Global Economic News – 05th December 2018

Being the start of the month, we have received Purchaser Manager Index (PMI) numbers which indicate the overall health of the economy. Any number above 50 indicates growth and conversely any number below 50 indicates a contraction.

In the UK, activity in the UK services industry slowed in November. The index it calculates from the survey fell to 50.4 in November, down from 52.2 in the previous month. The survey covers 650 firms who are asked if their volume of business has changed to the previous month and has been disappointing. Despite still being in growth, the number has fallen and shows the general consumer sentiment which is slowing down. Despite the UK being a resilient economy, November's performance is the worst since February 2013. Unless demand revives, a slide into economic decline at the turn of the year is a distinct possibility. This has a direct relationship with the slowdown in current business activity and the deterioration in business optimism to an intensification of anxieties over Brexit. Clarity in relation to Brexit agreements is a very important determining factor to ensure the current stalling of growth does not translate to a downturn. Brexit uncertainty is draining optimism. The monetary policy committee forecasts for GDP growth of 0.3% in Q4 looks positive, and whilst a small fall GDP isn't likely, however no one should rule it out at this stage.

In Europe, there is no denying that the eurozone economy has been a weakening by the slowing in global trade this year. This has been an important theme which economists have considered when talking about future expectations as this factor isn't one to be ignored. Even Mario Draghi at the European Central Bank highlighted this point in his speech at the European Parliament. The loss in the Eurozone growth momentum mainly reflects weaker trade growth, but also some country- and sector-specific factors. Eurozone exports came to a standstill over the course of 2018 disconnecting sharply from global trade. Also, weaker global manufacturing sentiment has meant that capital expenditure (CAPEX) has slowed down investment within the bloc. The threat of US car tariffs continues to make for a subdued 2019 outlook.

In the US, the manufacturing sector activity expanded more than expected in November as the index rose from 57.7 in October to 59.3 in November. A recovery in new orders, production, and employment points to sturdy near-term activity, but we look for momentum to gradually slow and building supply constraints in 2019.

Construction spending was weaker than expected in October, declining 0.1%, while spending for August and September was revised down sharply. Construction spending is starting Q4 below the third quarter average, pointing to softness in the investment in structures component of Q4 GDP. In October, residential construction spending and private non-residential spending declined. Public construction increased 2.6%.

Barometers

The Barometers below look at some of the data we review on a day by day basis and by having these detailed, it gives you some insight into what is happening.

US Earnings are important because if the US starts to slow down, then so does the rest of the world.

For Q3 2018 (with 97% of the companies in the S&P 500 reporting actual results for the quarter), 78% of S&P 500 companies have reported a positive EPS surprise and 61% have reported a positive sales surprise. For Q3 2018, the blended earnings growth rate for the S&P 500 is 25.9%. If 25.9% is the actual growth rate for the quarter, it will mark the highest earnings growth since Q3 2010. For Q4 2018, 68 S&P 500 companies have issued negative EPS guidance and 31 S&P 500 companies have issued positive EPS guidance. The forward 12-month P/E ratio for the S&P 500 is 15.6. This P/E ratio is below the 5-year average (16.4) but above the 10-year average (14.6).

Money Flows;

By calculating money flows, we can analyse investors' perceptions on the markets and quantify whether they were positive or negative. A positive money flow is when a stock is purchased at a higher price, or an uptick and vice versa. This indication will give us a sign as to where we are on the economic cycle and the current sensitivity as we edge closer to the top. To be able to quantify this, we have looked at the Money Flow Index (MFI) which is a momentum indicator that measures the strength of money entering or leaving a market. The MFI adds volume to the Relative Strength Index (RSI) and is also commonly referred to as the volume-weighted RSI. An MFI of over 80 suggests that the security in question is overbought and under 20 indicates that it is oversold (over the past week).

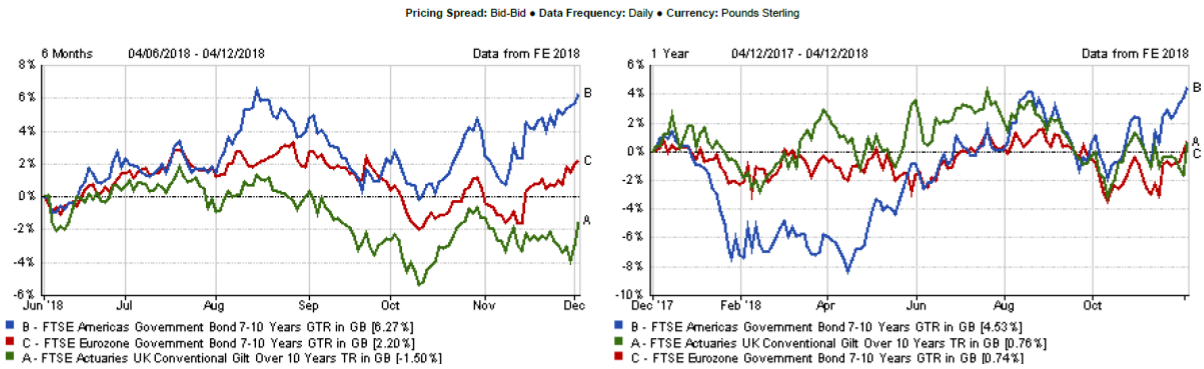
This week we have seen the money flows entering back into the markets after we have seen valuations drop. As the markets are volatile, we will continue to see volatility in the money flow index. To put into the context of how high the current market volatility is, we have been noticing on a weekly basis that the market flows enter new highs then new lows each week. Stock are expensive, and investors are willing to pay a premium for the stocks to benefit from the short-term uptake.

MFI.FTSE	FTSE 100	=	44.305	Previously 29.574 (Increase)
MFI.INX	S&P 500	=	65.046	Previously 50.306 (Increase)
MFI.STOXX	Euro STOXX 600	=	43.705	Previously 29.845 (Increase)

UK & Non-UK Gilt Yields;

UK and Non-UK Government Debt are a good measure, as they indicate whether we expect the economy to improve or worsen, with rising yields reflecting positive environment and reflecting positive interest rate movements as we look out. The opposite with lowering yields as the expectation is worsening economic conditions.

Over the last week, bond yields have dropped with corresponding valuations increasing for the UK, US and Europe. Markets are on the course for a correction at some point as equities are reaching record highs. Volatility remains high in these assets which should not be functioning like this. This is a further example of why we are still not directionally investing into these assets.



US Treasury Yield Spreads

The 10-year/2-year spread refers to the divergence between the 10-year US Treasury note and the 2-year Treasury note. In normal economic circumstances, the yield on the 10-year should be greater than the 2-year, creating a positive spread. This signals some combination of positive future growth expectations, that short term rates are low and money supply is strong and supportive of long term growth, giving rise to positive future inflation expectations, and basic recognition that more adverse economic events are likelier to transpire over a longer timeframe than a shorter timeframe. Therefore, investors are compensated for taking on the higher risk of longer-duration bonds in the form of higher yields. In its simplest form if the 10 year is greater than the two year then we are looking at expansion and rising rates if the opposite happens then we are looking at a slowdown and potential recession.

The current 10-2 Year Treasury Yield Spread is at 0.11% (divergence), compared to 0.15% the previous market day and 0.57% this time last year. This is significantly lower than the long-term average of 0.96%. The closer the two get to converging, the more risks are raised over a probable slow down or recession. It is apparent that the two are getting closer to converging, therefore we will closely be watching for when the two do converge. If we get an inversion which means the 2 year is higher than the 10 year that has signalled historically every US recession, so it cannot be ignored.

GBP to USD/Euro/JPY;

We monitor the GBP rate to see how much of the returns are coming from underlying equity valuation increases and movements in the currency, to see if we should be locking in the gains and hedging the risks. The 12-month expected range we have set below for sterling across the US Dollar, Euro and Japanese Yen is given the current economic climate and it is to reflect a more positive stance on Sterling in the near short term. Despite Brexit, the UK economy is quite resilient in showing optimism. It is inevitable that over the long term, as Brexit matures, Sterling will be more volatile and unpredictable, therefore it could potentially weaken further as the negotiations mature.

Sterling is completely correlated to Brexit at this current juncture as foreign exchange traders have found a reasonable place to park the currency. The currency continues to be a volatile picture and is impacted by any form of news which gives spikes to the exchange, such as this morning's services sector data, which showed that UK services slowed down, which edged the currency further down, we will continue to keep an eye on the currency markets and ensure we adjust our parameters below:

GBP / USD	–	Range 1.40 – 1.22	–	Today at 1.27392
GBP / EUR	–	Range 1.20 – 1.06	–	Today at 1.1238
GBP / JPY	–	Range 155 – 130	–	Today at 143.995
DXY (Spot USD)			–	Today at 96.451

Oil Price;

We monitor the oil price as it is a strong indicator of global consumption when balancing the output and inventory data. Strong supply and usage denotes a strong global economy. Opposite reflects underlying weaknesses.

The price of oil over the past week has been increasing. Brent Crude is currently trading at $61.83 and $53.04 for WTI Crude, up approx. 7% for Brent and up 7% for WTI. oil prices have been quite unstable recently and we are seeing really high volatility in the natural commodity. This weeks' volatility is between OPEC, the cartel of Middle East and African oil producers, and non-members such as Russia. Delegates from OPEC nations will meet tomorrow in Vienna before sitting down with non-members on Friday. There is speculation that OPEC and Russia could agree to production cuts to support oil prices. A cut in OPEC and Russia production of 1.3 million barrels per day will be required to reverse the ongoing counter-seasonally large increase in inventories.

Gold Price;

Gold is a safe haven and a spike in price can be an indicator of increasing underlying economic concerns and as always, the opposite.

Over the past week, we have seen the price of gold increase slightly by approximately $10 a troy ounce to $1,235.97 a troy ounce. Despite heightened risks in the market, gold is simply not doing what it should be and is therefore a reason why we are not directionally investing in the safe-haven asset.

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