‘Fat fingers’ or bear attacks - and US politics

The week started hesitantly, with a prominent media story discussing the possibility of ECB monetary policy turning less accommodative, together with an increasing chorus from Fed officials voicing the need to raise US interest rates. The end of the week also saw a significant attack on Sterling, which overshadowed the US Non-Farm Payroll numbers. The US dollar was firm in the growing belief that US interest rates are set to go higher. Otherwise, at the weekend, the making public of rather lewd comments made against women by Republican presidential hopeful, Donald Trump, raised speculation that his candidature may be coming to an end, with many Republicans calling for him to be dropped in favour of running -mate Mike Pence. Trump quickly hit back, saying that he “100% would not be dropping out”. Meanwhile, the IMF published updated growth forecasts confirming that emerging markets are taking the growth baton from developed nations. Accordingly, they say that world growth is still expected to expand by 3.1% this year, with 3.4% in prospect for 2017.

‘Sterling just needed a push, that’s all’

In foreign exchange markets last Friday, Sterling traded down very sharply in thin volumes in Asian trading. It was already on the back foot throughout the week, failing to hold recent lows of \$1.28. A sharp sell-off ensued, with newswires reporting a low of \$1.1841, down from the previous US close in the region of \$1.2630. Unofficial reports suggested it may have traded down to below \$1.14. So what prompted the sell-off, or allowed it to happen? Firstly, it was a tough week for British Premier, Teresa May. The markets appear to have finally realized that a so called ‘hard’ Brexit will not be at all palatable. Earlier in the summer after the shock Brexit result, there were hopes that the UK might be able to remain in Europe’s single-market in the way that Norway does, providing more stability to trade and keeping the UK’s interests in Europe very much alive. Instead, immigration matters have been prioritized, ahead of participation in the single-market, with no interim ‘Norwegian-style’ solution. The UK’s financial services industry (about 12% of GDP and just over a million UK jobs) will not receive any special treatment upon Brexit. Article 50, starting two years of negotiations, will begin no later than the end of March next year. It could be a very difficult, ‘clean break’ divorce from Europe. French President Francois Hollande on Thursday echoed this, highlighting that the rest of Europe would see this through. He hinted at tough negotiations, and perhaps the making of an example out of the UK to deter other members from leaving. **He added, "If not we will put into question the EU's principles”.**

Markets took fright. Sterling’s recent technical support gave way, with some now even suggesting that parity to the US dollar may be imminent. Quite good recent economic news was brushed aside in the process. US dollar-earning multinational companies (making up a high percentage of the FTSE 100 index) led to that index rallying 2.1% over the week, despite Sterling’s collapse. The yield on 10-year UK government gilts rose strongly by 11 basis points, to 0.98%, on expectations the Bank of England now has little or no scope for an interest rate cut. In fact, rates may now be forced to rise, to protect the currency. **Pre- the Brexit result we said that if Brexit were to happen Sterling could fall towards \$1.20. A fall below the \$1.20 level (it closed at \$1.2434 on Friday) cannot be ruled out after last week’s market action. With that in**


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mind we would caution investors against being over-exposed to the currency, especially after the dip to below \$1.20 and the unconvincing recovery later that day. On a technical basis there is no support until \$1.05, the record low back in 1985, and that is arguably of little relevance today. We would advise SELLING Sterling into any rally.

‘Will the ECB ‘taper’ - or won’t they?

A Bloomberg story early last week, sourced from ECB officials who did not want to be identified, caused quite a stir in the markets, mentioning as it did the possibility of ECB bond purchases being reduced (‘tapered’) by €10 billion/month once the decision is made. The so-called ‘taper tantrum’ of 2013 after the Fed winding-down of its final phase of quantitative easing caused a large up-move in bond yields, and markets are naturally concerned that something similar could happen again - and especially in the absence of decent economic growth in the developed world. The emerging world is now thought by some (including ourselves) to be more immune to such an occurrence, although it is still a matter of degree. Recently both the BoJ and the ECB essentially decided to stand pat on their QE programs, fueling suspicions of reductions in the absence of statements to the contrary. These QE programs have kept the patients alive, but have not been successful in driving growth, which requires the return of business confidence. At the same time the ECB can do without any Deutsche Bank-style deterioration at this time, and we foresee an end to zero rate policies, at least in the eurozone. We have no doubt that monetary experts at the ECB are working flat-out on how to 'twist' out of QE gradually, and in ways likely to minimize market concern. Having said all this, the minutes of the early September meeting of the ECB's Governing Council did confirm its support for extending the QE program beyond March next year, saying that there was the "willingness, capacity and ability to act" to achieve its inflation objective. **For the moment the ECB is neither confirming nor denying, saying that such further discussions have not taken place.**

The week started well for US economic data, with news that the ISM Services PMI in September came in at 57.1, vs. expectations of 53.0, and after a fall in August, showing broad-based improvement. Importantly, the ISM Manufacturing PMI for September rose to 51.5 (vs. expectations of 50.4, and 49.4 the previous month), hinting at a recovery in manufacturing. Factory output has been a weak spot for the US economy, but last month within this data the new orders sub-index rose to 55.1, from 49.1 in August, and the production index also rose, from 49.6 to 52.8. The private sector ADP payrolls - at 154,000 new jobs last month (vs. 166,000 expected) - were this month a good guide for Friday's September NFPs, which came in at 156,000, below the average forecast of 172,000. So these were slightly lacklustre. The headline unemployment rate firmed to 5.0%, from 4.9%, reflecting an increase in the labour force. **The NFP numbers did little to change the perception that rates were more likely to rise in December than not, with Bloomberg's implied probability edging up to 64.3, from 63.4% the previous day.**

'Our AA Committee added to its Gold overweight'

Gold and the rest of the precious metals suite had a difficult time last week, faced with the factors discussed above - a clearer perception regarding a Fed rate hike (based on net-hawkish commentary), the Bloomberg ECB tapering story, and a firmer dollar derived initially from the US PMI data. There can be periods when Gold in dollar terms can withstand a firmer dollar or expectations regarding this, but last week was not one of them. Gold closed at $1,257.08, down from $1,315.87, for a fall of 4.5%. Silver's experience was much worse, with the price closing just above our two-day closing stop level of $17.50 (deemed to be strong support), at $17.5463, 8.5% lower over the week. We believe that many of the weak holders have now been shaken out of both metals, and that they are now technically oversold. Religious holidays and China's Golden Week played their part in that volumes were low. Gold is now trading close to support in the $1,350/60 area. **Last week our Asset Allocation Committee decided to increase its overweight position in Gold, by reducing cash. All other aspects of investment strategy remain unchanged.**

WTI maintained a firm tone last week, closing at $49.81, up 3.2%. Some of the optimism from the accord to cut production by OPEC members in Algiers dissipated by the end of the week, however. Members could collectively cut output by about 700,000 million barrels/day, with more work to be done on this, probably on the sidelines of this week's World Energy Congress in Istanbul. Of course non-OPEC members can be expected to attempt to increase production further to take advantage of firmer prices should that occur. US crude inventories fell 7.6 million barrels in the previous week, according to the American Petroleum Institute. Investors are hoping to see US Department of Energy crude inventories sustain their recent fall below 500 million barrels. US oil production appears to have stabilized at just under 8.5 million barrels/day, with a minimal recent increase in the Baker Hughes rig count. Over the weekend Hurricane 'Matthew' was heading for Florida after devastating the Caribbean nation of Haiti, causing some concern over oil supplies to the South-Eastern US and keeping prices firm. **Overall, events in the oil markets last week keep our view mildly bullish, with an expectation that the upper end of our forecast range (i.e. $55 basis WTI) could be tested in the months ahead.**

ELSEWHERE: Exit polls in Georgia's elections over the weekend suggested the incumbents, centre left 'Georgian Dream', had the edge. In the Middle East, IMF Managing Director, Christine Lagarde, stated Egypt had 'almost completed' the actions required for the payment of an impending $12 billion loan to the country. S&P reaffirmed its rating on Friday for Saudi Arabia, at A- with a stable outlook. The rating agency highlighted that Saudi authorities will take steps to prevent any deterioration in the government's fiscal position, and that balance sheet positioning remained strong for the coming few years. India's Reserve Bank cut its central repo rate by 25 basis points, to 6.25%, a vote of confidence in its economy.

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