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Smart[im]: Weekly Market Review

11 May 2018
Smart Investment Management

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

Markets and Key Events

Positive week for equities in a week that President Trump seeks to re-impose sanctions on Iran

Despite last minute lobbying from European leaders, President Trump pulled out of the landmark nuclear deal with Iran, vowing to re-impose sanctions on Tehran. This sent the oil price to its highest level since late 2014 with Brent crude oil briefly touching $78 a barrel, before settling back to $77.4 by the end of the week. This boosted energy stocks and drove equity markets higher. It was also the week when the latest inflation print from the United States brought the US dollar rally to a halt, at least for the moment, providing relief to emerging markets. The US Standard & Poor's 500 Index rose 2.2% as of 12pm London time, MSCI Emerging Markets rose 1.8%, Eurostoxx 600 rose 1.3%, FTSE All Share 1.7%, and the Japanese Topix index climbed 1.3%.

US dollar loses momentum as inflation numbers come in below expectations

The US dollar, having rallied over 5% from its recent lows versus a basket of currencies, lost some of its impetus this week as the latest release of core inflation (excluding food and energy) in the US rose 0.1% over April. This was less than forecast, and kept the year on year rise at 2.1% which hardly pointed to an acceleration in inflation; in fact, the three-month annualised figure fell to 1.8% in April. The yield on the 10-year US Treasury, which moves inversely to price, fell beneath 3%. Encouragingly for the US Treasury department, despite the US Federal Reserve pulling back from quantitative easing, the latest auctions of $25bn worth of 10-year Treasuries and $17bn worth of 30-year Treasuries were both met with robust demand. The US Treasury department has not had to stump up as high a yield as anticipated, with the whole issue being taken up at 2.875%, versus expectations of above 3%. The soft dollar also allowed the gold price to rally, reaching $1,325 an ounce.

UK interest rates unchanged at 0.50%

The Bank of England left interest rates unchanged on Thursday at 0.50%, despite having previously guided towards a rate increase. A barrage of weakening data, particularly impacting the consumer and the high street, has led to this about turn, despite the Bank judging that the soft patch in the first quarter is temporary. Sterling briefly fell through $1.35, taking the exchange rate back to where it was at the start of the year versus the US dollar. The weakness in Sterling helped support UK equities, as those companies that derive significant revenues from abroad, benefit from the translation of revenues back into Sterling.

Italy a step closer to a Eurosceptic government

The Italian stock market came under pressure, as the two populist parties that won the most votes in the recent inconclusive general election came closer to forming a Eurosceptic government. Five Star and the League began discussing political agendas, policies of a joint government and their picks for prime minister and cabinet positions. The FTSE MIB, an index of 40 of the largest Italian companies representing a spread of sectors, was down 0.8% over the week.

Summit announced between US and North Korea

This was also the week that a summit was announced between President Trump of the US and Kim Jong-un of North Korea, due to take place in Singapore in June. North Korea released three US hostages on Wednesday as a diplomatic gesture, providing hope that the talks may yield a better outcome than history suggests.

Australian market rallies for the sixth straight week

The Australian S&P/ASX 200 finished the week marginally higher by 0.88%, its sixth straight week of gains. However, the financial sector detracted from performance as the Banking royal commission into financial misconduct, continued to weigh on banks and insurers. Notably this week, financial services company AMP Limited declined 5.8%, after the firm was issued with two class action lawsuits following allegations from the inquiry that AMP had lied to regulators, allegedly doctored an independent report, and charged customers fees for no service.

In other economic news, the Australian dollar finished the week up 0.1% at $0.754 against the US dollar, supported by a positive federal budget. The Australian government announced on Tuesday that it would return the country's economy to a budget surplus by 2019/20, a year earlier than planned.

Mahathir Mohamad sworn in as the world's oldest elected leader in Malaysia

Finally, Mahathir Mohamad was sworn in as Malaysian Prime Minister (PM) on Thursday, after sealing a historic general election victory that ended a six-decade long rule of the governing coalition he once headed. At the age of 92, he has become the world's oldest elected leader, trouncing the outgoing PM, Najib Razak, his onetime protégé, who has been widely accused of corruption, marking a sensational political comeback.

Issues under discussion

As markets have increasingly sought to price in higher inflation and higher interest rates in the US, there are yet to be any real signs of a significant acceleration in inflation. The latest figure of 2.1% for core US inflation, excluding energy and food, is hardly a figure that will send alarm bells ringing. Whilst inflation has undoubtedly picked up, from the middle of last year, a print of 2.1% is hardly new in this economic recovery, with the index having been at or above 2.1% for the whole of 2016.

Whilst we are not disputing that inflation and interest rates are rising, we are doubtful as to the magnitude they will rise by. If nothing else, the sheer indebtedness of the world economy means that a relatively small rise in interest rates will have a much more dramatic impact on slowing growth than in previous cycles. Therefore, we continue to believe that global growth is likely to remain low versus history, meaning that neither inflation, nor interest rates will rise as much as in previous cycles. This is likely to lead to an extended economic cycle, which is a positive environment for equities. However, if we are wrong, and the world economy is late cycle, historically this has still been a positive period for equity markets.