JUNE MACRO BRIEF.

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Financial Planning

LAST WEEK IN MACRO

10 JUNE HERE (UK)

Sunset Strip

I count 75 past Prime Ministers. On 7th June Theresa May will be the 76th. Nominations for the post of leader of the Conservative Party close three days later. As it stands, 13 candidates have declared and another 7 or so may or may not join the race. It is likely then, that the whole of June and a little of July will be given to a series of ballots before the final two candidates emerge (my money is on Boris Johnson and Michael Gove). A couple of TV debates will follow and the ultimate selection will be made by ordinary party members. Between you and me, I find the whole thing really quite exciting.

INFLATION (UK)

Two point whatever

The Office for National Statistics reports a 2.1 percent increase in the headline rate of inflation in April, up from 1.9 percent in March. The main contributor to accelerated price rises came in the form of energy costs which reflected a 'response from energy providers to Ofgem's six-month energy price cap'. I've read speculation that a further fall in sterling (a no deal Brexit is much more likely than it was) will see inflation persist above the Bank of England's 2.0 percent target and that, in turn, will encourage an increase in Bank Rate. The first part is right I think, the second is not. Bank Rate isn't going anywhere for a while yet.

10 JUNE THERE (USA)

Do what?

Last week, President Trump suggested he would impose a series of increasing tariffs on Mexican goods, beginning at 5 percent and heading to 25 percent, unless the Mexican government moves to stop illegal immigration. I'm not sure that this is quite the economic calamity some are suggesting but I can see no good in it. The net effect of punitive tariffs would be to increase 'taxes' on US citizens (in the short term at least) and to further impoverish Mexican citizens. More impoverished Mexicans likely means more illegal immigration. To an extent, the Donald's spat with China makes sense. This does not.

MANUFACTURING OUTPUT (CHINA)

Shrinking a little

The National Bureau of Statistics (China) reveals a worrying decrease in the survey results from the most recent Purchasing Managers' Index for the manufacturing sector. May's reading hit 49.4, downfrom50.1 in April and corresponding with a decrease in factory output.

The most recent deterioration is worrying because it comes on the heals of yet more fiscal and monetary easing. And it will have the effect of encouraging even more fiscal and monetary easing. That might be a good thing in the short term but it will have a destabilising effect in the long term.

Data source: Conservative Party,ONS, Wall St Journal, National Bureau of Statistics(China).

CONSERVATIVE LEADERSHIP ELECTION (UK)

What happens next

The 1922 Executive Committee and the Conservative Party Board have now set out the rules on how the leadership election will proceed. The net result is that we'll likely have the final two candidates identified sooner than anticipated. Indeed, the latest ballot of MPs is scheduled for 20th June and the first membership hustings for the final two candidates is scheduled for the 22nd June.

Beyond that, my best guess is that Boris Johnson will replace Theresa May as leader of the Conservative Party and Prime Minister on 23rd July.

EMPLOYMENT SITUATION (USA)

Tow point two five too

The Labor Department counts 75,000 new jobs in the May nonfarm payroll report; some way short of the 185,000 posts that made up the consensus expectation. Worse still, the earlier estimates for April and March were revised lower too. That brings the monthly average gain during 2019 to 164,000 compared with 223,000 for last year. The declining pace of payroll gains is consistent with other signs of a slowdown. The Atlanta Fed has the US economy tracking at a 1.4 percent pace as we speak, compared with closer to 3.0 percent a few weeks ago. That's why the bond market is pricing a rate cut in June at 25 percent and in July at nearly 90 percent. I'm not yet convinced of the necessity of a rate cut, but I am resigned to the likelihood.

MONETARY POLICY (EUROZONE)

Out of ammunition

The population of Lithuania, having peaked at 3.7 million in the early 1990s, has declined by as much as 25 percent in the decades since. Emigration accounts for the lion's share of that decline. Last week, the European Central Bank (ECB) did its best to reverse the brain drain, if only for a couple of days, when it held its meeting of the Governing Council in Vilnius.

At that meeting, Europe's top technocrats decided to maintain the policy rate of interest at -0.4 percent and to similarly maintain its current stock of government and corporate bonds by reinvesting principal payments from those that mature. In addition they promised not to increase rates until after the first half of next year – six months later than previously indicated.

The European Central Bank is adopting an increasingly dovish tone. There is good reason for that. Ever since the giant central bank ceased to add to its asset purchase programme in December, both inflation and output have dipped. The year-on-year increase in the Consumer Price Index has fallen from 1.5 percent to 1.2 percent and the manufacturing PMI has fallen from a little over 50 to a little under 48. Meanwhile the Bundesbank has warned that Germany, the euro zone's power house, is 'currently experiencing a marked slowdown'.

But what can the ECB do? In Mario Draghi's view, there is still plenty of 'headroom' for further asset purchases. In my view, there is not. Not without a significant change to the current guidelines. And so, significant changes are likely. Quite what those changes will be is anyone's guess right now, though I expect a clearer picture will emerge soon. Watch this space.

Sources: Conservative Party, Labor Department, CME Group, ECB, Bundesbank.

ECONOMIC OUTPUT (UK)

One step forward, two back

The Office for National Statics suggests that the UK economy shrank to the tune of 0.4 percent during April (hot on the heels of a 0.1 percent decline in March) though output increased 0.3 percent over the inclusive three-month period.

Rob Kent-Smith, in charge of the GDP calculation team, puts the most recent decline down to 'a dramatic fall in car production, with uncertainty ahead of the UK's original EU departure date leading to planned shutdowns'. There were broader signs of a slowdown in the manufacturing sector too though - as I anticipated - 'as the boost from the early completion of orders ahead of the UK's original EU departure date' brought production forward to the earlier period.

EMPLOYMENT SITUATION (UK)

A little lower

The Office for National Statistics counts 32.8 million in work in the UK; 357,000 more than a year ago. Discounting those that are younger than 16 and older than 64, 76.1 percent of UK citizens are in work – the joint highest level in a record that stretches for nearly 50 years. As an aside, at 72 percent, there are currently more women counted in the workforce than at any point previously recorded. The number of citizens reckoned to be unemployed is equivalent to 3.8 percent of the workforce.

Meanwhile total earnings grew at 3.1 percent (or 1.2 percent in real terms) in the three months to April.

CONFLICT (MIDDLE EAST)

Maximum pressure means maximum pressure

The US administration's campaign of 'maximum pressure' (coming in the form of punitive economic sanctions in the first instance and heavy diplomatic pressure in the second) is having a very real effect on the Iranian economy. Last year, economic output shrank by nearly 4 percent. This year, the International monetary Fund is forecasting a further decline accelerating toward 6 percent. Inflation is running away at 51.4 percent. Worse still, added to economic strife may well be military fury.

A month after anonymous attacks on four tankers off the coast of the United Arab Emirates, two more tankers have been similarly attacked with the finger of suspicion pointed in the direction of Iran's paramilitary group, the Islamic Revolutionary Guard Corps (IRGC). US Secretary of State, Mike Pompeo, thinks Iranian forces are 'definitely responsible' and our own Foreign Secretary, Jeremy Hunt, considers the same to be 'almost certain'. A video released by US Central Command does indeed appear to show the crew of an IRGC fast attack boat removing an unexploded limpet mine from one of the tankers in question. Iran has, in the past, threatened to disrupt the flow of oil in the region.

Intraday movements in Brent crude prices moved close to 5 percent as news of the incident emerged; not surprising perhaps, since around 20 percent of the world's traded oil travels through that particularly choke point. (Though 85 percent of that is bound for Asian, rather than US or European, markets).

Expect more volatility in coming weeks. Beyond that, I see little prospect of a sustained stoppage for maritime traffic in the region. Iranian attempts to do so would see friends desert Tehran very quickly indeed.

Sources: ONS, Central Command, BBC, Wall St Journal.

Inflation (USA, Japan, Euro zone, UK)

Out of town

Bond yields are down just about everywhere.

The 10-year rate in Japan closed last week at -0.24 percent. In fact, the benchmark 10-year rate has been consistently negative for close to 3½ years in spite of positive efforts, introduced by the Bank of Japan this time in 2018, to hold it closer to zero percent.

The equivalent German bond, yielding an astonishing -0.28 percent, has never been more highly priced than it is today. A little late to the party, but looking keen nonetheless, is the French 10-year rate currently priced at just 0.05 percent. Even the Spanish bond is dancing insanely fast toward the zero mark; compare today's 0.44 percent with a whopping 7.5 percent seven years ago.

Of course, sanity prevails in the anglosphere. The 10-year rate stands at 0.93 percent in Blighty, 1.30 percent in Australia and 2.07 in the US. Mind you, the music volume is beginning to creep up here too and rates have plummeted of late. The 10-year US treasury, for example, yielded 3.23 percent during October last year.

The punch hasn't been spiked though, not really.

There are those looking at the excesses in the bond market and pointing an accusing finger at the big central banks. Indeed, the Bank of Japan is holding a near empty bottle of saké and the mob from the European Central Bank (ECB) is running low on pilsner and pinot grigio. But, to be fair to them, that's why they were invited in the first place.

In fact, parties last as long as mum and dad are away. And bonds get giddy when inflation holidays.

Core inflation stands at 0.5 percent in Japan and 1.0 percent in the euro zone – miles from the 2.0 percent target. Core rates of inflation have been better behaved in the UK (1.7 percent), US (1.6 percent) and Australia (1.6 percent) but have consistently undershot 2.0 percent for years. The Federal Reserve's preferred measure of inflation, for example, has averaged out at 1.6 percent for the last 5 years or so. Worse, forward expectations of inflation in both the euro zone and USA signal sustained weakness.

The five-year-five-year inflation-linked swap rate, closely watched by the ECB, has just hit an all-time low and the Fed's own survey of consumer expectations has slipped to a two-year nadir. That is why we will likely see the Federal Reserve cut rates at it's next meeting and both the ECB introduce increasingly imaginative interventions in a bid to underpin consumer prices.

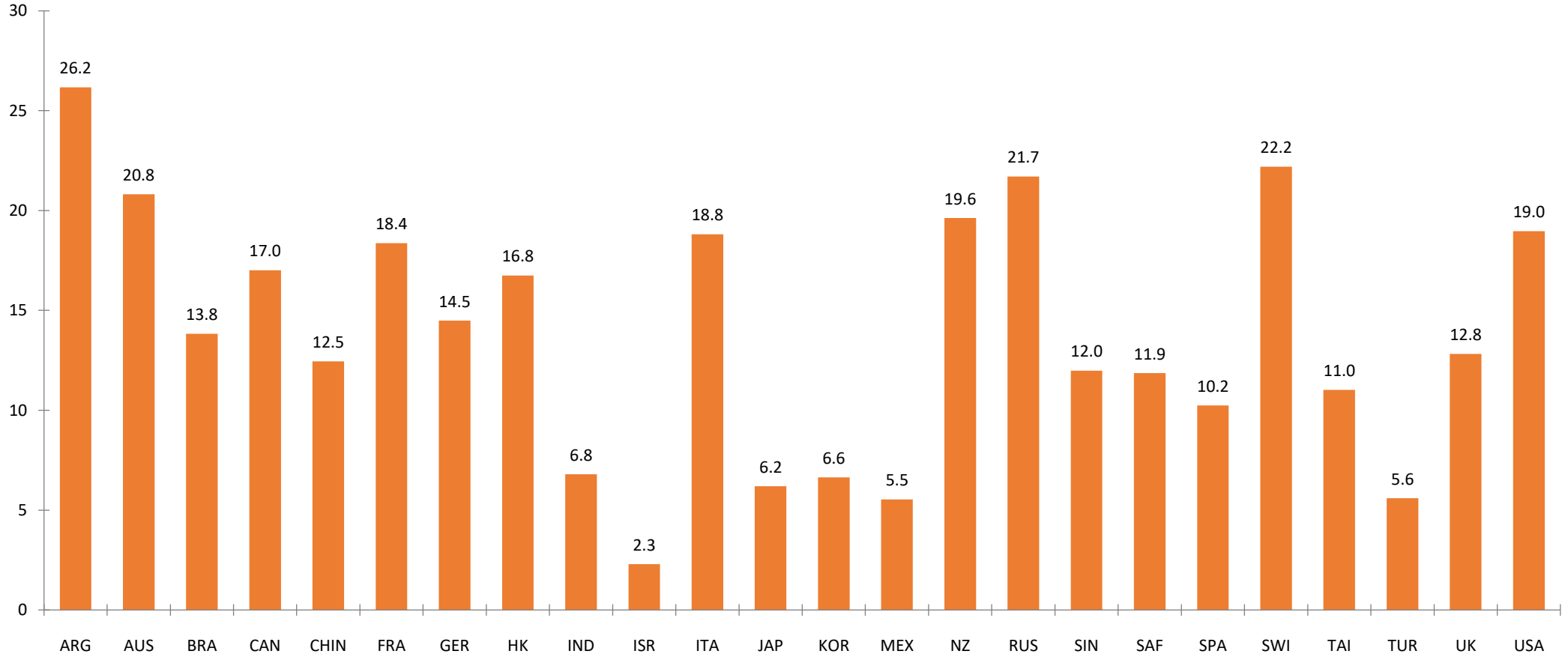
Inflation, or lack thereof, is a tailwind for bonds.

The notable exception is Britain. Only in the UK have we seen above-target inflation sustained for all but the briefest of moments. That, though, owes more to wild swings in the value of sterling. When the EU referendum was held in June 2016, the Consumer price Index was up just 0.5 percent on the prior 12 months. Sterling's immediate decline prompted inflation to jump to 2.6 percent the following year. Since then, it has averaged 2.6 percent. It's difficult to disentangle sterling's effects but my guess is that underlying inflationary pressures remain muted here too.

Who knows what might happen in the Straits of Hormuz and where oil prices are headed but, barring a protracted conflict, I see few reasons to believe the outlook for core inflation is anything but benign. Proponents of the 'great rotation' (or some other version of 'bondaggeddon'), if there are any left, have still longer to wait.

Sources: ONS, Central Command, BBC, Wall St Journal.

YEAR TO DATE IN STOCKS



Source of data: Financial Express Analytics, total return, local currency terms.

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.

www.townclosefp.co.uk

Suite 2, 258a High Road

Loughton

IG10 1RB

Tel: 020 7993 4898

Email: advice@townclosefp.co.uk