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WORLD MARKETS REVIEW

Markets extend gains as coronavirus uncertainty continues

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World markets review — Third quarter 2020

Equities

Global stocks posted a second consecutive quarter of strong gains following a pandemic-induced selloff earlier in the year. Developed and emerging markets rose, supported by massive government stimulus measures and investor optimism for a global economic recovery. However, fears of additional COVID-19 outbreaks sent markets lower in September.

Consumer-oriented technology stocks generated the largest gains, lifted by a surge in global e-commerce activity. The tech sector rally pushed some broad-based indexes to new all-time highs, underscored by Apple's rise to a $2 trillion valuation. Industrials and materials stocks also rallied amid a recovery in global demand. Energy stocks fell sharply.

	September 2020		3Q 2020		YTD 2020	
EQUITY INDEX RETURNS (%)	U.S. DOLLAR	LOCAL CURRENCY	U.S. DOLLAR	LOCAL CURRENCY	U.S. DOLLAR	LOCAL CURRENCY
S&P 500	-3.8	-3.8	8.9	8.9	5.6	5.6
MSCI ACWI	-3.2	-2.7	8.1	6.9	1.4	1.2
MSCI ACWI ex USA	-2.5	-1.3	6.3	3.5	-5.4	-5.8
MSCI World	-3.4	-2.9	7.9	6.7	1.7	1.0
MSCI Emerging Markets IMI	-1.6	-1.7	9.8	8.8	-1.3	2.6
MSCI EAFE	-2.6	-1.0	4.8	1.2	-7.1	-9.4
MSCI Europe	-3.3	-0.9	4.5	0.3	-8.8	-11.3
MSCI Pacific	-1.2	-1.0	5.4	2.9	-4.1	-6.2

Source: RIMES

Fixed income

U.S. bond markets rose, lifted by gains among investment-grade corporate and high-yield debt. Government bond returns were modest as demand for safe-haven assets waned. The Federal Reserve took no action on interest rates, but the central bank revised its inflation stance to allow for longer periods of price increases before considering any rate hikes.

FIXED INCOME INDEX RETURNS (%)	SEPTEMBER 2020	3Q 2020	YTD 2020
Bloomberg Barclays U.S. Aggregate	–0.1	0.6	6.8
Bloomberg Barclays Global Aggregate	–0.4	2.7	5.7
Bloomberg Barclays U.S. Corp IG	–0.3	1.5	6.6
Bloomberg Barclays U.S. Corp HY	–1.0	4.6	0.6
JPM EMBI Global Diversified	–1.9	2.3	–0.5
JPM GBI-EM Global Diversified	–2.0	0.6	–6.3

Source: RIMES. Returns are in U.S. dollar terms.

In foreign exchange markets, the U.S. dollar fell against the euro, the yen and most other currencies. A number of factors contributed to broad-based dollar weakness, including concerns about rising U.S. fiscal deficits, a prolonged period of ultralow interest rates, and a perceived overvaluation of the dollar in recent years.

EXCHANGE RATES (% CHANGE VS. USD)	SEPTEMBER 2020	3Q 2020	YTD 2020
Euro	–1.9	4.4	4.5
Japanese yen	0.5	2.2	3.0
British pound	–3.4	4.6	–2.4
Canadian dollar	–2.5	2.0	–2.9
Australian dollar	–3.1	4.1	2.0
Swiss franc	–2.0	3.1	5.4

Source: RIMES. Returns are in U.S. dollar terms.

North America

U.S. equities continued to rally, fueled by optimism about the path of the economic recovery. Activity picked up as businesses reopened and consumers adapted to new guidelines affecting work, commerce and recreation. Led by technology stocks, the market completed a full reversal of the bear market's steep losses: between March 23 and September 2, the Standard & Poor's 500 Composite Index soared 61%. In the third quarter, the index advanced 9% despite choppier markets in September as investors turned their attention to the upcoming U.S. election. Large caps topped small caps, and growth stocks outpaced value for the seventh straight quarter.

The unemployment rate fell to 8.4% in August, its fourth consecutive monthly decline, but remained far above pre-recession lows. Low mortgage rates and a desire for more living space while working from home during the pandemic propelled buyers back to the real estate market. Existing home sales spiked 10.5% in August from the previous year, including a 44%

increase in properties priced over $1 million. Retail sales rose in August but at a slower rate than the previous two months, which was partially attributed to the July expiration of the federal unemployment subsidy.

Apple became the first U.S. company with a market capitalization of $2 trillion, only two years after surpassing the $1 trillion milestone. Like several other large tech companies, Apple has benefited from robust online sales and strong demand for its products and services while consumers shelter at home. Amazon and Facebook also outpaced the broader market and touched record highs in the quarter. The tech-heavy Nasdaq Composite advanced 11%, led by a 99% return for shares of electric automaker Tesla.

The industrials sector climbed 12% as a surge in online shopping boosted earnings of delivery services companies. Shares of FedEx and United Parcel Service rallied 80% and 51%, respectively. However, Boeing shares dipped 10% as demand for air travel remained soft.

Energy was the only sector to decline, falling 20% despite a modest rise in West Texas Intermediate oil prices. Occidental Petroleum plummeted 45%, and shares of integrated giants Exxon Mobil and Chevron also traded lower. The sector is down 48% year to date.

Bond markets turned in another quarter of gains as some economic data showed the U.S. economic recovery grinding on, despite challenges tied to the pandemic. Spreads on corporate bonds have tumbled from their peaks in March, with investment-grade credit spreads narrowing to 129 basis points (bps) during the quarter. High-yield corporate spreads continued to tighten, falling 109 bps to 517 bps above Treasuries. The Fed adopted a new 2% average inflation framework that allows for higher periods of inflation in an effort to support the labor market. The new policy effectively signaled that interest rates will likely remain low over the next few years.

Europe

European stocks rose modestly, lifted by signs of improving economic activity as coronavirus-related restrictions were loosened in many countries. However, worries about a potential second wave of COVID-19 infections in the U.S. and Europe sent stocks lower in September, tempering gains for the full quarter. Overall, the MSCI Europe Index advanced 4.5% in U.S. dollar terms. In local currency terms, the index remained essentially flat.

German stocks led markets higher as Europe's largest economy revved up manufacturing activity amid rising demand from China and other foreign markets. German retail sales also rose at a higher-than-expected rate, climbing 3.1% in August. Shares of Daimler, SAP and Siemens — three of Germany's largest exporters — enjoyed strong rallies, posting double-digit gains during the quarter. European Central Bank officials left interest rates and stimulus measures unchanged at their September meeting, citing a "significant recovery" in domestic demand from prior quarters.

Consumer discretionary stocks rose 13%, rebounding from sharp declines earlier in the year. Shares of athletic apparel maker Adidas and luxury goods company Kering rose 23% and 22%, respectively. Industrials and materials companies also rallied amid a recovery in demand for chemicals, electrical equipment and logistics services. Shares of Vestas Wind Systems, the world's largest maker of wind turbines, soared nearly 60% on strong U.S. demand for alternative energy sources. Information technology stocks gained 8%, rising in sync with a rally in the U.S. tech sector.

Energy stocks suffered the biggest losses, weighed down by declines in the oil and gas industry. Oil giants BP, Total and Royal Dutch Shell were among the largest decliners in the MSCI Europe Index. Financial stocks fell, led by sharp drops in the shares of Great Britain's HSBC and Spain's Banco Santander. Companies in the communication services sector also declined, including Vodafone and Telefónica, which have both come under pressure amid fierce competition for wireless customers.

In fixed income markets, eurozone government bonds rose amid aggressive bond buying as part of the European Central Bank's economic stimulus program. The yield on Germany's benchmark 10-year note fell further into negative territory, dropping 6 basis points to end the quarter at –0.52%. Similar maturities in Italy declined 39 basis points to close the period at 0.87%. The euro rose 4% against the U.S. dollar amid broad dollar weakness in global currency markets.

Asia-Pacific

Japanese stocks rose despite continued economic weakness and the resignation of long-serving Prime Minister Shinzo Abe due to ill health. New prime minister Yoshihide Suga promised policy continuity, along with reforms in specific areas including regional banks, telecommunications and digital policy. The MSCI Japan Index rose 7% and the MSCI Pacific ex Japan Index gained 2%. The Japanese yen rose 2% against the U.S. dollar.

The Japanese economy remained weak. The Tankan survey of large manufacturers came in at –27 for the third quarter, reflecting low expectations for business conditions and casting doubt on the strength of Japan's recovery from a deep recession. Gross domestic product declined an annualized 28.1% in the second quarter, extending the contraction that began with an increase in the consumption tax last fall. In August, retail sales fell 1.9% from a year earlier, the sixth consecutive monthly decline, and household spending fell 7.6% in July for a 10th straight decline. Exports and industrial production both fell by double digits in July and August. The Bank of Japan maintained its ultra-loose monetary policy, but core inflation, which was last above zero in March, sank to –0.4% in August.

Most Japanese stock sectors advanced. Communication services (+13%), materials (+10%) and industrials (+9%) stocks rose the most, while consumer staples (+1%) posted the smallest gain. Just two sectors fell: utilities and energy each lost 2%.

Hong Kong's recession lengthened amid escalating geopolitical tensions. The U.S. imposed sanctions on senior Chinese and Hong Kong officials, including Hong Kong chief executive Carrie Lam, and revoked the territory's special trade status — among a series of steps in an escalating geopolitical showdown with China. Meanwhile, Hong Kong has seen sporadic street protests and arrests of pro-democracy figures since China imposed a national security law in June. Protesters were further agitated by a government decision to delay Legislative Council elections for a year. GDP declined 9% in the second quarter, extending Hong Kong's recession to a full year. A spike in coronavirus cases in July weighed on retail sales, which fell 23% from a year earlier. Hong Kong stocks rose 2%.

Australia entered its first recession in nearly 30 years. GDP fell 7% in the second quarter, the biggest decline on record. Third-quarter output may be dented by a renewed lockdown in populous Victoria state following a second wave of COVID-19 infections in Melbourne. Australian stocks rose 3%. Stocks in New Zealand and Singapore each lost 1%.

Emerging markets

Emerging markets stocks advanced, lifted by China's economic rebound, stronger commodity prices, a weaker dollar and stimulus measures in developing countries. The MSCI Emerging Markets Investable Market Index rose 10%, led by gains in the consumer discretionary and information technology sectors.

Chinese stocks posted another quarter of strong gains on positive economic data. Industrial activity and exports continued to rebound as China's pandemic recovery accelerated, with monthly retail sales turning positive for the first time this year in August. In the second quarter, China avoided a technical recession, with gross domestic product increasing 3.2% on an annualized basis. Year to date, the MSCI China IMI is up 16%, outpacing the S&P 500 and other major equity benchmarks despite rising geopolitical

tensions with the U.S., Europe and India. The renminbi rose 4% against the dollar.

Internet platform companies and semiconductor giants boosted the emerging markets index. Shares of Chinese e-commerce giant Alibaba and its smaller rival JD.com both gained more than 20% on strong quarterly sales helped by a consumption recovery in China. Taiwan Semiconductor, the world's largest contract chip contractor, reported a growing order book as some of its customers braced for potential supply chain disruptions. Shares of technology titan Samsung Electronics also rose.

Indian equities surged despite a challenging economic picture. Stocks in the information technology sector powered gains as India grappled with a rising number of COVID-19 cases and loan losses in the state-dominated banking sector. Pockets of India's economy began to bounce back after second-quarter GDP plunged 23.9% year on year. Government leaders also took steps to attract investments in the manufacturing sector, specifically targeting mobile-phone assembly as multinationals reassess their global supply chains. The rupee advanced 2% against the dollar.

Russian stocks fell, hurt by a sharp decline in global oil demand. The ruble fell 8% against the dollar. In Latin America, Brazilian stocks lost ground as Brazil struggled to contain the coronavirus and revive growth. Brazil's economy contracted 11.4% in the second quarter on an annualized basis.

Dollar-denominated emerging markets bonds rose. With ultralow yields in developed markets, investors flocked to higher yielding government debt in places such as Brazil and Mexico. In a significant development, index provider FTSE Russell announced it intends to add Chinese bonds to its World Government Bond Index starting in October 2021. It could attract more than $100 billion of inflows into the world's second-largest bond market, only a fraction of which is owned by foreign investors.