The path of least resistance in equities is upwards

Claude-Henri Chavanon

Head of Products & Services
Wealth & Private Banking

The S&P500 closed up 1.58% over the week, at a new all-time closing high of 2,500.23, the high of the day on Friday – and irrespective of the firing of North Korea's latest missile earlier in the day. One of the factors driving the markets was firmness in insurance stocks, which benefitted as it became clear that the total cost of tropical storm Irma is likely to be much less than earlier thought. In summary, risk aversion fell last week, with a bullish tone in equities being transmitted to Europe, where the STOXX 600 index closed up 1.38% over the week. UK stocks closed over 2% lower, however, reflecting a gain of almost 3% in sterling, to $1.3594, following a hawkish tone emerging from the Bank of England's Monetary Policy Committee. Japan's TOPIX index closed up 2.85%, helped by yen weakness vs. the dollar of almost the same magnitude over the week, to ¥110.83. Readers will by now be well-acquainted with the MSCI Asia Pacific (ex-Japan) index, which was 0.87% ahead over the week, with Chinese equities being only marginally firmer, taking a breather after recent solid gains (and reflecting a softer official renminbi and some soft economic data). **A point to note is that the People's Bank of China (PBOC), the central bank, recently allowed the daily onshore renminbi 'fix' (quotes on the CNY can move up to 2% either side of this) to strengthen, although it was beginning to look over-done. Accordingly, the PBOC has eased a few of the technical restrictions on the CNY, making it easier to sell the currency short - making for less of a 'one-way' market.**

"A Fed rate hike in December still isn't certain"

In bonds, the Bloomberg Barclays Global-Aggregate Total Return (without currency hedging), fell by 1.06% over the week, and although it recent failed to reach new all-time highs, the bigger technical trend still looks positive. The yield on the bell-weather US 10-year Treasury bond was up a fairly hefty 15 basis points over the week, to 2.2023%. Interpretations of recent US data must allow for storms Harvey and Irma, and the subsequent recovery from them. Headline US consumer prices rose 0.4% in August, driven by a one-off rises in gasoline and food prices resulting from storm Harvey, taking the year-on-year rate to 1.9%, vs. 1.7% in July and above expectations of 1.8%; the 'core' (ex- food and energy) year-on-year number was unchanged from the previous month, at 1.7%. Similarly, August retail sales fell 0.2%, month-on-month, reflecting Harvey; ex-autos, there was an increase of 0.2%. Common-sense suggests that auto sales should rise as vehicles written-off during Harvey and Irma are replaced. University of Michigan US consumer sentiment so far for September was posted, with this index falling to 95.3, vs. 96.8 for August, although slightly ahead of expectations of 95.1. Lastly, US industrial production fell 0.9% in August, as Harvey hit output, after an upwardly revised 0.4% increase in July; market expectations had been quoted in the 0.1% area for August. Turning to possible policy statements, Paul Ryan, House speaker, said the White House and the Republican Party intend to publish a blueprint of proposed tax reform plans by this month-end, with the aim of having these passed into law before the year end. The recent short-term tax ceiling deal with the Democrats is hopefully a lead-in to tax reform, the latter of which is being discussed by members of Congress. Our sense is that if Democrats agree a bi-partisan tax bill the Republicans will be pressured to make it more revenue-neutral in the short-to-medium term, rather than increasing the fiscal deficit hugely. Corporate entities have been holding back on their capital expenditure plans until they have more details, and when they have these they can be expected to spend. **With inflation continuing to 'bubble-under' the significant 2% level (- although we need to see the Fed-favoured PCE inflation series respond), and with the increased chance of a tax deal being reached in the immediate months to follow, the usual Bloomberg futures-based analysis now suggests a probability of 46.7% that the Fed will raise rates at its 13th December meeting, up from 26.9% at the end of the previous week.**

"Oil prices are looking increasingly solid"

In commodities, Brent crude was 3.4% firmer as commentators (including the International Energy Agency and OPEC) continued to talk optimistically about the improving outlook for end demand. The spread between near-month Brent and WTI narrowed slightly, to $5.73/barrel, and this can be expected to come lower as

US refinery capacity returns to normal. From earlier this year (in Outlook 2017) and in commentaries since we have been talking in terms of $60/barrel being exceeded by the turn of the year, based on an improving demand picture, itself based on incremental upgrades to global growth. We have argued that the US shale production story has been over-done; it is a factor that will likely cap prices at about $70 over the medium-term, but there are sufficient production uncertainties elsewhere in the world that – allied with a measure of improving demand – can result in $65 (or thereabouts) in Brent, the international marker. In other markets, gold fell by $26.40/oz over the week (by just under 2%), ending at $1,320.19, as haven assets sold off in the face of risk asset prices once again advancing. Nonetheless, the technical picture for gold has improved substantially in recent weeks, and the important $1,300 level looks increasingly secure. In base metals, as measured by the LME Metals index, these corrected by 1.5% on average, reflecting profit-taking, but without significant technical support levels being broken. **Copper, the bell-weather, fell by more than this (3.1%), with that market increasingly looking as though a 'buy the dips' strategy will be the correct one.**

"A delayed Saudi Aramco IPO will likely benefit KSA"

Reports from late last week that Saudi Arabia intends to rework the National Transformation Plan (dubbed 'NTP 2.0'), to be 'more focused', and with 'clearer governance', make much sense to us. Reports from Bloomberg and Reuters discuss the opportunity being taken to rationalize and re-define the sum total of the National Transformation Plan and Saudi Arabia's 'Vision 2030' (the latter of which has always reminded us of Abu Dhabi's Economic Vision 2030). Indeed both (or all) these initiatives have at their heart (a) the aim of diversification away from originally hydrocarbon-based economies, via the successful development of non-oil & gas sectors, and making such development as 'knowledge-based' as possible.

The articles point out that NTP 2.0 has to be made consistent with Crown Prince Mohammed bin Salman's Vision 2030, and now embraces possibly a wider overall series of privatizations than originally planned i.e. going further than the plan to sell a 5% position in Saudi Aramco, for an estimated $100 billion, with the sale proceeds being reinvested to achieve a measure of diversification in an era of lower oil prices. We like the explanation that planners now must link the NTP to Vision 2030 'in reverse', given that work on the original NTP had been in process before Vision 2030 was coined. Naturally, Saudi Arabia would love to be able to balance its budget by 2020, and that is part of the Fiscal Balance Program. The re-designed NTP will apparently still run to 2020, although the planning horizons for Vision 2030 will be easier to work within. Aspects such as improving the public sector, growing-out a tourism sector, and so on remain in place. Consultants are being summoned to Riyadh in an attempt to deliver a report to the government by the end of October. Also in the mix are discussions regarding accession to the throne. Certainly the effort going into the planning sounds truly considerable. Officials say they still aim to complete the Aramco sale by the end of 2018, "… ensuring that all IPO-related requirements are completed on time and to the very highest standards". Our comment would be that the all-embracing targets of the NTP and Vision 2030 will be better served if more time is taken to bring them to fruition. On a different - but very relevant – level, Saudi Arabia is uniquely positioned to understand the realities of the so-called 'rebalancing' in the oil markets. There is talk of an extension of the output restriction agreement into next year, and while rebalancing is occurring, it is taking longer than many expected. **If we consider the possibility that - for whatever reasons - the Aramco sale is delayed until 2019, in the long-run that could benefit the Kingdom in that oil prices will probably be a bit higher, and in what looks like being a further extended period of global growth. Also, by then the internationalization of the Saudi capital markets could have advanced further.**

"The FAB Asset Allocation Committee has been overweight in equities"

INVESTMENT SUMMARY: The FAB Asset Allocation Committee remains firmly over-weighted in global equities. It's true that Asia Pacific (ex-Japan) is cheaper than the US. When growth is good and improving, P/E ratios can exceed 20x. The tightening of global central bank monetary policy should proceed very slowly, and will be calibrated and shared-out (Japan has actually already begun this in a stealth fashion, and is making a good job of it). There is still a need to have some gold in portfolios as a hedge against unexpected adverse events. With the US dollar, even if the 'big trend' were now to be downwards, there is still room for a decent bounce, rather more than last week's 0.56% rally in its index. The global economic growth picture - as forecast by us in 'Outlook 2017' - is in many ways a 'Goldilocks' situation. **It is true that China's August retail sales, industrial production and fixed asset investment data missed estimates, although we believe this to have been a function of the so-called 'ghost month', which this year runs from 22nd August to 19th September based on the Chinese calendar, when investors typically postpone purchases and other financial activities.**

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

From West to East

Weekly Investment View
17th September, 2017

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