US inflation was the dog that didn't bark; and being fired by tweet

The S&P500 index closed 1.24% lower over the week, at 2,752.01. For the year-to-date it is 2.93% ahead, led by Information Technology (+10.5%), Consumer Discretionary (7.1%), and Financials (+3.9%). It was a week during which the doors continued to revolve at Trump's White House, producing some measured concern. Inflows into US equity funds were substantial, however, according to CNBC. Early in the week the president fired his Secretary of State, Rex Tillerson, by tweet (Mr. Tillerson isn't on Twitter) - and immediately replaced him with Mike Pompeo, who had been director of the CIA. The appointment of Larry Kudlow, television business and economics commentator, was announced as the replacement for the recently-resigned Gary Cohn, as chief economic advisor. Both Pompeo and Kudlow are known to be protectionists, more in line with Trump's own leanings. It also sounds likely there is a good chance of tariffs worth about $60 billion being imposed on imports from China. It is likely that President Trump is warming-up for the US mid-term elections in November, and looking to be seen to be keeping election pledges. Accordingly, this week the media has been filling-up column inches with speculation about a trade war - as well as gossip that H.R. McMaster, Trump's national security chief, is on the way out (although this has so far been officially denied). In other news, the US's all-important Labor Department February inflation statistics were published, and were broadly in line with expectations (unchanged at 1.8%, year-on-year for the 'core'). The Fed-favoured Commerce Department 'core' PCE numbers have been running about 0.3% below these, with the most recent core figure being 1.5% annualized, compared to the Fed's target of 2%, hence this inflation data was seen as 'the dog that didn't bark', and therefore not particularly newsworthy. **The US economy still looks in very good shape, with last week's 14-year high in the Michigan University consumer sentiment index offsetting short-term weaker-than-expected retail sales.**

"Japanese Prime Minister Abe is facing questions over a land deal"

The MSCI All Country World index closed 0.56% lower over the week, and is ahead by 1.84% for the year-to-date. The (mainly technology-driven) NASDAQ Composite index closed 1.04% lower, although consistent with our recommended investment policy in 'Outlook 2018' looks technically strong, and is currently up 8.38% for the year-to-date. It looks as though 'Big Tech' may well be facing a 3% tax on revenue in the Eurozone, but it could have been worse, and we regard this as a small bump in the road. European equities closed fractionally lower over the week, with the STOXX Europe 600 index down 0.14%. **In Japanese equities, the TOPIX index rallied by 1.23% over the week, despite news of Prime Minster Shinzo Abe's tangential involvement in altered details being recorded on a questionable land deal.**

"Bonds benefitted from subdued inflation, and less 'risk-on' elsewhere"

Turning to global bonds, the Barclays Bloomberg Global Aggregate index rose 0.29%, mainly reflecting less of a 'risk on' attitude towards other assets, as well as continuing subdued inflation. The yield on the 10-year US Treasury fell by almost five basis points over the week (to 2.8445%), consistent with our positive tactical positioning in G3 government bonds. Meanwhile, the yield on 2-year US Treasuries rose to a closing high for the current cycle of 2.2909%, this being a policy-sensitive tenor and more fully reflecting the Fed rate hike expected at the 21st March FOMC meeting. The yield on the German 10-year Bund fell by almost eight basis points over the week, to 0.571%, and was largely attributed to ECB policy-makers' comments that Eurozone inflation remains quite low, after official data for February showing a CPI reading of 1.1% year-on-year, which was below expectations. In foreign exchange markets, the dollar edged up by 0.15% on its index (DXY) over the week, to 90.233, holding just below our expected lower trading level of 91 for the current year. The euro was slightly weaker vs. the dollar (at $1.2290), while the yen was slightly stronger vs. the dollar over the week (at ¥106.01). Sterling firmed 0.66%, to $1.3942, during a week when Prime Minister Theresa May had to be seen to deal robustly with the well-publicized poisoning of two foreign nationals on its soil. Returning to the dollar, market commentators have of late regarded this as being held down by political factors, it being clear that interest rate differentials were taking a back-seat. For the time being at least it now looks as though these two forces have broadly neutralized each other. Wednesday's FOMC meeting is clearly very much in focus, and markets have to all intents and purposes discounted a rate hike, but the important devil will be in the detail i.e. in the so-called 'dot plot' of FOMC voters' views. **At this stage, markets are approximately 90-95% pricing-in a total of three Fed hikes for this year, including this week's.**

"…but could it be four hikes this year, rather than three? "

From West to East Weekly Investment View, 18th March, 2018

As we all know, Jerome ('Jay') Powell, the new Governor of the US Federal Reserve, will chair his first FOMC meeting this Wednesday. Although the head of this august institution, he is just one person on the Committee, and we don't expect any significant changes in approach. Having said that, the markets have presumed him to be net-hawkish, and while we are sure he will be as prudent as he has sounded so far, in the back of our mind is that he is a Trump appointee, and a Republican. As far as we can tell, along with Treasury Secretary, Stephen Mnuchin, Mr Powell will probably turn out to be one of Trump's best appointments. Rather than being mired in the 'Phillips Curve' (which dictates that realized inflation should trend upwards as unemployment tracks downwards, and via a pickup in wages growth), we think he'll be very much in the 'New World' of economics. Rather than saying more beforehand, we'll be sure to - like thousands of others in the financial services industry - do our best to interpret his prepared statement, and (probably more importantly) analyze how he deals with the Q&A (which incidentally might now take place after each and every FOMC meeting). **Last December, the median projection from Fed governors was for three rate rises this year; while our own guess is that (especially given the consensus on trade expectations has worsened) this will be unchanged, we could be wrong in the context of a Fed that for more than a few years has arguably been thought to be behind the curve and too dogmatic about reaching a 2% annualized 'core' inflation target.**

"US crude oil production reached a new weekly record - but markets weren't concerned"

In commodities, Brent crude oil closed 1.10% firmer over the week, at $66.21/ barrel, with its premium over West Texas widening to $3.87 (from $3.45 at the close of the previous week). This was despite (a) market concern expressed earlier in the week that oil supply could exceed demand this year, and the International Energy Agency (IEA) saying that any global trade war could reduce oil demand, and also (b) US Energy Information Administration (EIA) data that showed US crude inventories rising by more than expected last week, as well as rising US production. US weekly crude production, driven by shale-based output, reached 10.38 million barrels/day, a new weekly record. From a longer-term perspective, however, US commercial crude inventories have been trending downwards since April, 2016, despite rising production - so in practice it is the larger global picture that we continue to follow to see the real underlying trend - with the latter showing continuing gradual improvement. In gold, the price fell by just under $10/oz over the week (to $1,314.24/oz), and it was also marginally lower in euro terms. **Although gold remains technically trendless, investors still need some exposure as a disaster hedge in their portfolios.**

"Investors have had to absorb a flow of bad news out of Washington"

INVESTMENT SUMMARY:

Markets may well have to absorb a continued flow of negative Trump-related news - but the US economy continues to look very good. We remain 'risk on' in global equities, and favouring Asia and Emerging Markets, whose inherent growth is now strong enough for them to further differentiate themselves from the US, irrespective of tit-for-tat tariff actions.

Last week's positive OECD global GDP revisions (to 3.9% for this year and next) at the top line both exactly match those already made by the IMF in its own revisions made in January, so the OECD is playing catch-up.

In next week's report we will review the G20 finance ministers and central bank governors' meeting outcomes in Buenos Aires, 19th-20th March, as well as the Fed meeting.

China's holdings of US Treasuries stood at $1.168 trillion at the end of January, down from an interim peak of $1.202 trillion at the end of August last year, and down from an all-time high of $1.317 trillion at the end of November, 2013. China remains the largest foreign holder of US Treasuries (with Japan in second place, whose holdings stand at $1.066 trillion). This could be the beginning of a 'buyers' strike' in US Treasuries by the Chinese, and we'll be following this closely.

Brexit will come to the fore again in the coming week, as various hurdles to avoiding a 'hard' Brexit remain.

Unless there is very significant new adverse news beforehand, investors should expect a Fed rate hike of 25 basis points this week, which is fully discounted. Pending our study of the FOMC statement and Q&A, we still expect three hikes this year, and not four.

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