NBAD

From West to East

Weekly Investment View

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Hoping for limited data dependence at Jackson Hole

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The S&P500 closed fractionally lower at the end of a fairly nondescript week. Eurozone equities closed about 1.7% lower, led by banks. Japanese stocks did worse, as exporters were hit by a yen threatening to strengthen below 100 to the dollar. Chinese stocks were a standout (within generally firm emerging market equities), rising by just over 4% in terms of the CSI300 index, as recent concerns regarding China began to be offset by more positive factors - like global investors being underweight. For much of the week the dollar was looking to the downside, if not markedly, partly reflecting the dovishness of the minutes from the recent FOMC meeting not being fully countered by the hawkish remarks of individual Fed officials throughout the week. The dollar closed 1.4% lower on its index. The price of WTI and Brent oil continued to firm during the week, with the former last quoted at $48.52, and the latter just above $50/barrel. The yield on the US 10-year Treasury firmed by a little under 2 basis points over the week (to 1.5781%), with the yield on the US 2-year almost static at 0.7460%. Janet Yellen will be speaking at the Jackson Hole symposium this Friday, and investors will be hoping for some guidance after further evidence that the Fed is suffering from a lack of consensus on rates, and that rate 'normalization' might be seriously compromised.

'Can the dollar get through this weak patch?'

By the weekend it was looking as though Fed officials Lockhart and Dudley (especially) had taken it upon themselves to counter the lack of consensus apparent in the minutes of the last FOMC meeting, and to prepare the markets for an imminent rate hike. Almost, 'we are actually not behind the curve after all'. They know investors have not really believed the Fed is serious about raising rates, and so don't want to avoid consternation in the markets if or when it finally happens. William Dudley expects the economy to improve in current half year, and has said an interest rate increase as early as September is "possible". Atlanta Fed President Dennis Lockhart said that recent economic data justifies the "serious discussion of a rate increase". A dovish paper from Federal Reserve Bank of San Francisco President John Williams, on the other hand, suggested the Fed should consider new tools to tackle sluggish economic growth, including raising the inflation target (from the current 2% level). In the nature of markets - and having grown bored with hearing about 'data dependency' - by the end of the week dollar bulls were left feeling rather uneasy.

If FX market operators decided to gun for the stops of the yen shorts, that would eventually lead to the Bank of Japan powerfully intervening in the market, perhaps closer to the 95 level vs. the dollar. Turning to the euro, despite the negatives the currency looks capable of rallying. In the case of sterling, even here it looks as though recent bearishness could be overdone, given a more thoughtful Brexit than originally envisaged by many (and we were surprised by the good July retail sales, although would like to know the extent to which they were boosted by foreign visitors). Coming back to the Fed, and its thinking, we can only hope that the Jackson Hole discussions really do centre on whether current monetary targets are realistic, and/or whether they should be amended. Like others, we will be picking our way through any clues from Ms Yellen's speech.

'Can Donald Trump really turn it around?'

We were interested to see a summary of a paper written last year by Michigan State University's political expert, Corwin Smidt, containing the estimate that the 'swing' voter in the US is 5% of the electorate (down from 15% in the '60s). If this is correct, it is bad news for Mr Trump, as it seems there are only a limited number of those who can 'swing' towards him. We know that Mrs Clinton wants to raise the minimum wage, provide free public college education, deepen social security, tighten gun policy, and to be much harder on Wall Street. Mr Trump is maintaining his 'Put America First' message, as regards a tough attitude towards trade policy (e.g. with China), on immigration, the reduced protection of NATO allies, and huge tax cuts. For him, the emphasis appears to have been about attracting Democratic white voters in working class states; if he can 'pivot' successfully to win over other voters or powerful interest groups, only then can he improve his chances of winning the race. If Trump does not pivot, Mrs Clinton will probably be able to garner disaffected moderate Republicans aghast at the reality of the Trump persona, the changes in his campaign management team, and a growing sense that the GOP has allowed itself to be wrecked (at least for the immediate years ahead). The campaign can now be expected to get far dirtier than most of us had believed. There is always the possibility of a genuine accident, or a recurrence of hidden health issues. The Trump campaign now has new advisors. Can they turn things around? The New York

Times 'Upshot' model gives Hillary Clinton an 86% chance of winning the presidency, down from 88% this time last week.

Emerging markets (both equities and bonds) have taken up many column inches in recent days (e.g. on the front page of the FT Weekend). Capital Economics has highlighted that after a prolonged downturn, there are "early signs that EM industry is finally starting to turn a corner". Their measure of EM industrial production growth picked up to 2.4% year-on-year in June, from 2.2% in May, for a second month of acceleration. They comment that the latest rise was driven by the BRICs (Brazil, Russia, India & China), with industrial production strengthening in all of these economies in June. While industrial data for July from China and Russia was on the soft side, they note that the Markit EM manufacturing PMI has risen to its highest level since February 2015, "suggesting the recovery is likely to continue". The reading has moved above 50, into the 'expansion' zone. Capital Economics also gains comfort from recent buoyant EM retail sales growth (at its fastest rate since 2014). As the FT reported, EM funds have been attracting money at an increasing rate in recent weeks. Clearly, investors have been diversifying, although much of the new money appears to have been applied rather indiscriminately, via ETFs. EM equity funds are said to have seen inflows of $5.1 billion during the week ending 17th August. The bears of emerging markets will say that they will be damaged at the first sign of the Fed hiking rates, and that fund inflows can easily reverse. Although we would usually hate to say this, we do think 'this time it's different'. Of course investors have to be selective. Although growth in EMs can find it more difficult to reach investors' bottom lines, the growth rates in the emerging (and frontier) world are that much higher on average to start with. In time, China will rise, despite its problems, and the emerging world will be trading much more with… the emerging world. We will stay with these themes in the weeks and months to come.

'Moderate house price inflation could lead to feel-good in China'

Chinese house prices rose 7.9% year-on-year in July, the fastest increase since early 2014. House prices in Shenzhen and Xiamen did best, each up about 40%. Although the Chinese authorities are believed to be doing their very best to calm down any asset bubbles that appear, we think firming real estate prices will be helpful in the planned overall move towards a more consumption-led economy. At the same time, President Xi Jinping has been calling for steady advances in the 'One Belt, One Road' initiative, centreing on targeted infrastructure and related cooperation. For foreign investors, confirmation of the Shenzhen-Hong Kong exchange link enables investors in Hong Kong to be able to buy stocks listed the Shenzhen stock exchange, home to many of the country's technology and consumer companies. Some have questioned the effectiveness in reality of the Link's predecessor, the Shanghai-Hong Kong Link; either way, this kind of initiative should be welcome as a further means of liberalizing and opening China's markets to overseas investors. As always, 'buyer beware'. International investors are underweight in Chinese equities, and over time the index weights will increase.

In India, Prime Minister Modi has announced the successor to Raghuram Rajan, the country's departing central bank governor. It is Urjit Patel, the deputy in charge of monetary policy to Mr Rajan. The FT describes Mr Patel as 'a safe pair of hands', and consistent with monetary policy continuity, all of which is good news for India.

'Neither sell - nor buy - oil assets at $50'

In oil markets, the price of WTI has rallied towards the top of our recently-adjusted range of $40-50 for the immediate months ahead. We regard next month's possible meeting of oil producers in Algeria skeptically. Prior to this it seems likely that Saudi Arabia, Russia and Iran are producing flat-out. More bullishly, however, US inventories of crude oil fell last week, driven by strong demand; the EIA estimated that commercial oil inventories fell by 2.5 million barrels last week, vs. expectations for a 0.5 million barrel increase. Also, US gasoline stocks - which have been weighing on oil prices - also fell, by 2.7 million barrels, more than the expected fall of 1.6 million barrels. At the same time, however, the Baker Hughes rig count rose for the seventh consecutive week last week, so there continues to be a supply-side response. We would not add to oil-related assets at current prices.

INVESTMENT SUMMARY:

It is very true that with all the QE in recent years, and the resulting effects on how long a bull or bear market might last, relative to history, we live in strange investment times. As the FT has pointed out, S&P500 earnings have just fallen for four quarters in a row, and that such events are usually accompanied by bear markets. John Authers observes that during the bull run in recent years US equities have twice corrected by more than 10%, although they have technically avoided a bear market. He is worried about the markets, and he might well be correct. But we don't yet think it's correct to 'fight the (stock ticker) tape'. The same can be said about bonds, with more commentators and managers talking about a possible - and rapid - reversal in markets. Accordingly, investors in equities should not pay too much for growth, while in bonds they should not think it's fine to buy quality issues on historically very thin (or even approaching zero) yields. Our investment policy remains unchanged. The NBAD Asset Allocation Committee meets later this week.

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