

Further new S&P500 high – with NASDAQ confirmation

The S&P500 closed at a new all-time high on Friday, at 2,182.87, up 0.43% over the week, helped by the very well-received July Non-Farm Payrolls (255,000 jobs added) data, as well as a results season that is coming in better than expectations. The US dollar index was 0.70% firmer over the week, helped by the payrolls. With the tendency to more 'risk-on', the US 7-10 year government bond index closed 0.90% lower over the week, with the US 10-year Treasury yield currently at 1.59%, up just over 8 basis points over the week. The US 2-year Treasury yield, currently at 0.72%, was up just over 6 basis points. The NFP data naturally led to thoughts of a higher probability that the Federal Reserve will increase rates before year-end. The statistics - despite being just one month's data - was of course welcomed following the poor second quarter US GDP print of the previous week (at 1.2% annualized), which had lowered expectations regarding economic activity. Analysts had understood that an inventory effect was largely to blame for the 1.2% reading, but although history it had still been taken badly by the markets.

The other major event of the week was the 25 basis points reduction by the Bank of England in its key benchmark rate, to 0.25%, an historic low. Some commentators are saying that the BoE move now makes it a bit more difficult for the Fed to go in the opposite direction, to underline the policy divergence, likely *ceteris paribus* leading to a stronger dollar. The Bloomberg futures implied probability model is currently pricing-in a 26% chance of a hike in September, the same for November, and 46.7% for December, up from below 40% prior to the NFP data publication.

'S&P500 new high is good – with NASDAQ it's really good'

We believe it significant that the NASDAQ Composite index closed at a new all-time high, at 5,221.121, having risen by 1.1% over the week. This is an important

confirmation of the move by the S&P500, demonstrating a broadening bullish tone across the US markets - and shows an increased likelihood that the more bullish sectoral rotation away from staples that we have been looking for is actually occurring. Elsewhere, Eurozone stocks fell by about 0.6% over the week, and Japanese stocks fell by 1.9%, the latter impacted by the strong yen (currently at ¥101.82), following less policy accommodation from the Bank of Japan and the Japanese government than had been expected. Oil prices were approximately flat over the week, with WTI currently quoted at \$41.80, and Brent at \$44.27. WTI traded briefly below the \$40 level earlier in the week.

US private and public employers added 255,000 Non-Farm jobs in July, beating the high end of the expected range of outcomes according to Bloomberg (240,000), and the average consensus of 180,000. The stated unemployment rate of 4.9% remained unchanged, compared to the consensus estimate for a fall to 4.8%. Wage growth of +0.3% on the month in was slightly better than expected. ADP had said earlier that the US private sector added 179,000 jobs in July, beating the consensus expectation of 170,000; the official NFP statistics are more comprehensive than the ADP numbers, although the latter can at times be a good guide to the former - but not on this occasion. In other US economic data released last week, the Markit US Services PMI fell to 55.5 in July, from 56.5 in June, vs. expectations of 56.0. The Markit Composite PMI, which combines the manufacturing and services sectors, moved higher to 51.8, compared to June's 51.2. Lastly, US auto sales rose less than 1% in July, to just over 1.5 million new cars and trucks, Autodata Corp data showed on Tuesday.

'Mr Carney: A safe pair of hands'

The Bank of England met an almost unanimous expectation for a 25 basis point reduction in its key policy rate. It also increased its QE by £60 billion, as well as £10 billion in new corporate bond purchases



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over the next 18 months. Governor Carney once again signaled that he doesn't want to use negative rates, although they emphasized that the BoE has other options to provide stimulus if needed. The BoE cut its 2017 growth forecast to 0.8% (from the 2.3% in the May report), and marked expected 2018 growth down to 1.8%, from 2.3%. Our NBAD Global Markets FX colleagues are suggesting renewed downward pressure on Cable, noting that the MPC members have moved from 8/1 'in favour' of no cut last month, to 9/0 in favour of a cut last week. Since the Brexit vote, Mr Carney has wanted to see the immediate effect of it, and he clearly doesn't like it. For instance, UK July industrial production slumped. The Manufacturing PMI fell to 48.2 in July, from 52.4 in June, with an increase in new export orders being more than offset by reduced domestic demand. The Markit UK Services PMI posted 47.4 for July, down from 52.3 in June, the worst reading since March, 2009. It is well-known that the services sector is now the engine-room of the UK economy, responsible for about 80% of the value of output. The employment situation is believed to have turned a nasty corner. Mr Carney is hoping that the Bank's actions of last week will be sufficient to help offset the immediate

negative effects, and the seeming strength of them.

Eurozone manufacturing growth fell in July, according to the Markit Eurozone PMI, which fell to 52.0 in July, from 52.8 in June. This was apparently driven by weakness in France, Italy, Spain and Greece, although Germany, Austria and the Netherlands were quite strong. It looks as though the 'core' and the 'periphery' are once again diverging in terms of growth, which will be of concern to the ECB and the European Commission as they attempt to navigate the diverse Eurozone economy through the difficult "Brexit Straits".

'Japanese yen: possibility of a large short squeeze'

Turning to Japan, Prime Minister Abe's cabinet approved ¥13.5 trillion (\$133bn) in fiscal measures last week, in a package including ¥7.5 trillion in spending by national and local government, and ¥6 trillion via the Fiscal Investment and Loan Programme. It is thought that the plan could improve the outlook for growth in Japan in the year ahead, although there appears little expectation that inflation can be created, so the jury is still very much out on whether the yen can be weakened (to help exporters). Although the 100 level on the yen could be viewed as roundophobic, in reality it could be a very important level. If it were to give way, further – and quite rapid – yen appreciation could ensue.

India had some good news this week, in the form of India's upper house of parliament unanimously passing the GST, tax reform considered by many (including ourselves) as a truly significant event, and something awaited for more than a few years. With one unified tax rate across the country, economic growth should be facilitated. We currently have India under review, in terms of equities, fixed income, and the rupee. The reform now has to be approved by the states in the coming months before being implemented sometime in 2017, based on the fairly safe assumption that it will be approved.

'Downside risk in oil appears quite limited'

In the oil markets, prices look as though they have stabilized, having briefly dipped below \$40. In recent weeks the main concern had been increasing gasoline stocks, so US government data showing that gasoline stockpiles had fallen by 3.26 million barrels in the previous week was very good news, more than offsetting the effect of US crude inventories rising to 521.1 million barrels in the most recent data, according to the Energy Information Administration. Otherwise, the US rig count increased by seven, to 381, according to Baker Hughes data published on 5th August for the previous week. The World Bank recently said it sees oil prices staying below \$60 until 2020. We think this is too pessimistic a view.

INVESTMENT SUMMARY:

There is increasing comment about fiscal policy coming more to the fore in governments' economic policy, with much less reliance on monetary policy (at least in terms of QE). We have been hoping for this for some time, and it now appears to be happening.

'A disastrous Republican campaign'

In US politics, readers will be aware of the way in which the Republican campaign has been run during the last week, to the severe frustration of true Republicans. The latest New York Times 'Upshot' model gives Hillary Clinton an 81% chance of being the next US president, up from a low of 68% a few weeks ago. By the New York Times' own admission, their model may not be perfect, but none are. They also said it is slightly slow to react to the inputs, in which case the 81% reading may be slightly conservative. We will be paying attention when Donald Trump speaks on economic policy to the Detroit Economic Club tomorrow, Monday, the 8th August.

'High Yield dollar corporate debt still provides excellent yield – as well as capital upside'

Our Asset Allocation Committee is scheduled to meet later this week. In the meantime investment policy remains unchanged. We are overweight in US equities, which appears to be going well. We are also continuing to be overweight in High Yield Corporate Debt, which we believe continues to be part of the answer to the hunt for yield, as well as providing capital upside potential. The yield on the Bloomberg US Dollar High Yield Corporate Bond Index is 6.73%, with the index ahead for the year-to-date by 12.87%. It is at a 52-week high, and looks very sound from a technical perspective.

From West to East

Weekly Investment View

7th August, 2016

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