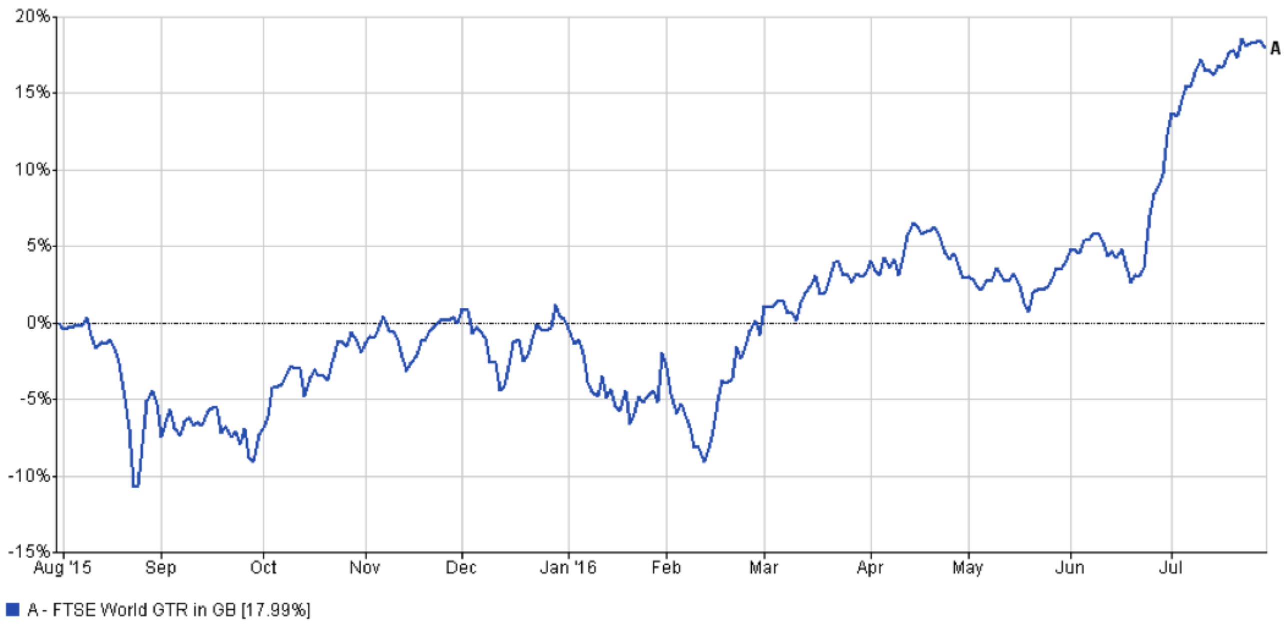
CAERUS Market Commentary – July 2016

Market overview

A good month for shares with the FTSE World Index advancing by 5.07% in sterling terms, resulting in a more than respectable rise of nearly 18% for the year to July. (Source: FE Analytics). As we saw in the run up to the Brexit referendum in June, politics may well dominate economics, with the intriguing US election now less than 100 days away. In bond markets, yields continue to fall, with the UK 10 year Gilt now yielding a meagre 0.73% and the German Bund "yielding" a negative 0.4% – extraordinary times! It appears some Investors are so risk averse, they are prepared to lose some money for the sake of safe Investments. The long term consequences of such low rates are yet to be fully established.



Source: FE Analytics

United Kingdom

The UK stock market has continued to progress upwards post the Leave vote in the last week of June. Certainly, the fall in sterling against other major currencies has helped companies that sell overseas via lower export prices, or those companies with a high level of overseas operations, as their profits translated back into sterling will have gone up. The long term economic effects of Brexit are still being hotly debated. It appears the economy was set fair prior to the vote, but since 23 June it appears there has been a fall in business confidence. This has generated expectations of a cut in the base rate in August. Overall, it is still too early to say if we are seeing a prolonged or a temporary blip, as consumers and companies get used to the new paradigm. We will be watching the figures in the next couple of months to get a clearer picture.

Europe

European markets recovered the losses incurred immediately after the UK's decision to leave the EU by returning approximately 4% during the month of July (FTSE Developed ex UK). Sterling weakened slightly against the Euro meaning UK Investors experienced marginally higher returns than their mainland European counterparts, albeit with currency playing a much lesser role than in June. The ECB continued their bond-buying programme, but with a 0.4% minimum yield requirement in place, eligible German Government Bonds are few and far between. Estimates suggest eligible German issuance may be exhausted within the next year. The month concluded with the results of the EU banking sector stress tests being announced. Perhaps unsurprisingly, Italian Banks were a cause of concern and duly took much of the pain in terms of share price falls, though the sector suffered as a whole. While the overall consensus was a broadly healthier industry when compared with the previous stress tests, the prospect of a low/negative interest rate environment continuing into the future will likely act as a headwind for the sector regardless.

United States

The main source of news from the US appears to be the forthcoming political tussle between Clinton and Trump in November. Both appear to have their admirers and detractors and, after the surprise of the Brexit vote, pundits are much more cautious as to who will win. Meanwhile, the US economy appears to be flat lining, with several major companies such as Caterpillar, Ford and UPS less optimistic about the future. GDP only grew at an annualised 1.2% in the second quarter, much less than many commentators had been forecasting. Lacklustre global demand and the forthcoming election may be making companies more cautious about investment. However, consumer spending was robust and grew at over 4% in the quarter. This makes it likely there will be no interest rate rise in September.

Japan

The problems of Japan are well known; an ageing population, low birth rate and few immigrants. In recent years, the weak yen has helped exporters via lower prices, but in 2016 this has reversed. The yen is seen as a safe haven in time of uncertainty and it has appreciated this year, making it harder for growth to come via exports. Interest rates are already negative, inflation is still low and retail sales were down on the year. It will be interesting to see what monetary weapons the Japanese have left to kick-start their economy.

Emerging Markets

The recent events in Turkey are a reminder that emerging markets Investment still comes with a lot of risk. However, recently there have more pluses; commodity prices are up this year, China appears to be stable and recorded over 6% growth year on year, plus a stable US dollar with interest rate rises being pushed back all helping. This is especially helpful to companies that owe debt in US dollars. When the US raises rates the dollar goes up, making that debt more expensive to repay. This perhaps explains why Investors have been increasing their allocations to this asset class over the past couple of months as a ‘lower for longer’ scenario in US rates should support businesses in the emerging markets.

CAERUS Sentiment Indicator