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Smart[im]: Weekly Market Review

23 February 2018
Smart Investment Management

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

Markets and key events

Equity rally comes to a halt

Last week's almost unbroken rally in equity markets came to a halt this week, as investors worried about a more aggressive interest rate stance from the United States (US) Federal Reserve, leading to large gyrations in markets. Over the week up to Friday 12pm London time, the US Standard & Poor's 500 index fell 1.0%, EuroStoxx 50 was flat at 0.0%, United Kingdom's FTSE All Share fell 0.7%, Japan's Topix index rose 1.3%, Australian S&P/ASX 200 rose 1.6%, MSCI Emerging Markets was broadly flat, rising 0.1%. The Chinese Shanghai Composite rose 2.8% but was largely playing catch up having been closed from Thursday last week due to the lunar new year.

Fed minutes point to a hardening stance towards interest rates

Following the US market correction triggered by rising Treasury bond yields, on Wednesday, the release of the minutes from the Fed's last meeting were keenly anticipated. In the run up to the release, the S&P 500 rose 1.2% on the day, before ending 0.6% lower by the close as the minutes were digested. The minutes pointed to the view that the US economy is set to gain momentum, hardening the argument for further rate increases. However, it is worth noting that at the time of the last meeting, Janet Yellen's last, much of the relevant inflation data had not been available, including the core consumer price index and average hourly earnings. The Fed's semi-annual monetary policy report due for release later today, will provide a timely update to the Fed's latest thinking. Attention has now shifted to the Fed's new chairman's, Jay Powell, first testimony before Congress next week. The yield on 10-year Treasuries (which moves inversely to price) rose to 2.957%, before falling back to 2.895% by the end of the week.

St Louis Fed cautions against rates rising too fast

As the probability of four US interest rate hikes rose from 20% to 27% as measured by the Fed Fund's futures market, James Bullard, president of the St Louis Fed, warned that central bankers needed to be careful not to raise rates too fast, thereby slowing the economy too much. This debate is set to run and run.

Oil price ticks up

The oil price rallied to a two-week peak following a data release from the US Energy Information Administration showing US crude stockpiles had unexpectedly fallen last week. Brent crude oil rallied to $66.39, before falling back to $65.92 by 12pm London time.

Gold falls back

Gold fell back from its recent highs, knocked by a resurgent US dollar, now trading at $1,329.

Changes to the portfolios

There have been no changes to the portfolios this week.

Issues under discussion

Inflation, deflation, productivity

We have cited for a couple of years now the potential for a return in inflation, and a policy error by central bankers as some of the key risks faced by investors. The events of the last couple of weeks has reinforced this view. However, when discussing the threat of inflation with the fund managers that we hold in the portfolios, they point out that many companies are still facing a weak pricing environment, often due to the enduring impact of technology, including the internet. The Federal Reserve's preferred measure of inflation, Core Personal Consumption Expenditures index, remains languishing at 1.52%, with the index historically having been closer to 2% before rates have increased. However, the recent pickup in average hourly earnings to 2.9% against a backdrop of a strengthening global economy, added to US tax cuts, and a Federal Reserve keen to 'normalise' interest rates ahead of the next downturn, have all understandably spooked markets. Until markets get greater clarity over inflationary pressures, we are likely to see increased volatility for much of this year.

Our expectations have been for inflation to rise, and for interest rates to follow suit, however, we continue to believe it is unlikely to get out of control, especially against a backdrop of a heavily indebted global economy. As well as keeping one eye on inflation, we are also increasingly looking for signs of productivity improvement, a factor that has been very much missing from this recovery, as companies have been reluctant to invest in their businesses.

In other news

KFC crisis

Whilst running a fast food outlet, the one thing you would have thought you would get right, is the supply of your key ingredient. However, this week more than 600 branches of Kentucky Fried Chicken in the UK have closed as they ran out of chicken! In some parts of the country, this has led the police to urge panicked fried chicken fans not to call 999 over the KFC crisis! The chaos has been caused by "teething" problems due to a change in the delivery contract to DHL.