Cruising towards year- end, with risk assets looking good

In markets last week probably the two most important items were the – almost surprise – agreement reached between the UK and EU regarding the Brexit discussions now being able to progress from the 'divorce settlement' stage, onto matters of trade - and the US non-farm payrolls. In the US a 'not too hot, not too cold' rise in US non-farm payrolls for November kept risk asset markets happy, although wage gains (of 2.5% year-on-year) disappointed market participants. It would have taken a really significant divergence from expectations, however, for the Fed to do anything but raise the Fed funds rate by 25 basis points at their policy meeting this week (to a mid-quote within the band) of 1.38%. **This will be one more brick in the 'normalization wall', and the markets have for some weeks already signed it off.**

"Risk-on in equities wobbled, but now looks back on track"

In equities, the bell-weather S&P 500 index returned to making steady upward progress over the week as a whole, closing up 0.35% at a new all-time high of 2,651.50, the result of the participation of a fairly broad range of sectors, including energy and healthcare - with technology coming good at the end of the week. This fresh new high was not matched by the main NASDAQ indices, which still had to properly recover from a (refreshing!) set back in tech stocks earlier in the week. In Europe, the STOXX Europe 600 index closed 1.38% higher, led by banks, and generally encouraged by the renewed progress in the Brexit talks. In Japan, the TOPIX closed marginally firmer over the week, latterly helped by real estate stocks, with that index once again above its 2007 peak, and above the 'roundaphobic' 1,800 level that some players seem obsessed with. Turning to Asia-Pacific (ex-Japan), the MSCI index of the same name closed 0.53% lower over the week, reflecting continued further moderate profit-taking, including in Chinese equities, after months of good gains for this asset sub-class. As our readers will be aware, this is the largest overweight position in regional equities held by the FAB Asset Allocation Committee. There was relative calm in fixed income markets last week, which once again tended to reflect renewed 'risk-on' positioning in equities. A Fed rate hike this week will, we think, probably be followed by three in 2018, taking the mid-value target Fed funds rate to 2.12%. However a few short rates and spreads in the markets still suggest only three-to-four rate hikes before the end of 2019, and while expectations will always be in a range it does look as though the average market participant expects only 3-4 rate hikes before the end of 2019 – let alone before the end of 2018. Our own expectations regarding the US economy are a bit more bullish than average, providing part of the reason why we think markets will be behind the curve on rates. Last week saw little overall movement in the US Treasury 10-year yield, which firmed slightly to 2.3760%; with the yield on the US 2-year also rising slightly (to 1.7945%); the 2-year vs. 10-year yield curve slope continued to flatten, to 0.5815%, from 0.5895% at the end of the previous week. The Japan 10-year yield firmed to 0.0530% (from 0.0350%), although remains well anchored quite close to zero. **The Bloomberg Barclays Global-Aggregate bond index (unhedged) in US dollars closed 0.47% lower last week, reflecting a return of 'risk-on' in other asset classes – although with no confirmation that the big bull trend in place for three decades or more is coming to an end.**

"Mrs May still looks under great pressure"

In foreign exchange markets, the dollar was 1.09% firmer on its index over the week, at 93.901, helped by a net-positive expectation for US tax reform being reconciled successfully between the House and the Senate, together with recent continued up-beat US growth statistics seemingly offsetting continued background concern about FBI investigations impacting the White House. Sterling, if the market had been looking for an initial broad conclusion in the financial settlement, decided to 'sell the news' that a roadmap had been arrived at. As Nigel Farage, ex-leader of the UK Independence Party said, however, it does look as though the whole process is belittling for the UK, with the British Prime Minister looking as though she is being pushed about by "un-elected bureaucrats in Brussels". In the initial heat of the short-term moment, cable quickly rallied to above $1.35, only to close the week at $1.3390, 0.65%

lower over the week. The euro was 1.03% lower against the dollar, at $1.1773, and the yen was similarly weaker vs. the dollar, at ¥ 113.48. In commodities, traders had tried to sell oil down earlier in the week, but prices rebounded, with Brent crude only 0.52% lower on the week, at $63.40, and with its spread above WTI recovering to just above $6/ barrel. The often-expressed concern about continuing increases in US shale oil production appeared to be more than offset by mentions of good demand from China, together with the possibility of an oil industry strike in Nigeria. **Gold had a difficult week, closing 2.51% lower, at $1,248.49/oz, suffering physical long liquidation.**

"The US economic environment looks healthy, heading into 2018"

Turning to US and other economic statistics, the increase of 228,000 in US non-farm payrolls for November came in above expectations in the region of 200,000, with unemployment remaining at 4.1%. Average hourly wages growth was 2.5% year-on-year, and after a small downwards revision for the prior month. This metric has disappointed the markets for a number of months now, probably because most participants are overly-concerned by the '4.1%' definition of unemployment. We believe that the US suffers from a significant skills shortage, and that many of the new jobs created are low-value ones. Otherwise, the preliminary December US consumer sentiment index published by the University of Michigan came in below expectations, at 96.8, compared to a final reading of 98.5 for November, and the consensus for a small increase to 99.0. We are not worried about one preliminary number, especially when viewed against the recent excellent performance of the Citi US Economic Surprises index, which is back to historic highs, meaning that data on the US economy (with the exception of wages) is continuing to come in well above expectations (consider last week's excellent third quarter GDP update). In the Eurozone, official statistics confirmed that the bloc's GDP grew 0.6% (quarter-on-quarter) in the third quarter. This was mainly due to better investment and exports, Eurostat said. Looking year-on-year, GDP there advanced 2.6%, up slightly from the earlier flash estimate of 2.5%. In Japan, the Cabinet Office's estimate of third quarter GDP was revised slightly upwards to a sequential gain of 0.67%, bringing the year-on-year change to 1.7%, meaning that The Economist Poll and IMF estimates for growth of 1.5% for 2017 continue to look on track – or even slightly on the low side. Lastly, China published some good trade data for November; exports in dollar terms grew 12.3% year-on-year, the General Administration of Customs said. Consensus estimates had called for exports to rise 5.9%. Also, imports came in at 17.7% year-on-year for the month, above expectations for 13.0% growth. **Accordingly China's trade surplus totaled $40.2 billion in November (up from $38.2 billion in October).**

"The FAB Asset Allocation Committee has over-weighted US Technology"

INVESTMENT SUMMARY: The FAB Asset Allocation Committee (ACC) has decided to move overweight in Information Technology, specifically in relation to US equities. Earlier in the year the positioning had been overweight, until in mid-year it was thought to be too excessive – too 'high-beta' – so it was reduced to neutral. With the benefit of hindsight, of course, this was a mistake, as the sector's out-performance resumed (at least we hadn't moved underweight). In the commodities and macro markets there is an expression referring to 'stopping oneself back into' a position – where one makes a mistake, acknowledges it, and puts the position back on. Essentially, that it what the AAC is doing in Information Technology. We are aware, for instance, that the majority of US mutual funds are underweight in IT, with many managers thinking they have almost a God-given right to be able to buy the sector (and the best stocks within it) below, let's say, 20x earnings. Yes, it's true that the FANG stocks (now the 'FAAMG' stocks, including Apple and Microsoft) look highly-valued – yet as a group – especially excluding Netflix – they actually produce significant free cashflow. This is not a 'dot-com' bubble, for we believe that something far, far, larger is going on: the growth in data (and the need to analyze it) is a huge opportunity, as is AI (artificial intelligence), while our original understanding of 'convergence' is taking on a massively different and exciting meaning, with endless possibilities. Meanwhile, a giant like Microsoft has successfully reinvented itself (via cloud computing), while the whole semiconductor sector, for instance, looks to now be in a structural growth phase, rather than what used to be quite good compound growth amplified at certain times by cycles which came and went. This paragraph hardly does justice to what we and our money management colleagues see ahead. Meanwhile in the markets, pre- year-end profit-taking in IT has been well-absorbed. **We will be discussing the sector in the FAB Global Investment Outlook 2018, to be published in early 2018.**

In all other respects, recommended investment strategy remains unchanged.

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From West to East

Weekly Investment View
10th December, 2017

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