# CAERUS Market Commentary – July 2017

## Market overview

### July Indices

| Index | June Return (£ base) |
|---|---|
| FTSE World Index | 1.06% |
| FTSE USA TR GBP | 0.54% |
| FTSE Europe ex-UK TR GBP | 1.82% |
| FTSE Japan TR GBP | 0.45% |
| FTSE 100 | 0.86% |
| FTSE all share | 1.17% |
| FTSE EM | 4.34% |

Source FE June 2017

Past performance is not an indication of future returns. The value of investments and any income from them is not guaranteed and can go down as well as up.

Volatility was subdued in July, but capital markets were offering mixed signals. Central bankers clambered to moderate the hawkish tone they had struck at the end of June when the market reacted nervously to the possibility that liquidity might be withdrawn. QE has been the life blood in asset pricing over the past decade but it is too soon to fear its complete withdrawal. As the graph below highlights, a reasonable unwinding by the US Federal Reserve is a mere head wind to a continued global injection. One estimate of total excess liquidity calculates it as high as $15tn – one fifth of global stock market capitalisation.


At some point central banks will turn off the liquidity tap but it is important to keep a focus on the evidence of a number of bright spots in global markets, albeit that valuations look to grow ever steadily pricier.

### United States

US manufacturing activity rose to its highest level in three years, while non-manufacturing activity was also strong. Retail sales disappointed and we saw a slight increase in the unemployment rate, while the participation rate – the percentage of the adult population at work or looking for employment – ticked up slightly. Consumer confidence remained strong and GDP estimates of 2.6% growth for Q2 were positive signals. With the US Conference Board's leading economic index rising faster than expected in June, there are signs growth could reaccelerate in the coming months. This would do a lot to encourage markets.

In other news, the US tech sector surged past its dotcom bubble peak for the first time (S&P500 IT index) as more than $9bn of new money was allocated to US tech stocks this year. It is interesting to compare the sector to its 2000s peak. Today, it is expected that 25% of the S&P500's earnings will come from the tech sector, compared to 15% at the peak in 2000. Despite doubts around the current level of tech valuations, today's earnings are generated from a market cap of 23% of the S&P500 compared to 33% back in 2000. This implies a valuation multiple, today, of 19.4x 2017 earnings, considerably more reasonable than the 70+ multiples at the turn of the century.

### United Kingdom

As we pass the anniversary of the Brexit vote, inflation data is highlighting the impact of costlier imports and more expensive foreign holidays on personal finances. While investors with overseas assets book profits, the indebted UK consumer is struggling to bear the brunt of the currency revaluation. Consumer spending fell at its steepest rate for four years in the three months to June, while disposable incomes have dropped for the third quarter in a row in the nine months to March. Previous data has shown that the savings rate has been sacrificed to bolster spending – a temporary solution at best. At 1.7% of disposable income, this is the lowest level since 1963. As recently as last year, the ratio stood at 6.1% and has averaged over 9% across the last half a century. In spite of the savings offset, a tightening of the belt and cuts in discretionary spending have still been required. There was no relief from other data; with business confidence contracting, service sector growth moderating, car sales falling and industrial production and construction data also poor. UK productivity saw its first decline in Q1 since 2015. Despite the FTSE100 deriving the majority

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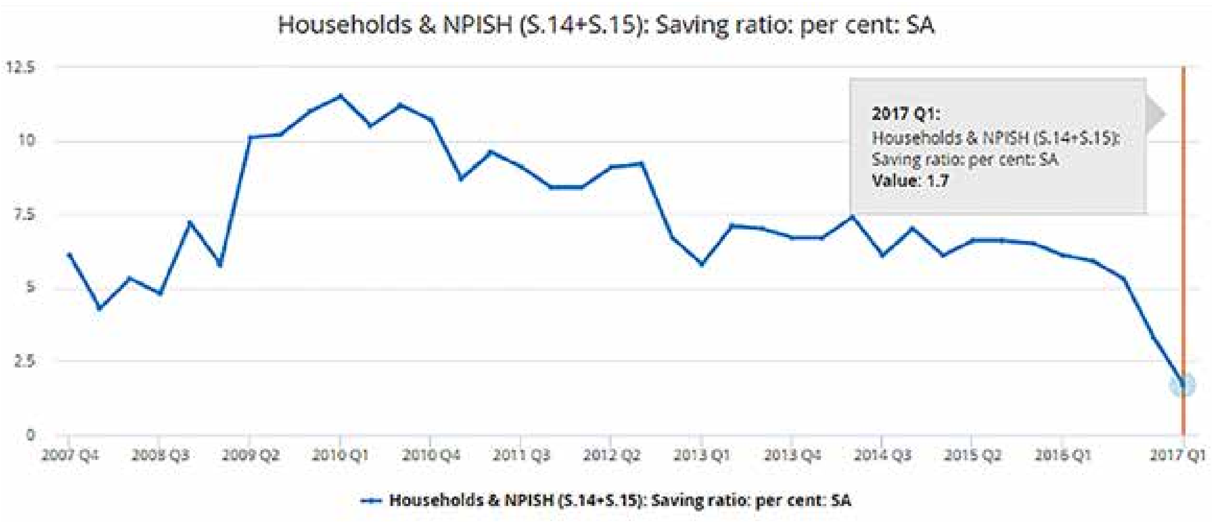
of its earnings from abroad, a struggling economy will put downward pressure on UK equity returns, given the holdings in domestically focused mid-cap companies which many active managers prefer.


Source: ons.gov.uk (release date 30Jun2017)

## Europe

European earnings expectations are looking much better this year, with analyst forecasts improving in stark contrast to the last decade of consistent downgrades. There is a long term international underweight to the Continent, so continued positive results could see a significant flow of investor money which would take months to play out. Equally, this flow should help support the Euro and give unhedged investments into the EU a boost. Euro-area industrial activity grew at its fastest pace in nearly six years while central Europe is seeing a wave of wage demands reflecting the strong growth and tight labour markets. German retail sales came in positively and the Spanish unemployment rate fell to 17.2% from 18.8%. All in all, there is continued positivity from a low base of expectations which goes a long way to explain why the European Central Bank is modulating its rhetoric with respect to monetary support.

Another notable positive was Greece raising £3bn in its first sovereign bond issue for a number of years. While its debt to GDP ratio, standing at 180%, is still of concern, this successful placement is another sign of confidence in the recovery of the Eurozone.

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## Japan

The significant news in July was that the EU and Japan have struck a free trade deal. This partnership could make up 19% of global GDP and 38% of global exports and points to a different future compared to the UK and its exit from the European trading block, and equally to the Trump administration as it postures to its supporters on the possibility of protectionism. Data release also showed that business confidence in Japan's large manufacturers came in at its highest level in three years.


## Emerging Markets

In another move, pushing back against the reaction to globalisation, China opened up its $9tn bond market, the third largest globally, to foreign investors for the first time, in July. This is further evidence of China's increasing standing in global asset allocation, coming fast on the tracks of last month's announcement of plans by MSCI to include China in its emerging markets indices. China's economy grew by an annualised rate of 6.9% during Q2, boosted by strong retail sales and an expansion of industrial production.

Meanwhile, Samsung became the most profitable non-financial company in the world, posting second quarter profits of £12.1bn. This compares to an estimated operating profit of $10.5bn for its smart phone competitor, Apple. More significantly, Samsung's profits are larger than the combined profits of the FANGs – Facebook, Amazon, Netflix and Google – which total $11.15bn. These strong results come largely from Samsung's memory chip business, where increased demand and reduced supply have boosted earnings. Samsung also controls circa 95% of the lucrative OLED (organic light emitting diode) market crucial to mobiles, PDAs and hand-held devices.