NBAD

From West to East

Weekly Investment View

31st July, 2016

‘Never sell a dull market’ - especially after new highs?

The S&P500 index closed 0.1% lower over the week, marginally below its closing all-time high of the previous week. There were a few occasions during the week when it looked as though at least some intermittent weakness would endure - but that simply didn’t last, probably helped by high cash levels in many portfolios, and eventually a bout of weakness in the US dollar boosting foreign earnings upon translation, if sustained. The dollar came off at the end of the week following marked yen strength after the Bank of Japan’s stimulus package disappointed, and also due to US economic growth for the second quarter coming in below expectations (at a 1.2% annualized rate). The Federal Reserve in mid-week said they would (as expected) leave interest rates unchanged, and that risks to the US economy had lessened since its last meeting. They did, however, leave the possibility of a rate hike before the end of the year open, clearly data-dependent. Other notable features were weaker oil prices (with WTI currently quoted at $41.60/barrel), and a firmer gold price, at $1,351.28. Overall, though, what almost certainly buttressed equity markets was a series of good (and in some cases excellent) second quarter US corporate results from the likes of Amazon, Facebook, Alphabet (Google), United Technologies, Texas Instruments, and Caterpillar. Eurozone equities rose by 0.6% over the week, while Japanese equities recovered some ground to close 0.3% lower, and despite yen strength.

‘S&P500 earnings estimate revisions have continued to be positive’

S&P500 estimate revisions have continued to improve, with analysts now expecting 10.24% earnings growth in the current year, to $117.80, according to Bloomberg. We cannot say enough just how supportive this is for the market. Also, NASDAQ stocks have been doing very well, with various of the ‘tech’ stocks benefitting from excellent advertising revenue growth. As the FT put it, ‘The week that Big Tech shook the ad world’. This is in line with the bullish sectoral rotation that we have been looking for.

There was a raft of US economic data last week, the most important of which were probably the consumer confidence indicator from the Conference Board, durable goods, and the estimate of second quarter economic growth. Consumer confidence fell from a reading of 98.0 in June, to 97.3 in July, vs. expectations of 95.9. GDP growth was an annualized 1.2 % in the second quarter, with a downward revised 1.8% for the first quarter. Analysts had been looking for 2.6% growth , in line with the regional Fed ‘Nowcast’, and above another regional Fed model expecting 1.8%. It is not just emerging markets which have difficulties with GDP data. In this case there was a contribution of -1.2% from inventory adjustments (destocking), which can admittedly be very difficult to forecast, and a contribution of -0.5% from fixed investment (Janet Yellen said the Fed was worried about this last week), and a 2.8% contribution from the consumer. Although historic data, it nonetheless rattled the markets. In time the industrial destocking will reverse.

‘The market had wanted the BoJ to be very irresponsible’

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

Regarding Japan, the markets had been expecting the announcement of some really aggressive action by the Bank of Japan last week, but was very disappointed. Rates were left unchanged, and EFT purchases modestly increased. Prime Minister Abe had already announced a Y27 trillion stimulus package to be funded by an extra budget, with further details to follow this week. It has already been a considerable monetary experiment, with some analysts believing that somehow it ‘would be different this time’, and that after numerous attempts to re-float the flagging Japanese economy over recent decades, this would finally work. Japanese growth remains very low, suffering from weak external and domestic demand, as evidenced by the latest trade figures for June. The headline trade data beat expectations, but exports fell 7.4% year-on-year, while imports fell 18.8%, for the eighteenth consecutive month.

The Chinese markets continue to go through their trials and tribulations.

China's CS300 index was volatile during the week, but closed above its lows after a plunge on Wednesday, down just under 1% over the week. There was talk in the markets that the China Banking Regulatory Commission intends to curve commercial banks' wealth management products. Also, there was concern that the China Securities Finance Corporation may have to refinance 2.7 trillion yuan in loans ($410 billion) due next month. If it has difficulty rolling-over any such loan, it may be forced to sell stocks it bought last year to support the market during its market crisis. We will continue to try to separate fact from rumour, although for those who wondered why Chinese stocks were weak, these factors were relevant, according to our sources.

'Lower oil prices are sowing the seeds of lower future production'

In oil markets, US crude inventories rose by 1.67 million barrels in the previous week, as output rose, according to the energy information administration, vs. the expectations from a Bloomberg survey of a 2 million barrel fall. These statistics followed the bearish API statistics published a day or so beforehand. Elsewhere, Iranian production is said to have been surprisingly strong lately, while the likelihood was growing at Libya's Petrolium Facilities Guard would end their blockade and resume exports as soon as the National Oil Corporation formally agrees to meet workers' demands. However, our colleagues in NBAD Global Markets have drawn attention to a report from reputable research firm, Wood Mackenzie, a major conclusion of which was that further planned capital expenditure reductions of about $150 billion over the next 12 months by US oil majors would cause oil production to decline by 4.2 million barrels - day by 2020. This will also be mirrored globally, and is expected to total $370 billion in 2016 - 17, with resultant significant loss of production capacity. Our view is that current prices in the low $40s will represent good value by the year-end. There is the chance of a spike below $40, but we would expect this to be short-lived.

INVESTMENT SUMMARY:

Our Asset Allocation Committee (AA) met last week, and decided that investment policy should remain unchanged. The overweight position in US equities was reviewed, with the conclusion that it should remain in place.

For any inquiries related to this article, please contact Alain.Marckus@nbad.com

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