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Smart[im]: Weekly Market Review

05 October 2018
Smart Investment Management

The week to date as at 12 p.m. Friday (GMT).

Markets and key events

Equity markets succumb to rise in US Treasury yields

Equity markets succumbed to a broad sell off mid-way through the week as US Treasury yields moved sharply higher, following data from the US Institute for Supply Management (ISM) which showed record activity in the US services sector. This has raised expectations around the keenly anticipated non-farm payrolls due out later today, as markets look for further evidence of labour demand and, more significantly, wage inflation. The yield on the 10-year US Treasury, which moves inversely to price, rose sharply, hitting as high as 3.23%, the highest yield in 7 years.

Broad sell-off

Equity markets lurched downwards, with emerging markets being hit hardest, as investors fear the US Federal Reserve may adopt a more aggressive stance, tightening interest rates ever further. As of 12pm London time, the S&P 500 was down 0.4% over the week, whilst the technology focused Nasdaq had fallen 2.1%. Emerging markets lost 3.6%, however, this excludes the Chinese Shanghai Composite which has not traded all week due to a five-day holiday. EuroStoxx 600 fell 1.4%, UK FTSE All Share fell 1.8%, Japanese Topix index fell 1.4% and the Australian S&P ASX 200 fell 0.4%.

All eyes on US non-farm payrolls today

The latest US non-farm payrolls figures, due later today, are forecast to add a further 185,000 jobs in September, with unemployment falling marginally to 3.8% and year-on-year average earnings rising by 2.8%, slightly down from the previous month's reading of 2.9%. However, post the ISM figures earlier in the week, all eyes are focused on whether these figures prove to be much stronger.

Canada signs up to revamped NAFTA

Last Sunday, at the 11th hour, Canada agreed to sign up to the revamped North American Free Trade Agreement (NAFTA) along with the US and Mexico. This has the less catchy acronym USMCA, the United States Mexico Canada Agreement. This is a welcome political win for President Trump ahead of the upcoming midterm US congressional elections in November.

Italian government bonds sell off

10-year Italian government bond yields rose to their highest level since 2014, peaking at 3.45%, following proposals by the ruling coalition government to run a higher than expected budget deficit of 2.4%. This represented an additional yield of 3% that investors demanded over and above its German equivalent.

Crude oil pushes higher

Crude oil pushed to new highs this week, with Brent crude oil touching $86.74 a barrel in intraday trading, despite US government data showing a sharp rise in US crude stockpiles, which rose by 8 million barrels. The looming US sanctions on oil exports from Iran is leading traders to anticipate a material tightening in the oil market as the Western world heads into winter.

Portfolio changes

We added an initial position in US Treasuries this week across Smartfund Cautious, Balanced & Growth, however, as we are concerned that longer dated yields could rise further, we invested in the 1-3 year part of the curve, where we think a greater proportion of future interest rate rises are already priced in. We also sold the very small position we had in 7-10 year US Treasuries ahead of this week's rise in yields.

Issues under discussion

The reaction of markets this week to the strong ISM data, continues to show just how jumpy investors are to the threat of re-emerging inflationary pressures and the potential for a more aggressive response from the US Federal Reserve. However, whilst we do not dispute that inflation is rising, it is the magnitude by which it rises that matters. As long as companies' earnings can grow faster than the increasing cost pressures on company margins, and inflation does not reach a level that the US Fed feels it has to further accelerate interest rate increases, we think markets can make further headwind from here. This is especially so whilst credit growth remains relatively weak in the US, as it is an important ingredient for inflation. However, it is also not a time for investors to be heroic and over the coming months we will increasingly be looking for opportunities to make further defensive investments.

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