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Smart[im]: Weekly Market Review

28 September 2018
Smart Investment Management

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

Markets and key events

The US Federal Reserve (Fed) stuck to the playbook this week, raising US interest rates by 0.25%, taking the Federal Funds rate to 2.25%, whilst providing enough guidance to point towards a further rate rise in December. Despite the ratcheting up in President Trump's global trade war, the Federal Reserve has yet to see any signs of tariff increases being passed on to consumers through higher prices. On the day, the US dollar weakened slightly, and US Treasury yields, which move inversely to price, fell, with the 10-year Treasury yield sliding from 3.11% down to 3.03%, as expectations of a more hawkish Fed were quashed. Over the week up to 12pm London time, the S&P 500 equity index fell 0.5%, whilst the technology focused Nasdaq index rose 0.7%. The 10-year US Treasury yield is currently trading at 3.04%.

The US dollar index, which measures the strength of the dollar against a weighted basket of internationally traded currencies, rose slightly after the Fed's latest interest rate decision. However, this was largely attributable to weakness in the Euro, rather than further weakness in emerging market currencies, which taken as a whole, strengthened against the dollar. Emerging market equities closed flat for the week, whilst Asian equities were down 0.7%, however, this disguises a rally in many Asian markets on Friday, despite US stocks losing momentum overnight.

On Thursday, despite previous assurances from Italy's technocratic economy minister, Giovanni Tria (who is affiliated to neither of the governing coalition parties), the Italian government unveiled plans for a sharp increase in public spending, proposing a 2.4% budget deficit, and putting it on course for a collision with the European Commission. The plan represents a statement of intent to stay true to their populist election promises, ahead of sending the budget plans to the European Commission for approval by the middle of October. A budget deficit of 2.4% represents a significant increase in fiscal expenditure from the target of 1.6% agreed by the previous centre-left government and is three times the level of 0.8% which had previously been planned for next year. On Friday, the Italian FTSE MIB equity index fell 3.8%, whilst yields on Italian 10-year government bonds spiked to 3.23%, having traded as low as 2.8% on Wednesday (bond yields move inversely to price). European stocks in general took a tumble on Friday, with the Eurostoxx 600 index trading 0.2% lower over the week and the UK's FTSE All Share 0.1% lower.

On Tuesday, Argentina's central bank chief resigned, after just three months in the post, triggering a 6% slide in the Argentinian peso over the week. The departure of the bank's chief has coincided with a 36 hour general strike in response to the government's new austerity budget. Additionally, the country has been seeking to close a revised bailout deal with the International Monetary Fund, which has already extended a $50bn programme to Argentina in order to shore up the country's finances.

Brent crude oil price hit $82 in intraday trading on Tuesday, its highest level in four years, as OPEC (Organisation of the Petroleum Exporting Countries) and Russia pledged to maintain current supply quotas. This was despite previously promising to increase supply in the face of falling Venezuelan output and ahead of US sanctions being imposed on Iran from November 5th. At the time of writing, Brent Crude is trading at $82.03 a barrel, while West Texas Intermediate is trading at $72.13.

The gold price continued to fall this week, suffering from the Fed's latest interest rate hike, now trading at $1,188oz. The latest inflation data out of the US, the Personal Consumption Expenditure index, came in at 2.1% excluding food and energy. With US interest rates now at 2.25%, this puts the US real yield, i.e. excluding inflation, in positive territory. Gold as a store of value, tends to perform well either in times of extreme stress or rapidly increasing prices, neither of which are being experienced currently.

Issues under discussion

The Fed thus far has remained consistent to its interest rate approach under Jerome Powell, steadily increasing rates against a background of mild inflationary pressures and increasingly robust US growth. Our expectations are that the Fed will continue on this path and for inflationary pressures to remain contained. Without an acceleration in US inflationary pressures, we do not believe the US dollar will perpetually appreciate, which should alleviate some of the pressures on emerging markets, particularly those running large current account deficits. Similarly, we think it is unlikely the Fed funds rate will get much above 3 to 3.5% in a world still heavily indebted. Therefore, 10-year US Treasuries yielding 3.10% or higher, offering a real return to investors after inflation, also look an increasingly interesting investment, especially given their defensive attributes in an uncertain economic environment.

In other news

It is being widely reported today that Elon Musk's tweet may go down as the most expensive tweet in history, given the decision by the US Securities and Exchange Commission (SEC) to file a fraud complaint against the Tesla chief executive, following his claim via Twitter that he was going to take Tesla private. The suit seeks to have Mr Musk barred from serving as an officer or director of a public company, threatening his leadership of Tesla at a critical time for the fledgling car company.

Fraud suits over publicly made statements are a very rare occurrence, with the expectation being that Tesla will settle with the SEC out of court.