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Smart[im]: Weekly Market Review

26 October 2018

Smart Investment Management

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

Markets and key events

Bellwether stocks spook investors

It has been a turbulent week for stock markets, spooked by the third quarter results of a number of US stocks, including Caterpillar, 3M and United Technologies. These companies, considered bellwether stocks by analysts trying to forecast the future direction of markets, reported rising costs, due to a combination of labour shortages and the impact of President Trump's global trade war. Many signalled that they will pass these rising costs on to consumers, raising fears about inflation and interest rate policy. The US S&P 500 Index fell by over 4% at its worst point, with the technology focused Nasdaq index falling 4.65%, its largest daily fall in seven years. This was a fall of over 12% for the Nasdaq from its August peak, and a 9.37% fall for the S&P 500 from its peak. However, solid results towards the end of the week from the likes of Microsoft, Ford and Twitter, enabled the market to recover somewhat, with the S&P 500 down 2.25% for the week, as of 12pm London time on Friday, and a loss of 1.75% for the Nasdaq. However, Amazon and Google issued disappointing earnings guidance for the fourth quarter after Thursday's closing market bell, and equity futures are pointing to further falls on Friday.

China records a positive week, but succumbs to equity market falls

Over the week most stock markets recorded losses, however, the Chinese stock market was one of the few exceptions. On Monday the Chinese stock market rose by its strongest one-day gain since 2015, with the Shanghai Composite rising over 4%, as Beijing announced a series of confidence boosting measures, following the release of slower than expected third quarter GDP growth of 6.5%. As investors mulled over the longer-term impact of these measures, together with rising concerns over the impact of the global trade war, Chinese equities soon went into reverse. However, over the week, the Chinese equity market still recorded a gain of 1.5%. Emerging markets as a group, were down 2.3%.

Rising costs passed on

On Tuesday, Caterpillar, the earthmoving equipment group highlighted rising costs due to higher metals prices as a result of the recently implemented US import tariffs. The group also reported that against a robust order book, it would pass these costs on to customers through price rises of between 1%-4% at the start of next year. It was a similar story for 3M, the industrial consumer products group that makes Scotch Tape and Post-it Notes, and United Technologies, which includes the lift business Otis. All three companies reported that profits would recover next year as these increased costs are passed on to consumers. This confirmed to investors the impact of the escalating global trade war, which up until now, had felt more like rhetoric rather than reality.

Mounting concerns

There is no shortage of other concerns on the minds of investors this week, as the European Union rejected, as expected, the Italian government's draft 2019 budget, pushing Italian government bond yields, which move inversely to price, back towards last week's highs. Despite the worsening political climate in Italy, and the softening in Eurozone economic momentum, the ECB (European Central Bank) announced on Thursday that it still expected to halt its asset purchase scheme by the end of 2018 as previously planned. The EuroStoxx 600 was down 3.2% for the week.

Conservative party rounds on Theresa May

Sterling fell beneath $1.30, currently trading at $1.279, as both pro 'Brexit' Conservative MPs and 'Remainers', rounded on Prime Minister Theresa May's Brexit plan. The FTSE All Share was down 2.3% for the week.

Crude oil falls beneath $80 as the Saudis suggest output to increase

Brent crude oil fell beneath $80 this week, as Saudi Arabia rowed back from a threat to the international community of higher oil prices, if Riyadh faced sanctions over the recent murder of the journalist, Mr Khashoggi. The announcement coincided with the latest data from the Energy Information Administration, showing another rise in US crude stockpiles. Brent is current trading at $75.98, having been as low as $75.2, and US WTI (West Texas Intermediate) is trading at $66.3.

A good week for safe assets

US Treasuries, UK Gilts and German bunds all made positive progress this week, with the 10-year bonds returning 0.7%, 1.7% and 1.1% respectively. However, given the low yields on offer, they do not provide the protection that they once would. Gold managed to buck its recent downward trend, rising 0.9% over the week, currently trading at $1,239 an ounce. Within equity markets, the Consumer Staples sector was one of the few safe areas in relative terms, falling 0.2% over the week.

Issues under discussion

It has been an anxious week for investors, as third quarter company results have increased nervousness that faster inflation may be on its way, combined with slowing growth, not a scenario that stock markets like. However, by the close on Thursday, of the 30% of S&P 500 companies that had reported third quarter earnings, 83% had beaten expectations. Investors, now in the second longest economic expansion on record, are justifiably jumpy, especially as the global trade war has escalated.

As for China, as the US has applied trade tariffs to Chinese imports, their currency, the renminbi, has weakened from Rmb 6.269 in April to Rmb 6.945 per US dollar today, a fall of 9.7%, which will help to maintain China's competitiveness and export a degree of deflation around the world. Despite recent stock market performance, emerging markets are in general in much better shape than they have been for years, and for many, much less dependent on dollar financing than they were historically.

What is key, is that the US Federal Reserve remains data dependent, and does not overtighten interest rate policy, choking off the economic cycle early. Whilst US interest rates continue to rise, markets are likely to remain volatile, even if, company results remain positive overall