'FOMO' (the fear of missing out)

The S&P500 index continued to climb, by a further 0.5% last week, despite some significant results misses in the technology sector. As we have pointed out in recent weeks, market technicians have identified something of a 'stand-off', with a resolution expected in the weeks to come. US corporate earnings have been falling, and the economy is slowing. The index closed 1.8% below its all-time high of last May. Alphabet, the parent of Google, published results that disappointed, so did Microsoft (especially) and Starbucks. In contrast, the market was pleased with 'old world' companies' results such as those from GE, Caterpillar, McDonald's, and Disney. Generally speaking, the market view that interest rates will remain 'low for longer' has - at least theoretically - gone some way to justifying historically high P/E ratios.

'An interesting battle building between dollar bulls and bears'

Perhaps the most notable occurrence of the week in the markets was the price of oil closing very firmly, above $45 on Brent and $43 on WTI (see below). Elsewhere, in forex markets the yen weakened (seemingly on the possibility that the BoJ may fund some loans at negative rates), as did the euro, following a lack of any new signals from the ECB after its latest pronouncement (i.e. no new actual change to existing monetary accommodation, with rates left unchanged). The dollar remains at a critical juncture in terms of these pairs, and more generally on its trade-weighted index, with an interesting battle building between dollar bulls and bears.

In the US, new housing starts fell during March by more than expected, at 1.089 million (vs. 1.166 million expected). Starts on single-family homes fell by 9.2% month-on-month, to 764,000 from February's multi-year high, and multi-family starts fell 8.5% to 312,000. New building permit applications, signaling construction in the pipeline, fell 7.7%. Existing home *sales* rose in March, by 5.1% (vs. expectations of +3.9%), but February's figure was revised downwards to -7.3% (from -7.1%).

'German investors expect conditions there to improve'

The ECB in its policy statement of last week left interest rates and the current stimulus program unchanged, although it did confirm June as the start month for its purchasing of corporate bonds. ECB President Mario Draghi reiterated that they would use "all instruments available" to achieve its inflation objectives. Specifically in Germany, April's ZEW investor sentiment survey was very positive, with the expectations component registering +11.2 (vs. +9.0 expected), and compared to +4.3 in March. Investors clearly expect future economic conditions to improve, despite perceptions of current conditions deteriorating to 47.7 (vs. 50.8 expected), and from 50.7 last month. It is clear there remain significant policy differences between the ECB and the German Finance Ministry.

Turning to the oil markets, these demonstrated a classic 'bullish divergence' last week, with prices rallying strongly following a move downwards into the high $30s in the wake of the failed Doha talks (and the resolution of the Kuwait strike). We have argued that the oil market is tracing out a bottom, although initially within the context of a $25-45 trading range. A few weeks ago we suggested that although the higher level was still intact, the lower level had crept up a few dollars (to about $28 or so). There are now grounds to think that this could now be in the region of $33, give or take a dollar either side.

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

'In reality, there are various limits to global oil production'

There must be considerable doubts that OPEC can collectively produce more oil. Within OPEC, Venezuela is in deep economic trouble, Nigeria has suffered outages due to militant attacks and poor infrastructure, and Iraq and Libya have been unable to

capitalize on their very large production potential. Iran may in reality be hampered by a severe shortage of storage space (even if it could pump much more crude), as many of its tankers have been used for this purpose, rather than to transport the end product, and there are doubts that all of these are fully seaworthy. Against the above, Saudi officials said last week they could increase output by as much as 2 million b/day (to over 12 million). Meanwhile, OPEC's secretary-general has said the organization may revive discussions regarding freezing oil production, with non-members, at its June meeting.

Outside OPEC, Russia has in recent months boosted production to a record, but the underlying truth is that most of its producing fields have been poorly-maintained and are in decline. Also, as an excellent article in the Daily Telegraph last week pointed out, oil production is collectively falling, 'in China, Latin America, Kazakhstan… and the North Sea'. Certainly, US shale-based production is now falling, such that the US Energy Department expects total domestic output to fall to 8.6 million barrels/day this year, from 9.4 million last year. The US Energy Information Administration said that US crude production fell for the sixth straight week last week, to 8.95 million barrels; US output peaked at 9.70 million barrels a day last April.

'Buy oil assets on dips towards $33, looking to 2017'

On the demand side of the oil equation, China's crude imports in March were the second-highest on record. China's government said that crude-oil imports in March were up 21.6% from a year earlier at around 7.7 million barrels a day, reflecting official stockpiling as well as local refineries wanting to take advantage of historically low prices. In addition, recent indications of oil demand out of India have been very good. ***We make no excuse for writing even more than usual about oil this week, given that last week was so notable, with the conclusions being that (1) any dip towards $33 on WTI should be bought into by patient investors on a six-to-nine month view, and (2) that closely-related asset classes such as MENA equities and bonds should be firmly held.***

Our Tactical Asset Allocation Committee met last week, and left its investment policy unchanged. The summary details are as follows: (1) Overweight in Fixed Income, and within that emphasizing Emerging Market Debt; (2) Marginally Overweight in Global Equities, with the only real divergence from neutral being an overweight in Global Emerging Markets, partly reflecting a more constructive attitude towards China; and (3) Underweight in Alternative Investments, pending a review currently underway in hedge funds and commodities, although remaining neutral in gold.

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