# Summer coming into view

**Last week was historic, seeing President Kim Jong Un of North Korea stepping over the border into South Korea, greeted by its President, Moon Jae-in, followed by a summit which may lead to the denuclearization of their peninsular.** Earlier in Washington, President Trump hosted first France's President Macron, followed by Germany's Chancellor Merkel, but with neither guest going home hopeful of getting the main things they wanted out of the discussions. The MSCI World index fell by 0.11% over the week, outperforming our favourite global bond index (the Bloomberg Barclays Global-Aggregate, unhedged), which closed 0.86% lower. The S&P 500 index was virtually unchanged over the week, after showing signs of weakness mid-week, for a year-to-date return of -0.14%. Overall, US corporate earnings have been beating expectations, led by excellent results last week from the likes of Amazon, Microsoft, Advanced Micro Devices, Intel – and Facebook. Amazon was particularly impressive. At the other end of the scale, Exxon disappointed. In Europe, the STOXX Europe 600 index rose 0.73% (the fifth weekly rise in a row), helped by a slightly weaker euro and indications from the ECB that the monetary punchbowl isn't being removed, at least for the time being. Japan's TOPIX was up a useful 1.49%, powered by continuing weakness in the yen, and a supportive monetary policy meeting at the Bank of Japan. In bonds, the bell-weather yield on the US 10-year Treasury traded up to just above 3.02% (with the last five or so basis points probably driven by derivatives traders who thought they could sustainably break the 3% level) – but that failed to hold, with the yield ending the week at 2.9568%, slightly lower over the week. There was more action at the 2-year, more policy-sensitive end of the curve, where the yield closed 3.6 basis points higher, at 2.4838%. The spread between the two fell to the low of a few weeks ago, just above 0.47%. **On balance, market participants' expectations regarding where the Fed funds rate would be in two years was almost unchanged over the week (at 2.67%, vs. 1.70% today), and a lasting break of 3% on the 10-year that traders are obsessed with will likely take longer.**

### *"The dollar looks to have re-gained the 91 level on its index"*

**In foreign exchange markets, the US dollar had quite a good week, closing 1.36% higher on its index, at 91.542,** helped by markets that are once again focusing on rate differentials – and at the margins driven by expectations of sustained accommodation in monetary policy – at least for the time being – from the ECB, BoE and the BoJ, as referred to above. In the case of sterling, this was 1.56% lower vs. the dollar, at $1.3781, as the market adjusted expectations for a May UK rate rise heavily downwards, after the initial estimate for UK first quarter GDP came in at only 0.1% annualized, a five-year low, and below the BoE's prediction of a fall to 0.3%. After its monetary policy meeting last week, Mario Draghi acknowledged the moderation in Eurozone growth, and said they will continue buying €30 billion of bonds per month until at least the end of September, once again linking the end of the ECB's QE with needing to see more sustained inflation. In the case of the Bank of Japan, they (in a surprise move) removed a time limit for achieving a 2% inflation rate, at the same time leaving rates unchanged just below zero, and with continued bond purchases – so with sustained monetary looseness, Japanese industry can once again benefit from a weaker yen as US-Japan yield differentials widen, boosting the dollar. So it once again comes back to who can 'lose' the currency depreciation game – especially in a tougher world trade environment, if that is what pans-out - and we would guess that for the time being the dollar will be more likely to strengthen on its index, than fall. Lastly, in commodities, crude oil closed at $74.64/barrel (Brent spot), with sentiment remaining firm; it was becoming clearer that, for instance, falling Venezuelan production (and ongoing supply interruptions in Libya) has been offsetting the continued boom in US shale-based production. In addition, the likelihood that the US will pull out of the upcoming nuclear deal (to be decided on about the 12th May) could take up to 500,000 barrels/day out of the market. **In gold, a stronger dollar in the absence of heightened geopolitical tension left the spot price just over $12/oz lower over the week, at $1,324.00.**

### *"First quarter US GDP beat expectations for the first time in some years"*

**The main economic news last week was probably that US GDP growth for the first quarter of the year came in at an annualized 2.3%, although above expectations of about 2%, and compared to 2.9% in the fourth quarter.** Growth was helped by a stock build, and consumer spending (which grew at 1.1%) moderated. Business investment was robust, and exports rose. Indeed the US Commerce Department separately reported that the goods trade deficit fell 10.3%, to $68.0 billion, in March; exports rose $3.4 billion (to $140.1 billion) last month, helped by the weaker dollar, while imports fell $4.4 billion, to $208.1 billion. Regarding US wage data, private sector wages and salaries in the first quarter came in at a respectable 2.9% rate vs. the same period a year earlier, and including government employees the gain was 2.7% - this is further evidence that perhaps lower unemployment (the latest figure was

4.1%) is finally about to have a quickening effect on wage gains, and with the possibility that (based on pricing power being in place) inflation is going to continue to edge upwards over-and-above the statistical effect the Fed recently mentioned. US durable goods orders increased by 2.6% in March at the top-line, vs. expectations of 1.6%, reflecting a jump in transportation equipment orders. Economists like to look at the number excluding aircraft (i.e. business spending, or the 'core' number), which was 0.1% lower last month, vs. expectations for an increase of 0.5% according to Reuters, and this 'core' data was revised downwards to a gain of 0.9% for February, from the previously reported increase of 1.4%. Lastly in US economic data, University of Michigan consumer sentiment deteriorated less than initially estimated in April, with their index for April being upwardly revised to 98.8 from the preliminary reading of 97.8. As a possible conclusion it's worth mentioning that the US first quarter GDP reading was the first time since 2008 that this had beaten consensus expectations; the 2.3% rate was much better than the average 1.2% growth rate achieved for the first quarter in the 2010-2017 period (CNBC). Looking ahead, let's bear in mind that the US Congressional Budget Office has predicted that Q4 growth this year could be 3.3% higher than the same period a year earlier, due to the effects of fiscal stimulus. By comparison, in the Eurozone, the widely-watched German IFO business survey index for April came in at 102.1, below consensus expectations of 102.8. This was its fifth consecutive decline, confirming that German companies have witnessed some deterioration in trading. **Despite the still-large US trade deficit, current economic metrics appear to support a firming dollar.**

*"We underline our liking for Technology"*

**Technology remains an important overweight in our sector selection, indicative of the fact that there are a lot of disruptive technologies coming to fruition.** While stocks in the sector can be somewhat more volatile, and they can look expensive, our clients are still keen to invest in it in the belief that expected growth justifies a premium valuation. When we talk about technology we don't in practice include social networking stocks. The evidence was demonstrated last week by the various positive earnings releases from the likes of Microsoft, AMD, and Intel – and these are large companies! They have been achieving above-market revenue and organic earnings growth, and sport free cashflow valuations that make it hard to be negative about them. In terms of the sub-sectors we continue to favour software companies (emphasizing the 'cloud') on the one hand, and semi-conductors on the other, as in both cases future growth potential appears substantial, while the valuations are reasonable (especially consider the 'PE-to-Growth' metrics). While it is true that European regulators, for instance, are trying to increase the tax paid by these multinationals, and regulate them more tightly, back in the real world of corporate results Intel produced a better-than-expectations second-quarter sales forecast and raised its earnings outlook for the year, while Microsoft exceeded analysts' estimates for fiscal third-quarter sales and profit, driven by strong corporate demand for cloud-computing services which now include new added features. Looking at the assumed earnings growth rates for the tech-heavy NASDAQ 100 index (whereas the Composite includes biotech), i.e. 12.6% for the current year and 12.9% for 2019, we view these as being far too conservative, making the P/E multiples of 17.6x and 15.6x respectively rather over-stated. **So we continue to like the technology sector, and further details are available upon request from our Investment Advisory teams.**

*"The Asset Allocation Committee has a mandate to be tactical"*

**INVESTMENT SUMMARY:** (1) In geopolitics, the Korean summit provides a good background for the imminent meeting of President Trump and President Kim Jong Un. Dismantling and verifying North Korea's nuclear capability lies ahead, if all goes well, and this would not be an easy process. (2) The Fed meets this week, but is unlikely to raise the Fed funds rate at this meeting; Bloomberg-calculated expectations show only a 35.3% probability of a hike. (3) The immediate balance of economic and political forces appear net dollar-supportive, for the reasons detailed earlier. (4) Market participants are becoming more wary of increasing inflationary expectations, and also know that US bond issuance will be needed to cover the tax cuts and to help fund the recent-passed spending bill. (5) Behind the scenes, investors are becoming more concerned that although the Republicans have 44 more members in the House of Representatives than the Democrats, 37 of those have said they will not stand again in the November mid-term elections, and this increases the range of political outcomes. The numbers in the Senate are rather tighter. **(6) Our FAB Asset Allocation Committee will meet later this week, with quite a lot to discuss, including whether it is appropriate to take some equity money off the table tactically, pending the summer. Having said this, we retain our bullish stance for equities for the year as a whole, and continue to believe in the likelihood of a prolonged economic cycle.**

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