Weekly Digest
9 July 2018

Investec
Wealth & Investment

The weekly insight into world stock markets

Plus Ça Change…

It has not been unknown for me to write the Weekly Digest either on Friday afternoon or over the weekend. Given last night's resignation of the Brexit secretary, David Davis, I was relieved to arrive at my desk this morning with a blank sheet of paper in front of me. It looks as though most of this morning's printed newspaper reports on the subject were good for nothing before they even arrived at the newsagents. Even so, it's not clear that being up with events offers greater clarity, and market reaction to the news seems to be pretty muted. Participants on all sides of the debate are saying exactly what you would expect them to say.

The pound has tended to be the main barometer of market sentiment towards political developments, so it is instructive to see how it has reacted. Against the dollar it closed at $1.322 on Thursday evening as the cabinet was preparing for the Chequers summit; this morning it is more than a cent stronger at $1.334. However, that is a bit misleading, as it largely reflects a weakening of the dollar on Friday in response to the monthly Employment data (more on which below). Sterling is marginally firmer against the euro, at €1.133 against €1.131. The message from the market seems to be twofold: first, there was little optimism of a firm outcome going into the talks, so the latest setback is hardly surprising; second, and perhaps more encouragingly, the pound is deemed to be cheap and therefore selling pressure is abating. Certainly, most work that we see on the subject takes the view that sterling offers good value on long-term models such as the Real Effective Exchange Rate and Purchasing Power Parity, although such value measures are notoriously poor at defining where a currency should be trading today.

I can also look at the relative performance of the FTSE 100 as a pointer, and that is lagging most other European indices this morning, as often happens when the pound is stronger. However, I am reluctant to read too much into one morning's movements, which could be equally (if not more) influenced by perkier markets in Asia overnight and a welcome lack of escalation on the trade war front. All in all, we don't seem to be any wiser than when we went home on Friday.

I mentioned the US Employment data, and they are amongst the most closely watched monthly economic figures at the moment. It was February's surprising jump in wages that triggered the market turmoil, and it is wages that are deemed to be an early indicator of rising inflationary pressures within the economy as a whole (which, in turn, could lead to higher interest rates). Friday's release was almost as good as could have been hoped for: lots of growth with limited inflation pressure. 213,000 new jobs were added to the economy, which was higher than expected, and May's figure was revised up as well. However, and perhaps most encouragingly, the Labor Force Participation Rate rose from 62.7% to 62.9%, as previously discouraged workers were tempted back into the jobs market. This pushed the Unemployment Rate back up to 4% and helped to hold wage growth unchanged at 2.7%. It might be going a bit far to say that if you want a job you can get one right now, but the number of job openings in the US is currently higher than the number of people registered as unemployed, and so there's little reason to see employment trends reversing soon. In terms of normal cyclical risks, investors probably most fear a US recession, but there is no sign of one developing yet. Of course, it's inevitable that one will come eventually, and we are already taking that into account in our medium-term attitude to risk.

The proximity of the summer holidays has encouraged the usual flurry of articles warning about the risks to markets engendered by reduced liquidity. The last time this was felt most keenly was in August 2015 when China "devalued" its currency by 3%, triggering near panic as investors worried that the Chinese economy was about to hit a brick wall. Not surprisingly, then, the recent weakness of the yuan has been encouraging a number of commentators to draw parallels with 2015. While the current weakness of the yuan is incontrovertible, there is limited evidence either that it is being engineered by the government or of wholesale capital flight. If anything it appears to reflect the current relative strengths of the US and Chinese economies and the relative direction of monetary policy. In fact, the yuan has strengthened from RMB 6.665 to RMB 6.617 against the dollar since Friday morning, reacting to the same data-driven influences I explained earlier.

There are also concerns that the Chinese authorities are prepared to "weaponise" the yuan to fight against Trump's tariffs by devaluing their currency. Given their most recent desire to enhance the credibility of the yuan as a potential reserve currency, we believe that this would be a retrograde step and therefore one they are unlikely to take. But, of course, we never rule anything out. In my latest Monthly Commentary I identified this "worry factor" as a key characteristic of markets since the financial crisis: "This has been the narrative for the last few years, it seems: investors, not unreasonably given the scars of financial crisis, find things to worry about, and then chase assets higher once the worst outcome does not come to pass." Trade wars, populism, Brexit and monetary policy tightening are just a few of the things that investors are currently fretting about.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

BT Group	6.3%
JUST EAT	5.3%
National Grid	4.5%
Severn Trent	4.5%
Marks and Spencer	4.1%
Vodafone	3.9%
ITV	3.7%

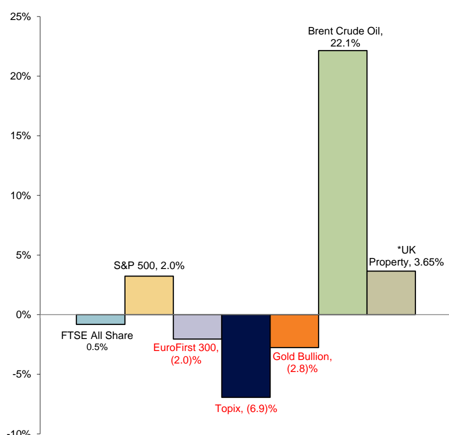
Source: FactSet

FTSE 100 Weekly Losers

Glencore	-9.1%
Associated British Foods	-9.0%
Barratt Developments	-6.3%
Berkeley Group	-5.5%
Smith & Nephew	-5.4%
Micro Focus International	-4.8%
Antofagasta	-4.6%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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