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Wealth & Investment

Eeekonomics

When previewing the recent general election, I speculated that there were four reasons why Theresa May might have felt compelled to call it. The first three were: to obliterate the Labour Party; to secure her own mandate; and to neuter the Tory Eurosceptics. It would not be harsh to say that she failed miserably in all of those ambitions. However, she might have nailed a fourth, namely to go to the polls before the economy hit a nasty soft patch. Recent economic data has been been poor, almost without exception.

Citigroup produces proprietary Economic Surprise Indices (CESI) for a number of major economies (yes, the UK still qualifies!) which are available on Bloomberg and widely quoted in the financial press, and has been compiling the series since 2003. Back in February this year, the UK CESI was over 100, a level it has hit half a dozen times since inception, suggesting rude health in the economy. By their nature, economic surprises tend only to be surprises for a limited period, because economists adjust their expectations - this is a classic mean-reverting series – so we shouldn't necessarily be surprised that the index has fallen from its peak. However, the decline has been unusually precipitous, especially given that our neighbour, and main trading partner, Europe, has been doing so well recently.

The index reading is currently -35. The last time it was this low was in early 2016 when there was far greater concern about a pervasive global slowdown. The last time we saw the index falling as fast and as far as it has this year was during the Eurozone crisis when it hit -80. There are no crises currently unfolding and global growth forecasts have been upgraded so far this year. This looks like a local difficulty, although the US is experiencing a similar phenomenon, more of which anon.

Last week's disappointing UK data included Purchasing Manager Indices as well as the trade deficit and Industrial Production in May. These come on the heels of, for example, very weak Retail Sales, where annual growth is now a paltry 0.6%, whereas it was running consistently over 3% for most of the last three years. Anecdotal evidence is also building negatively, with various surveys pointing to Brexit fears as a reason for subdued investment. One number that has been growing strongly is unsecured Consumer Credit, something which the Bank of England is already trying to subdue because it looks unsustainable. Consumers are spending to the max, with the Savings Ratio reaching a new historical low of 1.7% in March (this data series in its current form goes back to 1963). This while they are being squeezed between falling real wages and rising prices.

Directing monetary policy in this environment is not an enviable task. Inflation data calls for rate rises by some analysis, but the activity data points the other way. Meanwhile the Monetary Policy Committee is actively debating (for which read arguing in public) the right course. Markets are running with the hawks, suggesting a rate rise in March 2018. Such a short horizon has proved to be way too optimistic since the financial crisis, but markets are giving it more credence this time owing to the fact (as discussed over the last two weeks) that several central banks around the world are discussing a normalisation of interest rates – ie raising them. We still expect central banks to err on the side of too much inflation rather than too little growth, but you can see from market movements, particularly in the bond market, that investors are nervous about how this plays out. The optimistic view is that things are about as bad as they can get, but I find it hard to see a meaningful bounce in domestic activity. Mrs May's next plays in the great Brexit negotiating poker game are probably going to going to be made from a position of economic weakness.

I mentioned that the US is experiencing a similar drop in the level of economic surprises. Its index fell from a March peak of 58 to a June of low of minus 78, before bouncing to a current -58. There is a definitely a post-financial crisis seasonal pattern that seems to peak in December/January before bottoming in June. Nobody seems quite sure why the US economy persistently disappoints in the first quarter. The weather usually gets the blame, but it wasn't so bad this year. That has plenty of people questioning the underlying methodology, particularly the seasonal adjustments. Still, looking at all the data, not least the growth in employment, the US economy looks as though it can continue to rumble along at a steady pace even without any help from Donald Trump (or possibly in spite of him).

I should mention some other regions. Europe's CESI is currently 40, lower than the 70 level it hit a few times earlier this year, but also up from June's dip to 5. It has remained in positive territory and the underlying trends look good. China's is 18, down from April's peak of 72, but in a steady positive trend too. We would have expected some slowdown give the tighter attitude towards credit growth this year. Emerging Markets exhibit a similar pattern.

These indices are not a predictor of future growth, so must be treated with a little caution, but certainly are a very handy indicator of current trends. What they say is that the UK is something of an outlier in terms of current disappointments. I can't help feeling that at least some of that is down to Brexit fears and the unsettled political situation. Finally, if Irish equals four and Scots equals three, Coldstream equals two (the numbers represent the number of buttons in each cluster on regimental tunics). This week, who is the odd man out: Allen, Compton, Edrich, Warner?

John Wyn-Evans - Head of Investment Strategy

FTSE 100 Weekly Winners

Worldpay Group	17.0%
BHP Billiton	5.7%
Persimmon	5.5%
Rolls-Royce Holdings	5.1%
Royal Bank of Scotland Group	4.7%
Barratt Developments	4.6%
EasyJet	4.4%

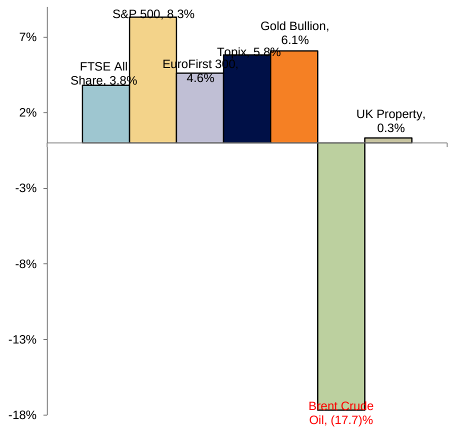
Source: FactSet

FTSE 100 Weekly Losers

ConvaTec Group	-5.5%
Fresnillo	-4.4%
Burberry Group	-3.1%
Whitbread	-3.1%
Johnson Matthey	-3.0%
Micro Focus International	-3.0%
Ashtead Group	-2.8%

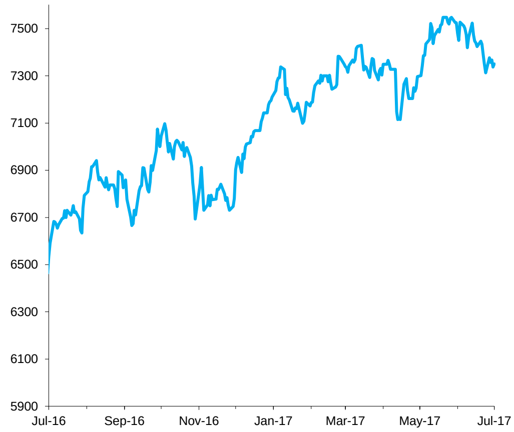
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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