DECEMBER 2018

MACRO BRIEF

In association with Cormorant Capital.

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LAST MONTH IN MACRO

Sino-US relations

Paused

The US administration was due to impose increased tariffs – from 10 percent up to 25 percent – on $200 billion of Chinese imports from 01 January next year. Now, following a slap-up meal for two in Buenos Aires, Presidents Trump and Xi have reached some kind of temporary accord.

The US has agreed to a 90-day moratorium on the increased rate and the Chinese have promised to address the imbalance in trade. Indeed, President Xi has offered immediate orders for US agricultural produce and, in the run up to 01 March 2019, 'very substantial' imports of energy and industrial goods.

And while the stock market will react favourably in the short term we are, I'm afraid, a very long way from any kind of lasting entente.

More important for the prospects of any kind of happy settlement between the world's giant economies will be coincident background negotiations pertaining to intellectual property and the transfer of technology.

The 'trade war' is really little more than a battle in a wider strategic struggle between China and the US for economic (and military) dominance. It's a wider struggle that will last a generation and pivots around technological know how. While Trump blows hot and cold on headline trade, there are those in his administration that will push hard for meaningful and measurable concession from China. Vague promises to increase imports won't do.

Meeting minutes (Federal Reserve)

Close to neutral

In more temporary good news for the stock market the Chairman of the Federal Open Market Committee made comments which the market took to mean that the Fed was close to the neutral rate of interest. A sharp increase in stock prices reflected updated expectations for just a single rate rise in 2019 (following another increase in December this year).

I'm not at all convinced that the stock market has interpreted this one correctly. I'm sticking with a baseline increase of 0.75 percent next year.

Data from the Wall St Journal, FT, Federal Reserve and CME Group.

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EMPLOYMENT SITUATION (USA)

Less than expected

The Bureau of Labor Statistics' Nonfarm Payroll report counts 155,000 new jobs during November. That falls some way short of expectations for around 198,000 and brings the average for the last three months, at 170,000, to the slowest pace in a year. Still, November marked a record 98th consecutive increase in filled positions. Meanwhile unemployment remained at 3.7 percent – the lowest level in 50 years – and wage growth held steady too at a year-on-year rate of 3.1 percent. Apparently, JP Morgan (as reported in the Wall Street Journal on Friday) put the odds of a US recession in the next 12 months at 35 percent 'based on the latest economic data', 42 percent based on 'financial markets' and 41 percent 'based on the yield curve'. I'm a little less alarmed than JP Morgan. Actually, the average estimate for the chances of a recession is closer to 20 percent and that feels about right to me. Bear in mind though that the same estimate was sitting at 15 percent at this time last year so we are not looking at a particularly dramatic increase. I'm not contending that the US economy is slowing. It is. But there is very little evidence to suggest that the slowdown is anything more than a reversion to trend rates of growth (closer to 2.5 percent) following a temporary boost to output.

MARKET MOVES (GLOBAL)

Gilts are good

Prices for British government bonds increased at quite a pace last week. Indeed, the long-dated gilt index – comprising gilts with a maturity of 15 years or more – is up 3.8 percent and the index-linked category is up 3.4 percent. Those movements might surprise some. I mean, eager demand for British bonds was apparent in spite of a coincident deteriorating outlook for the British government itself. Who knows what's going to come about from this week's vote in parliament, and freespending Jeremy Corbyn is actually the bookies' favourite to be the next Prime Minister. And those movements might disappoint others. Indeed, lots have shunned 'guaranteed losses' in bonds for the promise of some kind of absolute return elsewhere. Incidentally, the best performing 'absolute return' fund I can find is Sarasin's Systematic Absolute Return UK, whatever that is. It was up a miserly 1.8 percent during the week. But those movements will come as no surprise to you. It is a pattern we count on. And it is a pattern that affords two advantages… First, increased returns from gilts during periods of market stress have a braking effect on portfolio losses. Second, selected gains allow for the intelligent purchase of lower-priced risky assets (even as a function of normal portfolio rebalancing). That is why I advocate holding gilts.

Data source: Bureau of Labor Statistics, Wall St Journal, Financial Express Analytics.

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YIELD CURVE (USA)

Unconvinced

There are those that are utterly convinced that the US yield curve (see p.49) will invert in a matter of weeks or months. Taking that one step further, they are similarly convinced that an inverted yield curve will be unfailingly followed by a recession. Further still, a recession will occur not more than 18 months hence. It's all there in the tea leaves. I'm not minded to dismiss that view. Indeed, I think it entirely plausible that such a sequence of events may come to pass. But what does set me aside is that I am not wholly persuaded by a narrative which is, by now, widely held. In fact, I see other scenarios which are plausible to a greater or lesser extent than that. Actually one or two of those I am modelling are tantamount to heresy… For instance, the yield curve might not invert; in which case we may or may not see a recession. Or, the yield curve might invert; in which case we may or may not see a recession. I am at least willing to contend that the yield curve, as an indicator of near-term recessions, does not retain the predictive power others unquestioningly assign to it. I'll write in some detail about this early in the new year. In the meantime, if you're holding a generally diversified portfolio – comprising equities, corporate bonds and government bonds – you are in good shape come what may.

OECD COMPOSITE LEADING INDICATOR (GLOBAL)

Easing momentum

The boffins over at the Paris-based Organisation for Economic Cooperation and Development hypothesise that momentum in the global economy is easing. Output growth is slowing in the UK, the euro-area and, more recently, the US too. Meanwhile prospects for growth are stable in Japan and many of those countries that make up the emerging market economies. I'm neither cheered, nor alarmed by the OECD's assessment.

MONETARY POLICY MEETING (UK & USA)

We stick, they twist

The rate-setting committees at both the Bank of England and the Federal Reserve meet in the week ahead. The Bank of England will likely hold Bank Rate at 0.75 percent. Before that though, the Federal Reserve will likely increase the upper limit on the Fed Funds rate to 2.50 percent. Assuming they do instruct a fourth increase for the year, the market will be very keen to assess the accompanying projection material to see if the Fed still 'expects' to raise rates 3 times next year. Anything less than that will be warmly received by the stock market

Data source: US Treasury, OECD

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LAST MONTH IN WORDS

‘China hawks in Congress and the intelligence establishment began thwarting Huawei’s rise around 2007, current and former U.S. officials say. As the Chinese company burgeoned into the world’s biggest manufacturer of cellular-tower hardware and related telecommunications equipment, they expanded the effort into an allout offensive under President Trump, interpreting his anti-Beijing campaign promises as a green light… U.S. officials stress that although the anti-Huawei campaign has unfolded while the U.S. and China feud over trade, they consider this a separate, national-security issue’.

Source: Wall Street Journal, 08/12/2018.

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LAST MONTH IN WORDS

‘Germany is tightening rules to make it harder for non-European companies to buy stakes in German firms without its approval, signalling growing concern in Berlin about China’s push to acquire key technology and know-how.

China’s aggressive plans to purchase assets around the world has forced a series of countries to take steps to screen the investments, many times blocking them’.

Source: Wall Street Journal, 16/12/2018

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NOTES

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(1) MSCI United Kingdom Value, Bats 100, Bats 250, Bats UK Small Companies, S&P 500, Euro Stoxx 50, Nikkei 225, MSCI Brazil, MSCI Russia, MSCI India, MSCI China, Financial Analytics (2) MSCI United Kingdom, MSCI World ex Value, MSCI Emerging Markets, MSCI United Kingdom Value, Bats 100, Bats 250, Bats UK Small Companies, Barclays Gilt 1 – 5 Years, Barclays Sterling Gilts, Barclays Sterling Gilts 15+, Barclays UK Government Inflation Linked Bond, Financial Analytics (3) MSCI World, Barclays Global Convertibles, Barclays Global Treasury, MSCI World ex UK Large Cap, MSCI World ex UK Small Cap, MSCI World ex UK Value, MSCI World ex UK Growth, MSCI World, MSCI World Equal Weighted, MSCI World High Dividend, MSCI World Minimum Volatility, MSCI World Momentum, Financial Analytics (4) MSCI World Consumer Discretionary, MSCI World Consumer Staples, MSCI World Financials, MSCI World Health Care, MSCI Industrials, MSCI World Materials, MSCI World REITs, MSCI World Technology Hardware & Equipment, MSCI Telecommunications Services, MSCI World Utilities, Financial Analytics (5) SPDR FTSE UK All Share ETF, SPDR S&P 500 ETF, SPDR MSCI EMU ETF, SPDR MSCI Japan ETF, SPDR MSCI Emerging Markets ETF, SPDR Barclays Gilt, iShares Index-Linked Gilts, iShares Global Corporate Bond ETF, iShares Global High Yield Corporate Bond ETF, Mixed Assets assume separate equal weighted parcels of equity and bond exposure (6) Financial Analytics, overseas exposure assumes equal weight in US, Europe, Japan and Asia (7) Reference National Life Tables, Office for National Statistics, sustainable income assumes life expectancy, a gross 5 percent growth rate, annual income paid out at the start of the period.

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