

Running of the Doves

In the World

While the bulls ran in Spain, central bank “doves” – headlined by the U.S. Federal Reserve and its highly anticipated rate cut – took the spotlight in July. For the first time since the financial crisis, the Fed cut its policy rate by 25 basis points (ending a three-year hiking cycle that began in December 2015) and announced an earlier-than-expected end to its balance sheet unwind. Although the Fed was aiming to help keep the longest economic expansion in U.S. history on track, Chairman Jerome Powell’s press conference took markets by surprise as he shied away from providing specific guidance on further easing and indicated a “mid-cycle adjustment to policy” rather than the start of a protracted easing cycle. While the European Central Bank (ECB) left its policy rate unchanged, President Mario Draghi sent a clear signal of intent to ease further, stating the ECB was “determined to act” to spur inflation and help combat a worsening economic outlook. Elsewhere, the Bank of Japan (BOJ) left rates unchanged, but indicated potential for future support; the Reserve Bank of Australia (RBA) cut rates by 25 bps for the second time this year; and a host of emerging market countries, including South Africa, Malaysia, Turkey, and Russia, all cut rates.

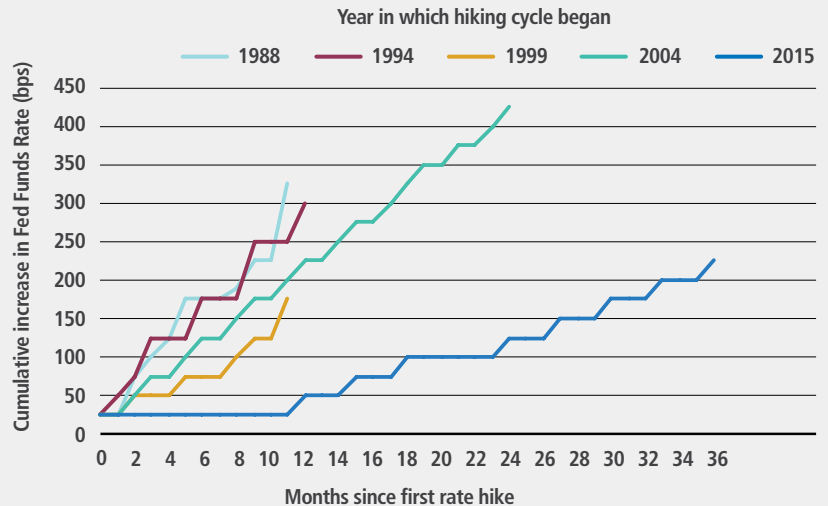
In odd timing for the Fed, U.S. economic data showed some resiliency. Although exports declined and business investment contracted, U.S. Q2 real gross domestic product (GDP) growth was still better than expected at an annualized 2.1%. Albeit slower than the first quarter’s 3.1% pace, the Q2 figure was led by robust growth in consumer spending. Retail sales were also stronger than anticipated, core inflation firmed, and U.S. job growth handily beat expectations. In contrast to better trends in U.S. economic data, fundamentals in the eurozone continued to weaken: GDP growth slowed to 0.2% for the second quarter, inflation dropped to 1.1% year-over-year (its lowest this year), and flash manufacturing

purchasing managers’ indexes (PMIs) fell deeper into contractionary territory. Meanwhile, political developments in Europe featured turnover in key posts: Germany’s former defense minister Ursula Von der Leyen became the new president-elect of the European Commission, Christine Lagarde resigned as the head of the IMF to replace Mario Draghi as president of the ECB in September, and Boris Johnson became the new Prime Minister of Great Britain. In Washington, the House passed a budget deal that extended the debt ceiling until after the 2020 elections and increased federal spending in 2020 by about \$50 billion.

Market performance was more mixed in July. In the U.S., Chairman Powell’s less accommodative-than-expected rhetoric helped send equities lower, the U.S. dollar stronger, and yields at the front-end of the curve higher (despite the 25-bps rate cut). Still, the S&P 500 managed to end the month 1.4% higher. Year-to-date gains crossed over 20%, and the index reached fresh all-time highs, due in part to a strong start to the Q2 earnings season (though many companies guided toward weaker Q3 results given trade tensions and slowing global growth). Outside the U.S., equity gains across developed markets were more modest as stimulus efforts from central banks were dampened by economic data that affirmed slowing growth momentum while emerging market equities fell 1.2% alongside a strengthening U.S. dollar. In Germany, the 10-year bund yield slid 11 bps to -0.44% (an all-time low) as expectations built for a September easing package from the ECB. In response to newly-elected Prime Minister Boris Johnson’s pledge to remove the UK from the EU on October 31 with or without a deal, the pound fell 4.2% to a two-year low. Lastly, Brent crude oil prices fell 2.1% as concerns about demand growth outweighed the impact of flaring tensions with Iran in the Gulf and inventory draws in the U.S.

LONG BUT SHALLOW: PUTTING THE RECENT FED HIKING CYCLE IN CONTEXT

The Federal Reserve lowered its target policy rate for the first time in over a decade, ending one of the longest hiking cycles in the past 30 years. While the cumulative increase in the federal funds rate of 225 basis points (bps) was relatively in line with most recent tightening cycles, it took three years to get there. One of the reasons for the longer and shallower cycle may be that the Fed’s objectives were different: This cycle was about getting away from the zero-bound – to remove emergency accommodation and have room to cut rates in future economic downturns – as opposed to tightening conditions to slow some type of overheating. The fact that there is less room to reduce rates than in past cycles may also help explain why the Fed focused on the cut as “insurance” to stave off the possibility of returning to zero in the near future; it is also likely the reason the FOMC members were divided, based on their forecasts in June, between leaving the target rate unchanged and cutting it 50 bps by the end of 2019.



Source: Bloomberg. As of 31 July 2019.

Market snapshot

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

BONDS	U.S.				U.K.				EUROZONE				JAPAN				CANADA			
	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018
	Level	Change (bps)			Level	Change (bps)			Level	Change (bps)			Level	Change (bps)			Level	Change (bps)		
Target Rate*	2.25				0.75				-0.40				-0.10				1.75			
2 YR	1.87	+12	-62	+60	0.44	-18	-32	+31	-0.78	-3	-17	+2	-0.20	+2	-6	-1	1.54	+7	-32	+18
5 YR	1.83	+6	-68	+30	0.38	-25	-52	+18	-0.72	-5	-40	-11	-0.24	+2	-9	-4	1.45	+6	-44	+2
10 YR	2.01	+1	-67	+28	0.61	-22	-67	+9	-0.44	-11	-68	-19	-0.15	+1	-16	-5	1.48	+1	-49	-8
30 YR	2.52	-0	-49	+27	1.32	-16	-50	+6	0.12	-14	-75	-39	0.35	-1	-37	-9	1.70	+1	-49	-8
5 YR ILBs	0.29	+6	-71	+71	-2.94	-40	-70	-9	1.33	+7	-14	-24					0.17	+11	-48	+40
10 YR Muni ^a	1.54	-9	-78	+31													2.33	-0	-70	+17
CURRENCIES	USD**				GBP/USD				EUR/USD				USD/JPY				USD/CAD			
	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018
	Level	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	98.52	2.5%	2.4%	4.4%	1.22	-4.2%	-4.7%	-5.6%	1.11	-2.6%	-3.4%	-4.5%	108.78	-0.8%	0.8%	2.8%	1.32	-0.7%	3.4%	-7.8%
EQUITIES	2.5%				FTSE 100				EURO STOXX 50				NIKKEI				SPTSX			
	2.4%	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018	July '19	MTD	YTD	2018
	4.4%	Change			Level	Change			Level	Change			Level	Change			Level	Change		
	2,980	1.4%	20.2%	-4.4%	7,587	2.2%	15.7%	-8.7%	3,467	-0.1%	18.2%	-12.0%	21,522	1.2%	8.5%	-10.7%	16,407	0.3%	16.1%	-9.6%

SECTOR SPREADS***				
	July '19	MTD	YTD	2018
	Level	Change (bps)		
MBS ^b	38	-8	+3	+11
IG ^c	101	-8	-40	+54
HIGH YIELD ^d	420	-2	-125	+206
EM EXTERNAL ^e	333	-33	-102	+124

COMMODITIES				
	July '19	MTD	YTD	2018
	Level	Change		
Oil	\$59	0.2%	29.0%	-24.8%
Gold	\$1,426	0.9%	11.3%	-2.1%
Copper	\$267	-1.5%	1.3%	-20.3%
Grains ^f	\$29	-5.8%	-5.0%	-7.4%

*Central Bank Policy Rate

**U.S. Dollar Index (DXY)

***Sector spreads to like-duration government bonds

Source: Bloomberg

^aThomson Municipal Market Data (MMD) AAA Curve, ^bBarclays Global Agg MBS Index, ^cBloomberg Barclays Global Agg Credit Average OAS, ^dBarclays Global Agg High Yield Index, ^eJPMorgan Emerging Markets Bond Index, ^fDow Jones – UBS Grains Subindex

Outlook

Based on PIMCO's cyclical outlook from March 2019.

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. **Headline inflation is likely to remain in the 1.5%–2% range this year, while core CPI moves sideways.** With growth likely to continue slowing through the year and inflation remaining below target, the Fed has adopted a more dovish stance and looks likely to cut rates by 50 basis points (bps) by year-end 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 some countries experience a recession. An improvement in global trade conditions would contribute to a gradual reacceleration. Reflecting firmer wage growth, **we expect a modest pickup in core inflation, which has been stuck at 1% for some time.** Mirroring the dovish shift by many central banks, the European Central Bank (ECB) has also taken an accommodative tone with some potential for more easing policies in 2019..

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 lower-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.

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), 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, stabilizing somewhat in the second half of the year as fiscal and monetary stimulus find some traction. . We expect fiscal stimulus of 1.5% to 2% of GDP. **Inflation remains benign at 1.5%–2.5% in our forecast,** and we may see additional stimulus if credit conditions deteriorate more. 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.

A “safe haven” is an investment that is expected to retain or increase in value during times of market turbulence. **All investments** contain risk and may lose value.

Past performance is not a guarantee or a reliable indicator of future results. 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, and low interest rate environments increase 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. 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**. **Currency rates** may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **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. Income from **municipal bonds** is exempt from federal income tax and may be subject to state and local taxes and at times the alternative minimum tax; a strategy concentrating in a single or limited number of states is subject to greater risk of adverse economic conditions and regulatory changes. **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. **Treasury Inflation-Protected Securities (TIPS)** are ILBs issued by the U.S. government. Income from municipal bonds may be subject to state and local taxes and at times the alternative minimum tax. **Corporate debt** securities are subject to the risk of the issuer’s inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to factors such as interest rate sensitivity, market perception of the creditworthiness of the issuer and general market liquidity. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. **Commodities** contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. It is not possible to invest directly in an unmanaged index.

The **credit quality** of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. The quality ratings of individual issues/issuers are provided to indicate the credit-worthiness of such issues/issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody’s, and Fitch respectively.

This material contains the opinions of the manager and such opinions are subject to change without notice. This material has been distributed for informational purposes only. Forecasts, estimates and certain information contained herein are based upon proprietary research 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.

PIMCO provides services only to qualified institutions and investors. This is not an offer to any person in any jurisdiction where unlawful or unauthorized. | **Pacific Investment Management Company LLC**, 650 Newport Center Drive, Newport Beach, CA 92660 is regulated by the United States Securities and Exchange Commission. | **PIMCO Europe Ltd** (Company No. 2604517) and PIMCO Europe Ltd - Italy (Company No. 07533910969) are authorised and regulated by the Financial Conduct Authority (12 Endeavour Square, London E20 1JN) in the UK. The Italy branch is additionally regulated by the Commissione Nazionale per le Società e la Borsa (CONSOB) in accordance with Article 27 of the Italian Consolidated Financial Act. PIMCO Europe Ltd services are available only to professional clients as defined in the Financial Conduct Authority’s Handbook and are not available to individual investors, who should not rely on this communication. | **PIMCO Deutschland GmbH** (Company No. 192083, Seidlstr. 24-24a, 80335 Munich, Germany), PIMCO Deutschland GmbH Italian Branch (Company No. 10005170963), PIMCO Deutschland GmbH Spanish Branch (N.I.F.W2765338E) and PIMCO Deutschland GmbH Swedish Branch (SCRO Reg. No. 516410-9190) are authorised and regulated by the German Federal Financial Supervisory Authority (BaFin) (Marie-Curie-Str. 24-28, 60439 Frankfurt am Main) in Germany in accordance with Section 32 of the German Banking Act (KWG). The Italian Branch, Spanish Branch and Swedish Branch are additionally supervised by the Commissione Nazionale per le Società e la Borsa (CONSOB) in accordance with Article 27 of the Italian Consolidated Financial Act, the Comisión Nacional del Mercado de Valores (CNMV) in accordance with obligations stipulated in articles 168 and 203 to 224, as well as obligations contained in Title V, Section I of the Law on the Securities Market (LSM) and in articles 111, 114 and 117 of Royal Decree 217/2008 and the Swedish Financial Supervisory Authority (Finansinspektionen) in accordance with Chapter 25 Sections 12-14 of the Swedish Securities Markets Act, respectively. The services provided by PIMCO Deutschland GmbH are available only to professional clients as defined in Section 67 para. 2 German Securities Trading Act (WpHG). They are not available to individual investors, who should not rely on this communication. | **PIMCO (Schweiz) GmbH** (registered in Switzerland, Company No. CH-020.4.038.582-2), Brandschenkestrasse 41, 8002 Zurich, Switzerland, Tel: + 41 44 512 49 10. The services provided by PIMCO (Schweiz) GmbH are not available to individual investors, who should not rely on this communication but contact their financial adviser. | **PIMCO Asia Pte Ltd** (Registration No. 199804652K) is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence and an exempt financial adviser. The asset management services and investment products are not available to persons where provision of such services and products is unauthorised. | PIMCO Asia Limited is licensed by the Securities and Futures Commission for Types 1, 4 and 9 regulated activities under the Securities and Futures Ordinance. The asset management services and investment products are not available to persons where provision of such services and products is unauthorised. | PIMCO Australia Pty Ltd ABN 54 084 280 508, AFSL 246862 (**PIMCO Australia**). This publication has been prepared without taking into account the objectives, financial situation or needs of investors. Before making an investment decision, investors should obtain professional advice and consider whether the information contained herein is appropriate having regard to their objectives, financial situation and needs. | **PIMCO Japan Ltd**, Financial Instruments Business Registration Number is Director of Kanto Local Finance Bureau (Financial Instruments Firm) No. 382. PIMCO Japan Ltd is a member of Japan Investment Advisers Association and The Investment Trusts Association, Japan. All investments contain risk. There is no guarantee that the principal amount of the investment will be preserved, or that a certain return will be realized; the investment could suffer a loss. All profits and losses incur to the investor. The amounts, maximum amounts and calculation methodologies of each type of fee and expense and their total amounts will vary depending on the investment strategy, the status of investment performance, period of management and outstanding balance of assets and thus such fees and expenses cannot be set forth herein. | **PIMCO Taiwan Limited** is managed and operated independently. The reference number of business license of the company approved by the competent authority is (107) FSC SICE Reg. No.001. 40F., No.68, Sec. 5, Zhongxiao E. Rd., Xinyi Dist., Taipei City 110, Taiwan (R.O.C.), Tel: +886 (02) 8729-5500. | **PIMCO Canada Corp.** (199 Bay Street, Suite 2050, Commerce Court Station, P.O. Box 363, Toronto, ON, M5L 1G2) services and products may only be available in certain provinces or territories of Canada and only through dealers authorized for that purpose. | **PIMCO Latin America** Av. Brigadeiro Faria Lima 3477, Torre A, 5° andar São Paulo, Brazil 04538-133. | No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission. PIMCO is a trademark of Allianz Asset Management of America L.P. in the United States and throughout the world. ©2019, PIMCO.