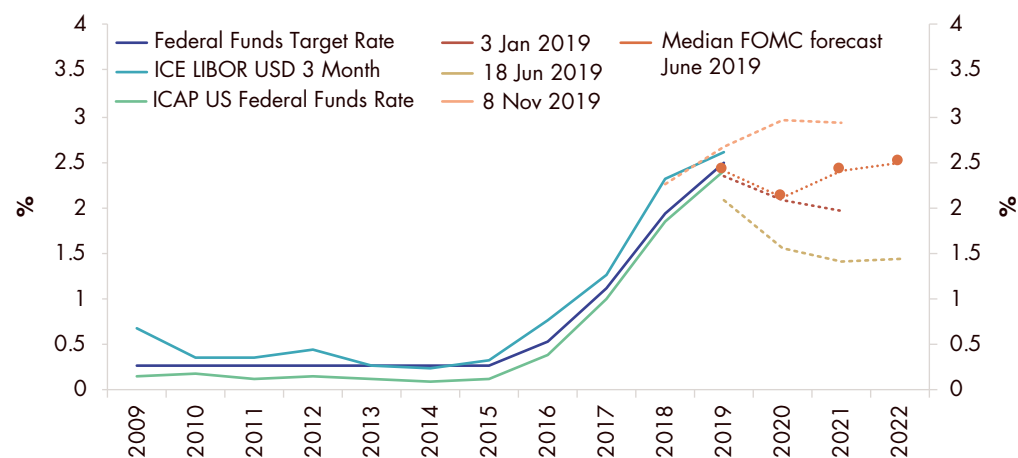
First, markets through much of the year have overestimated the amount of easing the Fed can or will deliver. The latest FOMC meeting, perhaps encouraged by a better run of US data surprises, saw the central group stick to their guns and forecast less easing market has been wishing for.

Second, yield curve inversion is a reliable indicator of recession. Here is the Fed's favourite measure - 3 month interest rate in a year versus current 3 month rate. It shows a consistent lead on economic downturns and, statistically, outperforms the market favoured 2 year - 10 year spread.

It's probably also worth noting that this indicator is also a decent predictor of future equity underperformance.

## Exhibit 5 The market still pricing a US recession

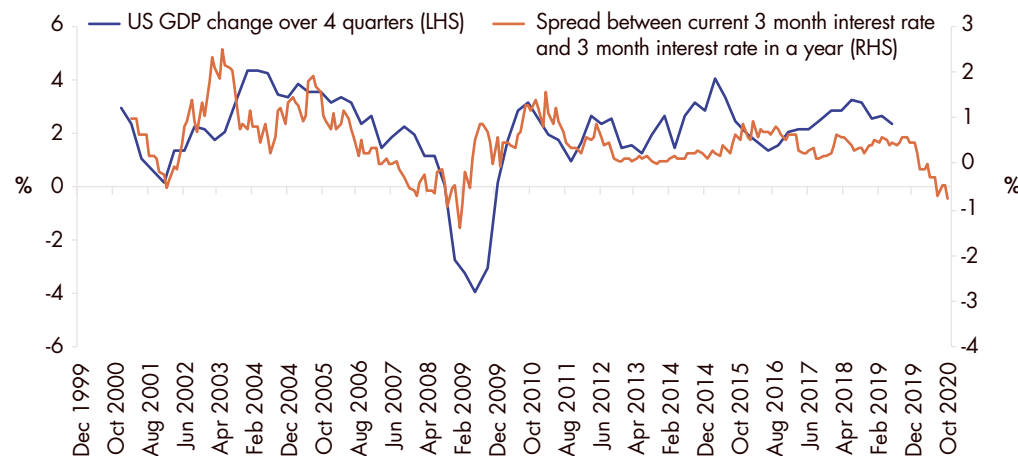
### Fed Funds target, market and Federal Open Market Committee forecast



Source: Bloomberg, Federal Reserve

## Chart 6: The Fed's best predictor

### Three month interest rate in a year versus current three month rate



Source: Bloomberg, spread between current 3 month rate and 3 month rate in a year is ED5 minus ED1 and Leading GDP (four quarter-ended) by five quarters.

## US economy

For the moment, the US economy is keeping its head above water, with consumers continuing to spend. This is offsetting a trade drag and weakness in business sentiment and investment.

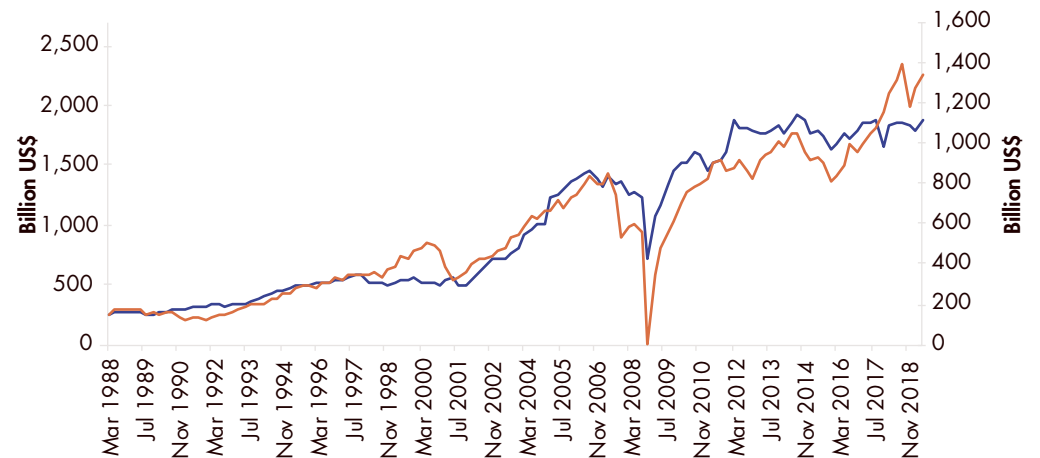
Poor business sentiment is not surprising. On top of trade/policy uncertainty, top down earnings and margins across the economy are flat/weak, diverging from bottom-up analyst estimates. This is another sign that the economy is late in the growth cycle.

Can the consumer continue to carry the US? It would seem to depend on employment growth which, so far, had only slowed moderately. But despite this, and despite low rates, signs of consumer credit stress are starting to appear. In part, this reflects the distribution of income gains, with the bulk accruing only to the top couple of income deciles.

Although only mild so far, consumer credit default indicators are rising. If employment and or incomes stall, credit defaults will rise much more sharply.

### Chart 7 - Bottom-up profits strong but top-down flat?

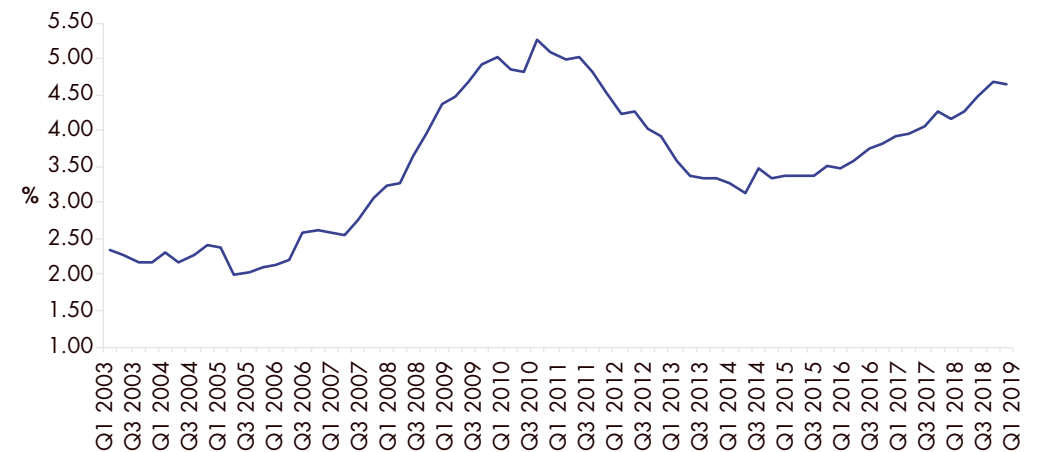
Aggregate corporate profits (NIPA earnings) and earning of S&P 500



Source: US Bureau of Economic Analysis, S&P

### Chart 8: Consumer credit default indicators are rising

Percentage of auto loans more than 90 days delinquent



Source: NewYork Fed

## Central Banks in Retreat?

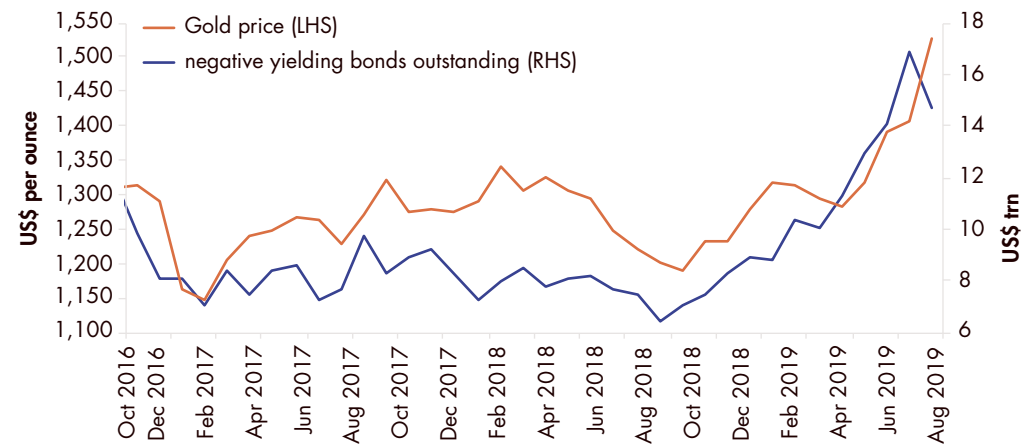
Ironically, investors' faith in the ability of central banks to avoid recession seems unshaken, at a time when central bankers themselves are increasingly sceptical about their ability to manage economies with the tools at their disposal. We note the recent comments by RBA Governor Phil Lowe, former New York Fed President Bill Dudley and various papers and remarks at the Fed's Jackson Hole retreat and recent G7 meeting.

The massive quantity of government debt paying negative yields is distorting asset markets. A negative yield on a "risk-free asset" is not appealing, but it's important to note that they are only risk-free if held to maturity, since a significant back-up in yields would see significant mark-to-market capital losses, in turn pushing up demand for other assets.

Indeed, the price of gold, a zero yield asset, tracks well against the volume of negatively yielding government securities on issue.

There is a "glass half full" interpretation of this: that, finally, policy makers will stop pushing on a string, and focus on policies to more directly stimulate the economy. Unfortunately, the "glass half empty" interpretation is that it seems that convincing governments and then getting policies underway will take too long to prevent a slowdown first.

**Chart 9: The gold price tracks negative yielding bonds**  
Gold vs the value of negative yielding bonds outstanding



Source: LBMA, Bloomberg, 1 October 2016 to 1 September 2019

## Gold takes hold amid uncertainty

We believe many aspects of the financial system are far from normal, and the record economic expansion looks to be on its last legs. These abnormalities may create extraordinary and unpredictable risks.

A comparison with previous multi-year periods of rising gold prices lends insights as to where the market is heading. The chart below compares several gold bull markets from the past 50 years, classified as either “secular” (long term) or “cyclical” (short term and occurring within an multi-year period of overall declining gold prices or a “bear market”). The gold price performance since 2015 has been tracking the same pattern as the 1993–96 cyclical bull market. However, the price trend since June puts the current market on a trend that is becoming more like the secular bull market from 2001 to 2008 in our view.

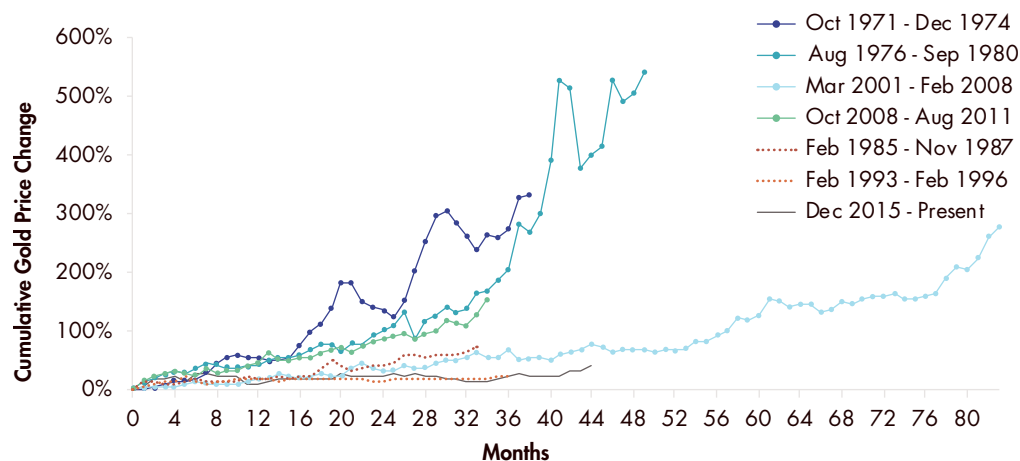
There are many similarities between the gold industry in 2001 and today. 2001 marked the end of a secular bear market in which gold prices fell to US\$253 per ounce and investor sentiment towards the sector was depressed. Likewise, 2019 marks the end of several years of stagnant range-bound trading that was preceded by one of the worse peak-to-trough bear markets on record. Sentiment and valuations are again at extreme lows, in our view.

A significant difference between the companies today and those in 2001 is a lack of hedging. The mark-to-market of many hedge books turned negative as the gold price rose in the 2000s. This cost companies billions. Today’s gold industry is essentially unhedged, which may give the current miners more leverage to rising gold prices than their earlier counterparts.

Regardless of whether gold equities reach the heights of past cycles, we believe there are now enough risks to financial markets to be supportive of gold and gold stocks for some time.

## Chart 10: Gold bulls

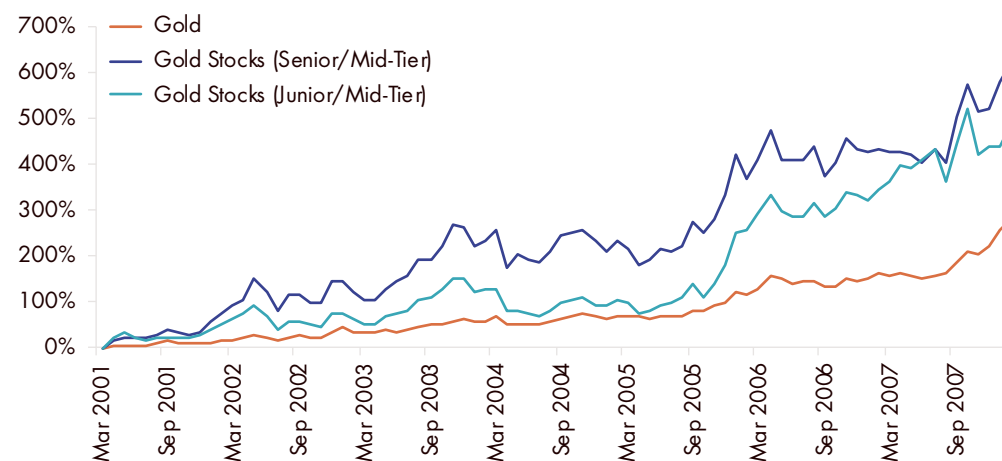
Gold performance in historical gold bull markets



Source: VanEck, Bloomberg. Data as of August 2019. “Gold” represented by Gold Spot (\$/oz). Past performance is not indicative of future results.

## Chart 11: If 2019 is similar to 2001?

Gold vs gold stocks during the March 2001 to February 2008 gold bull market



Source: VanEck, Bloomberg. Data as of August 2019. “Gold” represented by Gold Spot (\$/oz). “Gold Stocks (Senior/Mid-Tier)” represented by NYSE Arca Gold Miners Index (GDMNTR). “Gold Stocks (Junior/Mid-Tier)” represented by MVIS Global Junior Gold Mining Index (MVGDXJTR). “Senior” miners are defined by production levels of approximately 1.5-6.0 million ounces of gold per year (“Mid-Tier” miners approximately 0.3-1.5 million ounces per year; “Junior” miners approximately <0.3 million ounces per year). Past performance is not indicative of future results.

## China and emerging markets

The rest of the world should not hope for China to perform as the growth locomotive for global growth like it has in the past, for two reasons. First, stimulus to date has not yet arrested the slowdown in China industrial output growth.

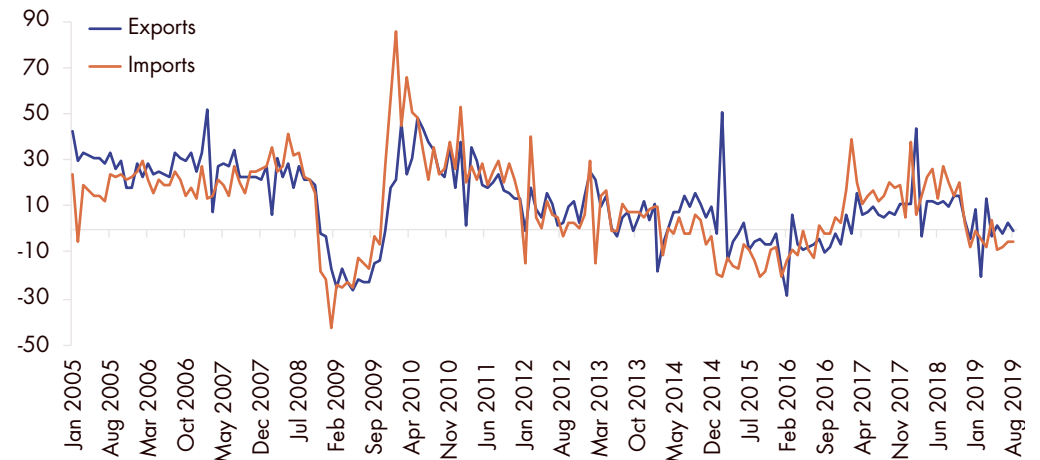
Second, China stimulus appears to be staying home, as outlined below, not fuelling production elsewhere. While Chinese exports are down about 1 per cent for the first 8 months of 2019, imports are down a far steeper 5.6 per cent, implying a net drag on rest of world growth.

While the trade negotiations have had an impact in China, the more interesting news came from China's Communist Party's Politburo during the quarter. The country's governing body concluded an economic review meeting to discuss the country's second quarter performance and the tone of its post-meeting communique indicates where China is headed. The Politburo's message made it clear that China is in this for the long haul. After the meeting, the country's leadership declared that "we must be good at turning crisis into an opportunity by getting our domestic things done." This sets the tone that China's leaders are focused on strengthening their country's consumers to withstand further US tariffs.

Elsewhere, in emerging markets news during the quarter was dominated by Argentina where the peso fell to record lows forcing the government to impose currency controls. The reaction from the rest of the world was swift and spreads widened, but we see a strong case for Argentina going forward. We believe a market-friendly government is likely to be elected on October 2 and the economic and policy setup is nowhere near as bad as it was in the prior Argentina default, nor as bad as it was in all the other sovereign defaults of the past 20 years.

## Exhibit 12: Chinese exports slowing but imports falling faster!

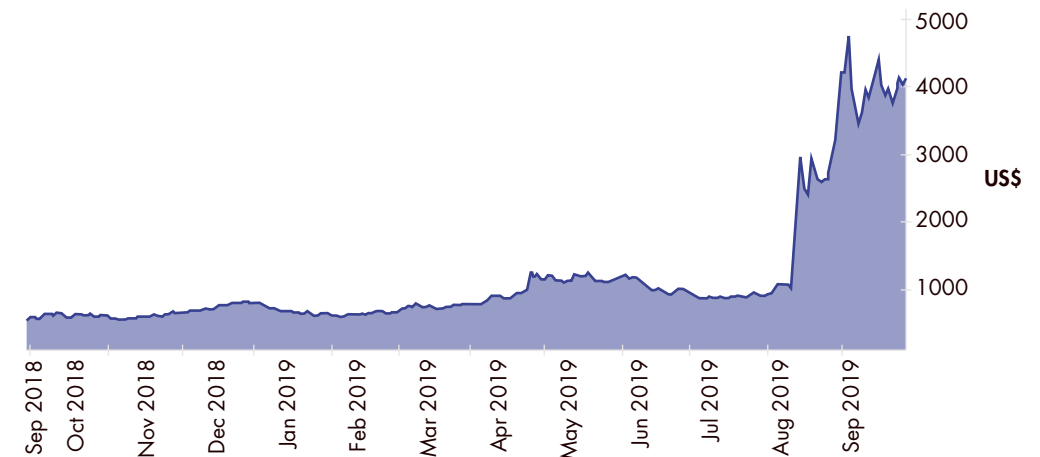
Exports and imports percentage change on year ago



Source: National Bureau of Economic Research

## Exhibit 13: A full blown crisis in Argentina?

Argentina Government Sovereigns 5 year credit default swap



Source: Bloomberg



## Europe

Germany's exposure to China has seen it lose its status as the strong man of Europe. France and Italy are less exposed and also have been more willing to use fiscal levers

Fiscal mutterings are starting to emerge in Germany. A German turn to fiscal policy would be a positive, not just for Germany but for Europe as a whole.

It's worth recalling that the first countries to change the fiscal stability pact were not the peripheral nations, but France and Germany, back in 2003. If Germany starts to find the fiscal straitjacket a bit too tight, we could again see an easing of fiscal rules.

Across the Channel, chaos reigns. Odds of a hard Brexit continue to rise, although it's still possible one side will blink. It seems that it will take the Europeans to blink especially with gathering sentiment in the UK that in the long run exiting Europe will be the best outcome for the British economy.

It's hard to say whether that will be the case. On the one hand, a much lower exchange rate (already achieved) will help revitalise British industry. But the UK may be looking to a major restructure of its economy, in almost the opposite direction to the past 30 years, that is, we could see a retreat of finance, as London's favourable position and access downgrades, but a resurgence of industry as a lower exchange rate and deregulation boost the real side of the economy

It remains guesswork as to whether, and how long it will take, for the "new" UK economy emerge from the transition (if ever). But it's likely to be measured in decades than months!

## Chart 14: Germany falls behind

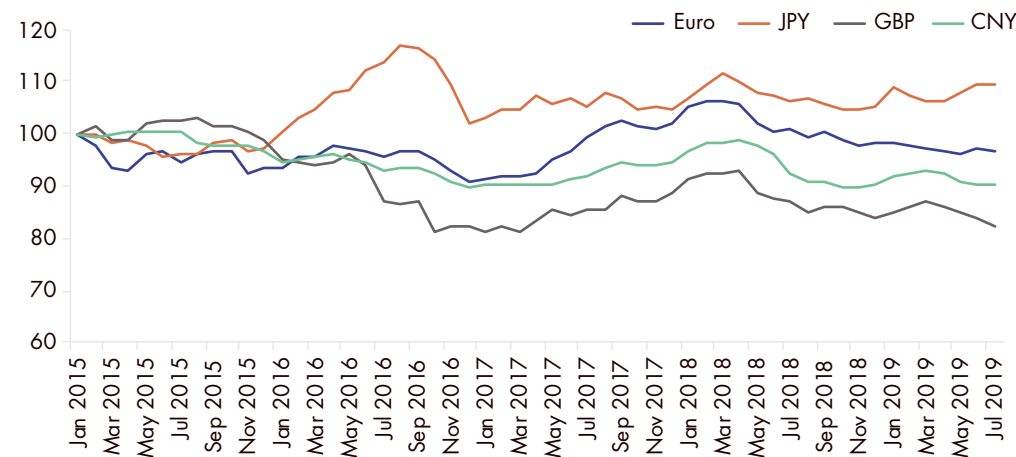
PMI of European nations in G7 ex-UK



Source: National Bureau of Economic Research. PMI above 50 is considered expansionary.

## Chart 15: Brexit fears have boosted UK competitiveness

Pound versus major currencies



Source: Bloomberg, currency majors v US dollars rebased to 100 on 1 Jan 2015

## Australia

Like the US, Australia has all its eggs in the labour market basket at the moment.

Growth has been substandard, teetering on the brink of recession, indeed, on a per capita basis, GDP has been going backwards.

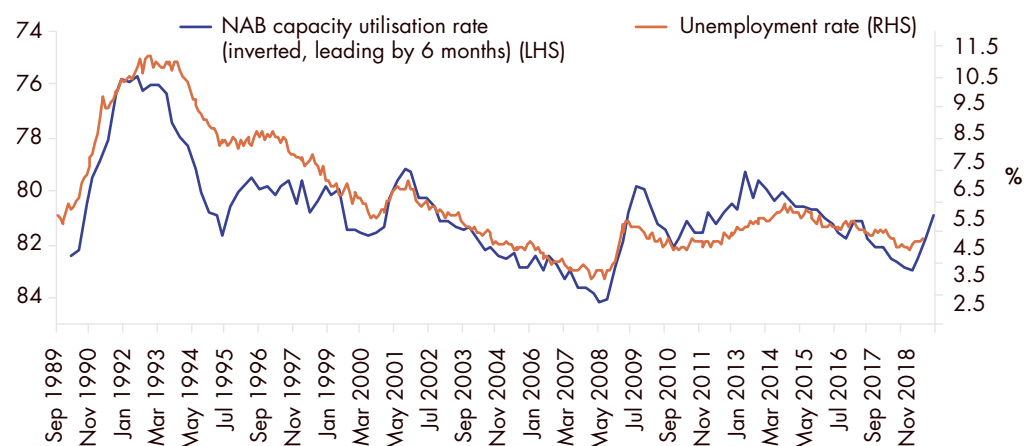
The Government, and optimists, are pinning their hopes on tax cuts and a housing market revival. Post the election, there has been a modest revival in the housing market. The question is sustainability.

The labour market has continued to weaken modestly, with the unemployment rate now at 5.3%, up from a low of 4.9%. Based on softer capacity utilisation, this should continue to rise.

Weaker profitability of Australian companies, especially away from the low labour intensity mining sector, should also sap employment prospects. The latest reporting season featured historically high proportions of profit downgrades and despite this the share market continues to trend higher.

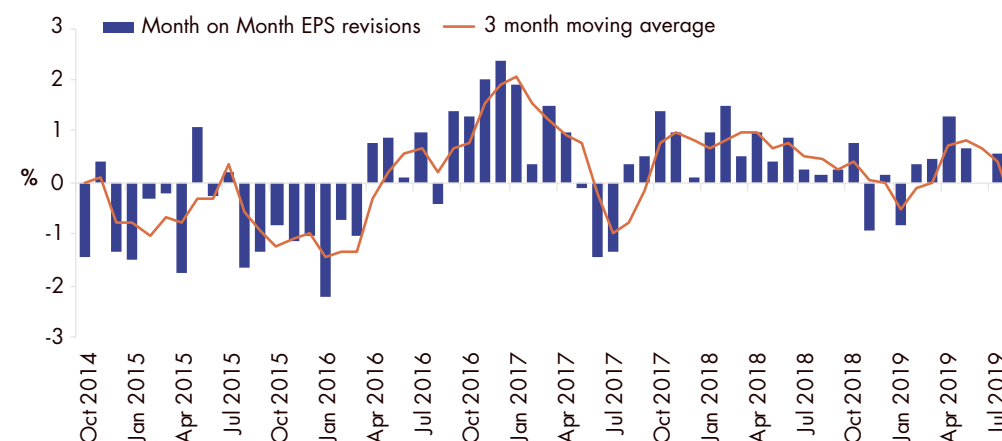
So far at least, the Federal Government seems more fixated on preserving a budget surplus than using fiscal policy to support growth, despite pleas from RBA Governor Lowe. The Australian economy looks like it will need more help than the authorities currently plan to provide.

**Chart 16: Unemployment set to rise**  
Unemployment rate and NAB capacity utilisation rate



Source: NAB, ABS

**Chart 17: Profitability of Australian companies**  
S&P/ASX 200 month on month EPS revisions (%)



Source: Bloomberg

## Range of VanEck Vectors Exchange Traded Funds (ETFs) on ASX

ETF Name	ASX code	Index	Management costs (% p.a.)
<b>Australian Broad Based</b>			
Australian Equal Weight ETF	MVW	MVIS Australia Equal Weight Index	0.35%
<b>Australian Sector</b>			
Australian Banks ETF	MVB	MVIS Australia Banks Index	0.28%
Australian Property ETF	MVA	MVIS Australia A-REITs Index	0.35%
Australian Resources ETF	MVR	MVIS Australia Resources Index	0.35%
<b>Australian Small and Mid Companies</b>			
Small Companies Masters ETF	MVS	MVIS Small-Cap Dividend Payers Index	0.49%
S&P/ASX MidCap ETF	MVE	S&P/ASX MidCap 50 Index	0.45%
<b>Sustainable Investing</b>			
MSCI International Sustainable Equity ETF	ESGI	MSCI World ex Australia ex Fossil Fuel Select SRI and Low Carbon Capped Index	0.55%
MSCI Australian Sustainable Equity ETF	GRNV	MSCI Australia IMI Select SRI Screened Index	0.35%
<b>International</b>			
ChinaAMC CSI 300 ETF	CETF	CSI 300 Index	0.60%
China New Economy ETF	CNEW	CSI MarketGrader China New Economy Index	0.95%
MSCI Multifactor Emerging Markets Equity ETF	EMKT	MSCI Emerging Markets Diversified Multiple-Factor Index (AUD)	0.69%
Morningstar Wide Moat ETF	MOAT	Morningstar Wide Moat Focus Index™	0.49%
MSCI World ex Australia Quality ETF	QUAL	MSCI World ex Australia Quality Index	0.40%
MSCI World ex Australia Quality (Hedged) ETF	QHAL	MSCI World ex Australia Quality 100% Hedged to AUD Index	0.43%
<b>Global Sector</b>			
FTSE Global Infrastructure (Hedged) ETF	IFRA	FTSE Developed Core Infrastructure 50/50 Hedged into AUD Index	0.52%
FTSE International Property (Hedged) ETF	REIT	FTSE EPRA Nareit Developed ex Australia Rental Index AUD Hedged	0.43%
Gold Miners ETF	GDX	NYSE Arca Gold Miners Index	0.53%
<b>Australian Fixed Income</b>			
Australian Corporate Bond Plus ETF	PLUS	Markit iBoxx AUD Corporates Yield Plus Index	0.32%
Australian Floating Rate ETF	FLOT	Bloomberg AusBond Credit FRN 0+Yr Index	0.22%

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