

Weekly Digest

Week ending 17 July 2016

Come what May

As of last week, the UK officially has a new Prime Minister as Theresa May saw all competition in the Conservative leadership race either be cast aside by her party or rule themselves out of contention. As the week progressed the new cabinet was announced and it provided insight into the pressing concerns for May's government. Gone is the Department for Energy and Climate Change whereas the UK now has the Eurosceptic David Davis as Minister 'for Brexit' heading up the newly minted Department for Exiting the European Union.

Big changes have also taken place at the Treasury. Following the UK referendum, it had been widely understood that George Osborne would follow David Cameron out of front bench politics and last week that became a reality. In his place Philip Hammond has been appointed Chancellor of the Exchequer. Prior to the UK's membership referendum, George Osborne had envisaged announcing an emergency budget in the aftermath of a shock vote to leave, such were the perceived risks posed by Brexit. The new chancellor has ruled out taking such a step and this, combined with the Bank of England's decision to leave interest rates unchanged until there are greater levels of available data to analyse, leaves the UK economy in familiar territory for now. There is a powerful message in the maintenance of the status quo as long as there is no significant need to alter policy. Should conditions change, then it may be necessary to act quickly to stimulate the economy, but despite some deferral of investment and consumption due to the uncertainty of the outcome, neither a knee jerk rate cut nor an emergency budget seem necessary today.

Nevertheless the new chancellor will undoubtedly make some substantive changes to the UK's economic policy. The loss of George Osborne seems likely to bring with it

the end of his post-financial crisis, austerity driven policies. Mr Hammond has already gone so far as suggesting that while Mr Osborne's extreme public spending cuts were appropriate at the time, the economy is in "a new phase" implying that there could be greater flexibility on the timescales applied to balancing the UK's fiscal position.

It seems likely therefore, that Mr Hammond will allow more spending on public investment and, given the lowly prevailing interest rates payable on UK government debt, it would seem like a reasonable time to allow for borrowing so long as it is done prudently. This could ease some pressure on the beleaguered public sector as well as providing capital for infrastructure and other investment.

This increase in spending would likely bring with it an increase in overall demand because a portion of the spending would inevitably find its way into the pockets of the consumer and this should, in turn, provide a boost to consumer activity. This increased consumption (which accounts for a large proportion of the economy) coupled with a weakened sterling forcing up the price of imports could see inflation rise later this year. Further, if this becomes entrenched in inflationary expectations, rather than being viewed as an inflationary spike, it could lead to further upward price pressure. Too great a level of inflation would be unpopular today but it is fair to say that central banks are not short of firepower should they deem it necessary to act to curtail inflation through monetary policy. Nevertheless too harsh a tightening would be difficult in the face of weak activity data from the first half of this year, and could easily tip the economy back into low or negative growth; should inflation pick up this year it seems likely that the Bank of England would not be too quick to curb it unless it became entrenched in future expectations.

The Marketplace

- Strong US data pushes shares to record highs
- Continued expectations for Japanese stimulus; yen sells off
- China GDP growth on target
- European bank stocks rally
- Sovereign bond yields rise

Market Focus

US

- Strong monthly data from the US included retail sales rising by 0.6% month-on-month last week, versus expectations of +0.1%. Official measures for both Industrial and manufacturing production printed above expectations: reading 0.6% and 0.4%, above expectations of 0.3% and 0.1% respectively. One year inflation expectations also rose by 0.2% to reach 2.8%.
- The positive data resulted in the Atlanta and New York Federal Reserves both revising Q2 GDP growth forecasts up by 0.1%, to 2.4% and 2.2% respectively.
- US equities were up 1.5% for the week. The S&P 500 and Dow Jones Industrial Average indices both closed the week at record highs.

Japan

- Economists' expectations of a new JPY 10-20 trillion stimulus package, following Shinzo Abe's election victory, pushed the Japanese stocks market higher and caused the yen to devalue against the dollar:

Japanese equities rose by 8.9% last week, whilst the yen fell 4.1% against the dollar. Despite the weekly depreciation, the currency is still up 14.7% against the greenback year-to-date.

China

- China Q2 GDP growth came in at +6.7% year-on-year, beating expectations of 6.6% growth and falling within the government's target range of 6.5-7%. Chinese equities were up 2.2% over the week.

Europe

- In the UK, Theresa May was officially instated as the new Prime Minister after her only remaining competitor Andrea Leadsom dropped out of the race. In a surprise move, Mrs May appointed Boris Johnson as Foreign Secretary in her new cabinet. The former foreign secretary Philip Hammond becomes the new Chancellor, after the new PM dismissed George Osborne.
- European bank stocks rallied on the hope that the EU and Italy could come to an agreement on how to handle the troubled Italian banking sector. German Chancellor, Angela Merkel, made reassuring comments, stating that: "Overall, I see no crisis-like developments." The Euro Stoxx Banks index gained 8.4% over the week whilst Italian equities rose by 4.3%.
- A positive week for UK (+1.2%) and continental European (+3.2%) equities coincided with rising bond yields. Most notably, yields on 10-year German government bonds rose 19.5 basis points to finish the week with a positive yield of 0.006% for the first time since 'Brexit'.

James Klempster, CFA & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 15 July 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.5%	3.1%	6.7%	4.2%
United Kingdom	GBP	1.2%	2.5%	9.6%	2.4%
Continental Europe	EUR	3.2%	2.7%	-5.6%	-12.7%
Japan	JPY	8.9%	5.7%	-13.9%	-18.3%
Asia Pacific (ex Japan)	USD	4.5%	4.3%	6.8%	-3.5%
Australia	AUD	3.8%	3.8%	4.9%	1.0%
Global	USD	2.3%	2.9%	3.6%	-1.8%
Emerging Market Equities					
Emerging Europe	USD	5.1%	4.9%	15.2%	-7.0%
Emerging Asia	USD	4.8%	4.2%	6.5%	-4.5%
Emerging Latin America	USD	4.3%	3.9%	30.3%	-3.0%
BRICs	USD	4.5%	4.1%	8.8%	-8.9%
MENA countries	USD	2.2%	2.9%	2.1%	-17.1%
South Africa	USD	6.2%	4.5%	20.9%	-10.0%
India	USD	2.8%	3.8%	7.1%	-4.0%
Global Emerging Markets	USD	4.8%	4.2%	10.9%	-5.2%
Bonds					
US Treasuries	USD	-1.3%	-0.4%	5.3%	6.3%
US Treasuries (inflation protected)	USD	-1.1%	0.3%	6.8%	5.1%
US Corporate (investment grade)	USD	-0.5%	0.7%	8.4%	8.7%
US High Yield	USD	1.8%	2.8%	12.1%	4.3%
UK Gilts	GBP	-1.1%	0.3%	12.5%	16.0%
UK Corporate (investment grade)	GBP	0.6%	2.6%	10.1%	12.3%
Euro Government Bonds	EUR	-0.8%	-0.2%	5.5%	7.8%
Euro Corporate (investment grade)	EUR	0.3%	1.1%	5.2%	5.9%
Euro High Yield	EUR	1.2%	1.7%	5.4%	4.1%
Japanese Government	JPY	-0.8%	-0.4%	7.3%	9.6%
Australian Government	AUD	-0.4%	0.2%	6.3%	8.5%
Global Government Bonds	USD	-2.0%	-1.2%	9.3%	11.0%
Global Bonds	USD	-1.2%	-0.5%	7.8%	8.7%
Global Convertible Bonds	USD	0.8%	1.1%	0.4%	-0.8%
Emerging Market Bonds	USD	-0.1%	1.5%	14.0%	14.5%

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Property					
US Property Securities	USD	0.3%	1.6%	14.5%	18.9%
Australian Property Securities	AUD	1.0%	3.0%	17.0%	17.9%
Asia Property Securities	USD	3.5%	2.2%	5.4%	-1.7%
Global Property Securities	USD	1.6%	1.8%	10.9%	9.9%
Currencies					
Euro	USD	-0.3%	-0.8%	1.5%	0.6%
UK Pound Sterling	USD	1.8%	-1.0%	-10.5%	-15.7%
Japanese Yen	USD	-4.1%	-1.6%	14.7%	18.1%
Australian Dollar	USD	0.1%	1.6%	3.9%	2.6%
South African Rand	USD	-0.3%	1.0%	6.2%	-14.8%
Swiss Franc	USD	0.0%	-0.7%	2.0%	-3.1%
Chinese Yuan	USD	-0.1%	-0.8%	-3.0%	-7.2%
Commodities & Alternatives					
Commodities	USD	1.1%	-1.1%	9.6%	-13.7%
Agricultural Commodities	USD	1.3%	-0.3%	4.7%	-7.2%
Oil	USD	1.8%	-4.2%	27.7%	-16.5%
Gold	USD	-2.1%	1.2%	26.0%	16.4%
Hedge funds	USD	0.3%	1.0%	0.0%	-5.1%

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