From West to East

Weekly Investment View
3rd September, 2017

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Global growth is improving, in line with 'Outlook 2017'

The S&P500 closed 1.37% higher over the week, at 2,476.55, just 0.18% below its all-time closing high of 2,480.91 on the 7th August. Market participants were minded to gloss over the - on the face of it - poor August US non-farm payroll data, concentrating on the positive second quarter GDP revision (to a 3% annualized rate, from the earlier estimate of 2.6%), and probably more so the good manufacturing PMI data for August. US Treasury bonds, although volatile after the jobs data release, closed very steadily for the week as a whole. While 156,000 jobs added failed to meet expectations in the 178-180K range, (a) they were far from being a disaster, and (b) investors have become more aware that August jobs data tends to almost perennially disappoint. The unemployment rate edged up to 4.4%, from 4.3%, and wage growth once again disappointed, at a 2.5% year-on-year rate for the fifth consecutive month. The net result for the markets was well summed-up by the usual Bloomberg estimation of the probability of a Fed funds rate increase in December remaining almost unchanged over the week, at 33.8%, indicating that market participants are not convinced that a rate increase will occur in December. Of course incoming data can change this assumption, and it still does look like an elongated, 'late-stage' cycle, so the Bloomberg reading mentioned still has time to tick upwards, and this would in practice almost sign-off any Fed action beforehand (while having its objectives to meet, the Fed prefers not to surprise the markets). In other equities, the STOXX Europe 600 index closed 0.55% to the good over the week, following US markets, but also recognizing that the euro has so far failed to break above the $1.20 level against the dollar, as well as reflecting very good Eurozone manufacturing PMI data. Fund investors have in recent weeks been selling European (and to an extent also US) equities, with the STOXX 600 about 9% below its all-time closing high of April, 2015). The Japan TOPIX index closed ahead 1.41% over the week, despite the overhang of North Korean-related tensions, and probably helped by the yen easing slightly on the week; in addition, Goldman Sachs commented that the Bank of Japan was thought to have been adding to its Japanese equity ETF positions. Elsewhere in the Far East, the MSCI Asia Pacific (ex-Japan) index rose 0.44% over the week, with Chinese equities outperforming within this group (up 0.92% on the CSI 300 index), and with the onshore (official) renminbi rate vs. the dollar having been allowed to strengthen further, to 6.5584 (from 6.6465 the previous week). **So the 'Goldilocks' environment for global equities remains intact, in which overall favourable economic news is helping to propel operationally-leveraged improvements in corporate earnings - and crucially these positive economic developments have not been derailed by US political developments or global geopolitics.**

"In the Brexit discussions the EU says the 'bottom line' must come first…"

In fixed income markets, and starting with US Treasuries, these ended the week in slightly volatile fashion, although with the yield on the 10-year Treasury bond almost exactly unchanged over the week, at 2.1657%. At the short end, the yield on the policy-sensitive US 2-year Treasury firmed marginally, to 1.3420%, up one basis point. In German 10-year Bunds, the yield was close to unchanged, at 0.3790%, while that on Japanese government 10-year paper fell to zero (-0.001%), from 0.019%. In foreign exchange markets, our readers will know the US dollar index has been markedly weak in recent months (down 9.2% for the year-to-date), as earlier expectations of a stimulatory Trump Administration policy agenda has been held back by gridlock in Washington; also, Trump's behaviour has at times been difficult to assess, and investors have begun to question his competency as US Commander-in-Chief. Members of his own party - and indeed those within his immediate team - appear to be doing all they can to ensure damage limitation. Fortunately the US has extensive checks and balances. Donald Trump has himself admitted that the job of being president is more difficult than he thought it would be. All that said, the dollar appears to have reached a level on its index (92.814) at which many of these travails have probably been discounted, with the index having recovered to above important technical support close to 92.600. Consistent with that, on the other side of the coin, the euro has failed to immediately break through $1.2000 level, closing at 1.1860, down from a close of 1.1924 at the end of the previous week. The yen closed a bit weaker against the dollar, at 110.25, after 1.0936 the previous week. **Rather surprisingly, sterling closed 0.53% firmer, despite rather bleak news regarding the progress of Brexit divorce discussions with the EU (basically there hasn't been any), and this will have been a factor putting the brakes on euro upside, despite excellent Eurozone economic data.**

"Commodity prices indicate global growth – and crude oil should gradually follow"

Turning to commodities, the price of

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WTI was 1.21% lower on the week (at $47.29/barrel), with markets complicated by about one third of US crude refining capacity having been compromised by tropical storm Harvey. The US Department of Energy authorized the release of half a million barrels of crude from the Strategic Petroleum Reserve, helping to offset the outages. Elsewhere, the Brent international crude marker rose by 0.65%, to $52.75, with its premium over WTI widening to $5.46, from just over $4 at the end of the previous week. We still expect oil prices to gradually improve, with positive demand factors offsetting a few negative supply factors at the margin as the year progresses. Copper prices rose once again, by 2.12%, to $3.0980/lb, with commentators attributing this to improving economic growth. In this year's Outlook 2017 we wrote at the time that base metals as a group needed to correct, and that if this occurred they should be bought. There was a correction going into May. Gold did well last week, rising 2.62% (or $33.88), to $1,325.23, successfully taking out the $1,300 resistance level, which we said last week was a 'real' chart level, rather than simply 'roundaphobic'. The FAB Asset Allocation Committee retains its hedge position (insurance against the various things that can adversely affect risk asset prices). As we go to print there was confirmation that what was originally thought to be an earthquake in North Korea was a new 'H' bomb nuclear test. **Some portfolio insurance should be present in all properly diversified global investment portfolios, and is of course something investors hope they will never need.**

"Last week's economic data was generally excellent for markets"

Looking further at last week's major economic data, in the US, the ISM manufacturing PMI came in at 58.8 (vs. 56.3 the previous month); this was a six-year high, and well above consensus expectations. These days the services sector is much more important than manufacturing to the US economy, although this doesn't prevent commentators getting excited about manufacturing when it does well. US July headline PCE inflation rose 1.4% year-over-year, in line with expectations, while the 'core' PCE inflation reading (excluding energy and food) - the Federal Reserve's favourite measure - rose 1.4% year-on-year, down from 1.5% the previous month, and a source of continuing frustration for the Fed as they would like to see it firming towards their 2% target. On the debit side of the US economic ledger, the University of Michigan consumer sentiment index disappointed, falling 0.8 to a reading of 96.8 for August. The Markit Eurozone manufacturing PMI for August came in at 57.4, vs. 56.6 for the previous month, and well ahead of expectations; euro strength may take the edge off export orders and earnings with a lag, however. Staying in the Eurozone, August official 'HICP' inflation rose to 1.5%, from 1.3% in July, coming in slightly above market expectations. German inflation for August came in above expectations, rising 1.8% year-on-year. Eurozone unemployment for July fell slightly, to 9.1%, its lowest level since February 2009. **Lastly, the markets were impressed with the official China manufacturing PMI for July, which improved to 51.7, from 51.4 in July, when a fall had been expected.**

"North Korea notwithstanding, the global equity outlook is better than for some years"

INVESTMENT SUMMARY: Global equities have just advanced for ten straight months, with the MSCI All Country World Index up 13.76% for the year-to-date, so far justifying the 'risk-on', overweight equity position in Outlook 2017. The NASDAQ Composite index closed at a new all-time high last week, and by way of market action serving to climb a 'wall of worry', rather than shooting upwards in a spiky, speculative, fashion. While the Asset Allocation Committee did recently reduce Technology to a neutral weight, its overall positioning in global equities remains very much overweight, counter to numerous views in the market suggesting caution in equities. In the US, a detailed tax reform proposal is currently being 'socialized' (to quote Steve Mnuchin, US Treasury Secretary) in Congress, with the hope that it can be voted on this year and successfully signed into law. Investors are expecting that events in Texas might push Congress into burying its differences regarding the US debt ceiling, although stories on Bloomberg and elsewhere suggest that in reality members of Congress will prevent the President from wrapping up disaster relief for Texas and the debt ceiling into one discussion and vote. On the central bank front, the Federal Reserve continues to be frustrated at the seeming inability of core inflation to respond to what they regard as a tighter labour market, and one in which wage gains have been insufficient to add impetus to the economy. It will be interesting to watch the reported outcome of the ECB policy meeting later this week, especially as inflation in the bloc has firmed, with growth picking up (including in the periphery); such arguments are in favour of reversing QE, although they will want to follow the Fed along this path, in order to maximize the chances of winning the behind-the-scenes currency depreciation war. The FAB Asset Allocation Committee meets later this week, and we will write about the outcomes in next week's report. **In the meantime, investment policy remains unchanged, yet as always these days with one eye in the (North Korean?) rear-view mirror. As mentioned earlier, though, we would emphasize that global economic growth is continuing to improve - but not at too fast a pace - and that the outlook for risk assets continues to look good, and possibly better than for some years.**

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First Abu Dhabi Bank

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