Weekly Digest
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Investec
Wealth & Investment

The weekly insight into world stock markets

"An Ounce of Prevention…"

"… is better than a pound of cure". Thus spoke US Federal Reserve Board chairman Jerome Powell following last week's meeting of the Federal Open Market Committee. The Fed didn't actually change its monetary stance at the meeting, but delivered the strongest hint yet that it is poised to do so at the next meeting. Indeed, it better had, because futures markets are now pricing in a 100% probability of an interest rate cut in July, with more cuts to come later in the year. Six months after the interest rate rise that triggered the final leg down for equities and corporate bonds, this represents a huge U-turn for the Fed, largely driven by a deceleration of the domestic economy, but also by concerns about a more pervasive global slowdown. These in turn can, at least in part, be blamed on the uncertainty created by President Trump's policy agenda (more on which below). Trump himself has been a vocal critic of the Fed, which has left Mr Powell in the difficult position of trying to conduct himself in a manner appropriate for the economy while also appearing to remain free of presidential influence.

No such problems for Mario Draghi, President of the European Central Bank. He has shown himself to be completely independent of political interference during his tenure, and, if anything, has been pushing euro zone finance ministers to get on with lending some fiscal support. Last week's ECB meeting delivered a surprisingly dovish message, although Signor Draghi did not refer to grammes or kilogrammes of prevention and cure. What he did say was that further interest rate cuts (with pundits noting the plural) remain part of the ECB's toolkit, and that the Asset Purchase Programme (central banker-speak for Quantitative Easing) still has considerable headroom. Such potential largesse sent the euro lower, drawing immediate accusations of currency manipulation from Donald Trump.

The one developed country where the central bank and the government are singing from the same hymn sheet is Japan, and the Bank of Japan also met last week. There was little of note to report here, but with the BoJ already owning 50% of all government bonds there's not a lot to do. They can't really do any more QE in the secondary market because there are no sellers left.

My colleague Darren Ruane wrote last week about the extraordinarily low yields on government bonds, and they briefly went even lower following these central bank statements. It is testament to the gravitational pull of negative yields in the core euro zone, Japan and Switzerland that even the UK 10-year Gilt yield continues to hover near its latest low of 0.8%. The Bank of England has been itching to raise the base rate again, but is completely hamstrung by the ongoing Brexit saga and the fact that the UK economy looks as though it will not grow at all this quarter. Thus the Monetary Policy Committee's statement was about as neutral as it could possibly be.

The net effect of all this was to drive pretty much all financial assets higher. This included gold, which has hit its highest level since the summer of 2013. In some ways this is a bit odd, as gold is viewed as an insurance policy held against increasing risk threats. But gold also benefits when the dollar is weaker (because it's priced in dollars), and when interest rates are lower (reducing the opportunity cost of holding an asset with no yield). Even so, the rise speaks to an underlying nervousness about the current economic and political situation. This was also reflected in Bank of America Merrill Lynch's latest Fund Manager Survey, which gave the most bearish readings since the financial crisis. A few days later the S&P 500 Index hit an all-time high! As ever, the market trade-off is between growth expectations and the outlook for monetary policy. Growth forecasts are definitely being reduced, but we are not yet in negative territory. Monetary policy is deemed to be supportive, with more fuel in the tank. Good for financial assets on balance.

It will be interesting to see how markets deal with the outcome of next weekend's proposed Trump/Xi meeting at the Osaka G20 gathering. An agreement of any sort would bolster growth expectations, but at the same time obviate the need to loosen monetary policy. It could finally trigger the long-awaited (by some) rally in Value sectors relative to Growth. Whatever happens, it will probably not settle the arguments between the US and China for good, so we wouldn't want to get carried away with any euphoric reaction.

And Trump's policies appear set to continue to dominate the agenda. Iran is a live situation, with up to a third of the world's oil supplies threatened by any closure of the Straits of Hormuz. It's really hard to see exactly what Trump wants out of this particular conflict other than to reach a new settlement that has his own name on it rather than Barack Obama's. The recent threat to impose tariffs on Mexico in an attempt to halt the flow of immigrants shows that Trump is willing to "weaponise" trade to reach other goals, which we do not deem to be a positive development. There remains a threat that Europe's automotive industry will be his next target.

Our own Global Investment Strategy Group also met last week, and the vote was to recommend a reduction in equity risk equivalent to 2.5% of portfolios. This does not reflect an imminent market collapse, more than having put a bit more risk back on table towards the end of last year in the face of collapsing markets we are happy to bank some profit and return to the glidepath towards a more defensive position that we continue to believe will be warranted on our eighteen month investment time horizon. That's our "ounce of prevention".

John Wyn–Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Ashtead Group	11.1%
Standard Life Aberdeen	6.8%
John Wood Group	6.5%
NMC Health	6.0%
Prudential	6.0%
Tesco	5.5%
St. James's Place	5.4%

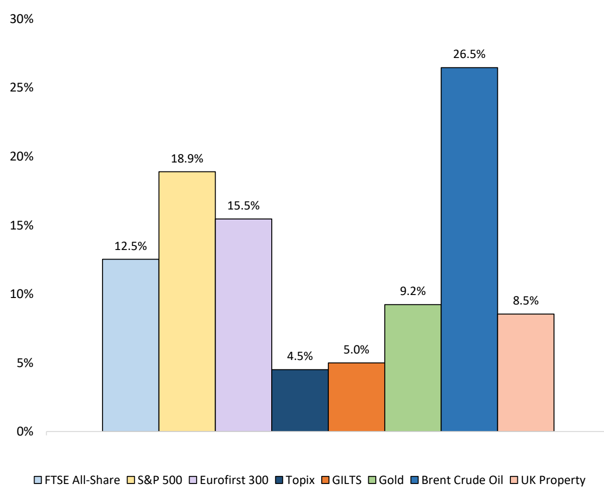
Source: FactSet

FTSE 100 Weekly Losers

Carnival	-13.6%
Evraz	-8.6%
Imperial Brands	-5.4%
EasyJet	-4.9%
Reckitt Benckiser	-4.9%
Whitbread	-4.3%
Compass Group	-3.2%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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