NBAD

From West to East

Weekly Investment View

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Many resolutions due

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The rally in the S&P500 earlier in the week, based on an initially lower dollar and better energy prices, failed to result in US equities breaking out of their recent range, with the better-than-expected April retail sales leading to bearish rather than bullish conclusions. The S&P closed 0.5% lower over the week. Eurozone stocks ended the week 1.1% firmer, helped by a weaker euro, and ignoring weak industrial production data. Japanese stocks took comfort from a weaker yen, and rose 1.9% over the week. Chinese stocks were about 2.3% weaker on average, following on from the economic concerns of recent weeks, and as suggested by correcting industrial commodity prices. Reflecting the more risk-off tone in other markets, as well as good demand at the US 10-Year Treasury auction, the 10-Year yield fell by 8 bps, to 1.70%. The 10-Year Bund yield closed at 0.12%, close to its all-time low. The dollar firmed by 0.8% in terms of its DXY index, back up to significant resistance at close to 94.56, helped by the retail sales data. Oil price gains were contained to 3.5% on WTI (currently at $46.21), and with Brent at $47.83, on balance capped by a firmer dollar and Canadian oil-sands re-starts. Gold recovered to $1,273, helped by a good statistical update and brushing aside late dollar strength.

'Expectations of a June rate hike still very low'

The eagerly-awaited US retail sales for April came in at +1.3%, month-on-month. Excluding autos, gasoline, and building materials, the 'core' increase was 0.9%, on the face of it still a very good number. The improvement in the top-line number was led by autos, gas stations, and website-based retailers, and contrasts very much with the results from most US department stores (as well as Gap, for instance), whose figures (and subsequent stock price movements) were very much on the downside. Selling goods online is obviously less profitable than in-store sales, and it is far more competitive. Most analysts were caught-out by these numbers, and it remains to be seen whether there were exceptional circumstances, like heavy discounting by auto dealers. ***We need more than just one month's data to see what the real picture is - although it is being underlined that much of the traditional US retail sector is suffering from over-capacity, and that their business models appear hopelessly out-of-date.***

Eurozone industrial production unexpectedly declined 0.8% month-on-month in March, featuring falls in both consumer and capital goods. German industrial production (the 'core', excluding energy and construction) fell 1.3% month-on-month, compared with expectations of -0.2%, and with a negative adjustment for the prior month. Given the importance of Germany (at just under 28% of eurozone GDP), this has raised concerns about stalling growth. In France, manufacturing production for the same month fell 0.9% month-on-month, vs. expectations of -0.6%, with output having been negative in four of the last six months. Again, the weakness in March was apparently broad-based, affecting many sectors. ***Such data - although admittedly a bit historic - paints a picture of continued low growth at home and in global export markets.***

'UK voter will be too scared to Brexit'

As the Brexit voting deadline of 23rd June gets nearer, the institutional 'powers that be', are weighing-in on the side of maintaining the 'status quo'. As if Brits hearing that the latest Halifax UK house prices index had come in at -0.8% (compared to the -0.3% expected) was enough to have to stomach, they were then frightened by repeated salvos of advice to 'Bremain'. Mark Carney, the Governor of the Bank of England, who only quite recently attempted to remain aloof from the discussion, has warned against the dangers to UK growth of a Brexit. Christine Lagarde at the IMF has also warned of the dangers. Moody's, too, has warned about the likelihood of slower medium-term growth upon an exit. Prime Minster Cameron a week or so ago argued that the UK would be safer in the EU, and he knew exactly what he was saying, clever politician that he is. His close colleague and friend, the Chancellor of the Exchequer, George Osborne, said last week that the Treasury has started contingency planning in case it is necessary to shore-up Britain's financial system in the unfortunate event of an 'Out' vote. He told MPs that he and his colleagues were working with the Bank of England to counter the possibility of extreme volatility in markets, and that the Treasury needed to be involved "if taxpayer support was to be required", and that "There's no coming back…". ***Being in the EU may very well have costs and disadvantages, but is it really any wonder that - after all these scary news-clips - the latest YouGov Brexit poll favours 'In'?***

China's consumer inflation (CPI) rose 2.3% year-on-year in April, in line with the consensus forecast, and March's reading. Although still below the government's target pace, the CPI confirms a positive trend in inflation. In addition, Chinese wholesale prices fell 3.4% year-on-year, better than forecasts and compared to March's 4.3% fall, although presumably reflecting higher basic materials' prices over that period (which have subsequently reversed, with steel having been especially weak). Chinese trade shrank in April, with exports falling 1.8% from a year earlier, and imports dropping 10.9%, leaving a trade surplus of $45.6 billion. It was probably the imports figure that unnerved the markets the most, against the background of continued high bank lending and money supply growth being used to avoid a 'hard landing'. Growth in China fell to an annualized 6.7% in the first quarter. Last week we attended a conference hosted by the Economist Intelligence Unit, in which they said they expected Chinese GDP growth to slow towards the 4% mark within two or three years. This figure is in line with our own assumptions, and if it turns out to be accurate, the *quality* of growth should be much higher than previously. According to an article in the Chinese 'People's Daily, China's economic growth will be 'L-shaped', rather than 'U' or 'V'-shaped. It told investors not to expect more monetary stimulus as the authorities don't want the economy to grow via bubbles. ***For the time being, local and international investors will probably continue to avoid Chinese equities. We retain a minimal absolute exposure via our models, while we continue to track the fundamentals.***

'Increasing our average oil price assumptions'

The fundamentals of the oil markets are arguably becoming more complex than they have been for a number of years. After what has been a huge rally off the bottom of the trading range we suggested in January of $25-45 on WTI, what happens now? We said the lower limit of any range should be raised, firstly to about $28, and very recently to $33. Until a week or so ago it was unclear whether the $45 level would be convincingly broken - but this was exceeded by a few dollars last week, suggesting we re-think our assumptions. Canadian oil-sands production is coming back on, partially offset by production outages in Nigeria totalling about 400,000 mb/day, which look more and more permanent. Shell is evacuating workers from the Niger delta because of poor security, a union official has said, leaving oil production there at the lowest levels in about 25 years. Meanwhile, Saudi Arabia, following the replacement of its oil minister, has made it clear that oil production will be increased, perhaps to above 11 mb/day. On the demand side, the International Energy Agency has left its forecast for global growth in oil demand broadly unchanged at 1.2 mb/d for this year, but said the risks to this were to the upside. Last week US oil production fell for a ninth week, to 8.8 mb/d. The Russian Energy Minister, Alexander Novak, recently said he thought the global oil surplus stood at 1.5 mb/day, and that the market might not balance until the first half of 2017. ***We are increasing our WTI price assumptions to averages of $44 for 2016, and $57 for 2017, from $38 and $47 respectively. For Brent, add $1-2/ barrel.***

Trading in many markets is about to become quieter and thinner due to seasonal and also because of cultural factors related to the Holy Month. Our TAA Committee meets later this week, and we wouldn't want to pre-judge any of its conclusions, hence investment strategy remains essentially unchanged, and in the meantime very well-balanced and risk-averse. In US equities, the bell-weather S&P500 has still to break out of what has become an increasingly narrow range, despite investors liquidating holdings in global equity funds at the fastest rate since 2011, according to the FT. Meanwhile, the US dollar has bounced during the last week, although it remains unclear which of the central banks will win the currency war, in a period during which investors are less and less able to determine which of those institutions still retain some semblance of credibility. ***Safety first appears the best policy for the moment, pending various outcomes (relating to Greece, Spain, of course the possible - although unlikely, we think - UK Brexit, leading to the US's November election). A full weighting in quality bonds seems a good idea, and an emphasis on income and yield generally as a means of preserving capital until many of the clouds on the investment horizon clear. We expect the fourth quarter of the year to be rather more decisive and positive for risk assets, and correct positioning coming into that period will be crucial.***

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