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Smart[im]: Weekly Market Review

11th January 2019
Smart Investment Management

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

Markets and key events

Equity markets continue their strong start to the new year

Equity markets have returned very strong returns for the first full week of the new year, as bargain hunters have come out in force, buoyed by optimism over trade talks between the United States and China, and more accommodating words from the US Federal Reserve (Fed). The US S&P 500 rose 2.6% as of 12pm London time, whilst the technology focused Nasdaq index rose 3.7%. Emerging markets rose 3.5%, with the Hong Kong Hang Seng index rising 4.1%. Japanese equities climbed 4.0%, and in Australia equities rose 2.8%. European equities have been the relative laggards, with the EuroStoxx 600 rising 1.6% and the UK's FTSE All Share 1.9%. However, the more domestically focused UK mid cap index rose 4.4% over the week.

Fall in German industrial output

The latest industrial output data from Germany did not help European equity markets, as industrial activity fell by 1.9% between October and November, the third consecutive month of decline, with sectors from consumer goods to energy all impacted. This was far worse than the 0.3% gain forecast by economists. Germany's GDP fell in the third quarter, a further fall in the fourth quarter would place the country in a technical recession.

Government bond yields remain low as Fed points towards pause in rate increases

Government bonds gave up a little of their recent gains but continue to trade at historically low yielding levels, partly due to various members of the Fed pointing to a pause in US interest rate policy. The Fed chairman, Jerome Powell, reiterated that the Fed had the ability to be patient with monetary policy, and, amongst others, James Bullard, another voting member of the Fed, warned that further interest rate rises risked pushing the US economy into recession. Similarly, minutes from the European Central Bank's latest meeting, showed increased concern amongst policymakers over the downside risks to the region's economic outlook. 10-year US Treasuries are currently trading at a yield of 2.71%, German Bunds 0.25%, and UK Gilts 1.29%.

Crude oil rallies

Within commodity markets, oil has been the standout performer year to date. Brent Crude has risen over 8% this week, and US WTI (West Texas Intermediate) rose over 10% as markets have factored in OPEC (Organisation of the Petroleum Exporting Countries) production cuts that are due to come into force this month and hopes for better global growth if the US/Chinese trade war subsides. Gold has continued to gently climb, now trading at $1,292 an ounce, as investors have increasingly sought out potential safe havens.

US dollar shows signs of weakness

Perhaps most significantly, on the back of the less aggressive US interest rate outlook, the US dollar has fallen back to levels last seen in October of last year. A strengthening US dollar sucks liquidity out of financial markets as investors repatriate funds to the US, and debt servicing costs of countries reliant on external financing spiral. Therefore, a

reversal in the US dollar has the opposite effect, an important ingredient for a recovery in emerging markets, where equity valuations are cheap, as long as the world economy can avoid a recession.

Equity rally loses steam as doubts return

Towards the end of the week the rally in equity markets began to lose steam, as doubts continued to linger whether the US and China can resolve their differences, before the 90-day truce runs out on the imposition of new tariffs between the two countries.

Issues under discussion

Next week the corporate earnings season kicks off in earnest. Companies need to convince investors that profits can continue to rise through higher sales, even as profit margins start to decline against a backdrop of higher input costs. Equity analysts have already been revising down their earnings forecasts, but further cuts may be required before markets find a firmer footing.