AUGUST 2019 MACRO BRIEF.

In association with Cormorant Capital.

TOWN CLOSE
Financial Planning

LAST WEEK IN MACRO

MONETARY POLICY (USA)

A hawkishcut

The Federal Reserve did exactly what the market anticipated when it cut the upper limit on the target range for the Fed Funds rate to 2.25 percent. At the same time the Fed announced plans to ease bond sales earlier than previously planned.

Still, the stock market sold off and the dollar gained. All because Jerome Powell's comments in the press conference afterward were less doveish than had been expected. Indeed, some market participant shave come to describe the fed's policy move in terms of a 'hawkish cut'.

I don't buy that. Mind you, I hadn't expected anything like a series of rate cuts. Indeed, the market appears to have reacted most awkwardly to the chair's suggestion that the rate cut they've instituted is merely an attempt to 'adjust policy to a somewhat more accommodative stance' to insure against headwinds in the form of 'weak global growth' and to 'support the return of inflation toward 2.0 percent'. Rather than beginning a long series of cuts of the sort the Fed might be expected to deliver in response to risks of a recession, the Fed's response better reflects a 'mid-cycle adjustment'.

In my view, there is little justification for anything more than the odd reduction in the main policy rate of interest. Inflation is muted and output growth has moderated but I'm struggling to see anything more serious than that.

As it stands, the market is pricing – to the point of near certainty – another cut when the Fed next meets again in September. Barring some emerging entente in trade talks with China, I reckon another rate cut is indeed likely. But that's about it.

INFLATION REPORT (UK)

Uncertain

The Bank of England published its latest quarterly inflation report last week and, in the process, revealed it's expectations for lower output growth for this year. Gross domestic product is expected to grow at just 1.3 percent compared with expectations in May for something like a 1.5 percent increase. Similarly, the risks are weighted toward an undershoot on the 2.0 percent target as far as inflation is concerned. But you can forget all of that; nobody can see beyond the next few weeks with anything approaching clarity. That's why you can also forget Mark Carney's suggestion that the Monetary Policy Committee is equally likely to raise rates as to reduce them. If the Bank of England raises rates anytime soon, I'll eat the late Paddy Ashdown's hat.

GENERAL ELECTION (UK)

Quite possible

The betting markets infer a probability of something like 54 percent that a general election is held before 2019 is finished, that's up from 42 percent a few weeks ago. The likelihood that the current parliament sees out its full term with an election close to May in 2022 is just 14 percent. I think an election is more likely than is currently priced by either the betting market, the capital markets or the foreign change market. If I'm right, expect the greater part of an additional associated uncertainty to play out in a still lower exchange rate.

Right now, the bookies are pricing a hung parliament at 58 percent, a Tory majority at 36 percent and a Labour majority at 12 percent.

ECONOMIC OUTPUT (UK)

The sort of surprise you expect

A couple of weeks ago, I guessed that gross domestic product (GDP) would come in flat during Q2. My estimate was in line with that of the Bank of England and with the broader consensus too. In the event, a 0.2 percent fall in output – bringing the year-on-year rate to just 1.2 percent – came as something as a surprise. Not much of a surprise, mind – I mean, we're all heavily caveating our forecasts and invoking the 'Brexit uncertainty' clause as if one additional 'known
unknown' is the thing that fatally obscures our vision of the future.

Still, Brexit is actually the most likely explanation for the fall in aggregated output. Indeed, a surprisingly weak showing in Q2 follows a surprising strong performance in Q1. Rob KentSmith, head of GDP at the Office for National Statistics, points out that 'manufacturing output fell back after a strong start to the year, with production brought forward ahead of the UK's original departure date from the EU'. We may well see a similar effect boosting production in the run up to the 31st October. That, in turn, reduces the chances – a little at least – that we see a contraction sustained into Q3.

Of course the inventory rundown wasn't the only contributor to a fall in the real value of UK output. Business investment remains subdued and, unnervingly, activity in the hitherto buoyant services sector was also weak.

On the brighter side, consumer spending held firm over the period supported by a strong labour market and energetic wage growth.

I'm guessing we will avoid a consecutive fall in output during Q3, thus swerving a 'technical recession'. But there wont be much in it either way and, from the narrow perspective of an investor, the effects ought not to be malign either way. In fact, news of the second quarter fall encouraged sterling lower and forced bond yields down too while having no discernible effect on the price of London-listed stocks (those listed in Frankfurt, Paris and Milan fell by more on the day).

Consequently, British investors would have felt the benefit in higher bond prices (presupposing they haven't stripped their portfolio of bonds in favour of 'alternatives') and revalued overseas assets in particular. I remain positively enthusiastic about the prospects for UK stocks in the medium term.

BOND YIELDS (GLOBAL)

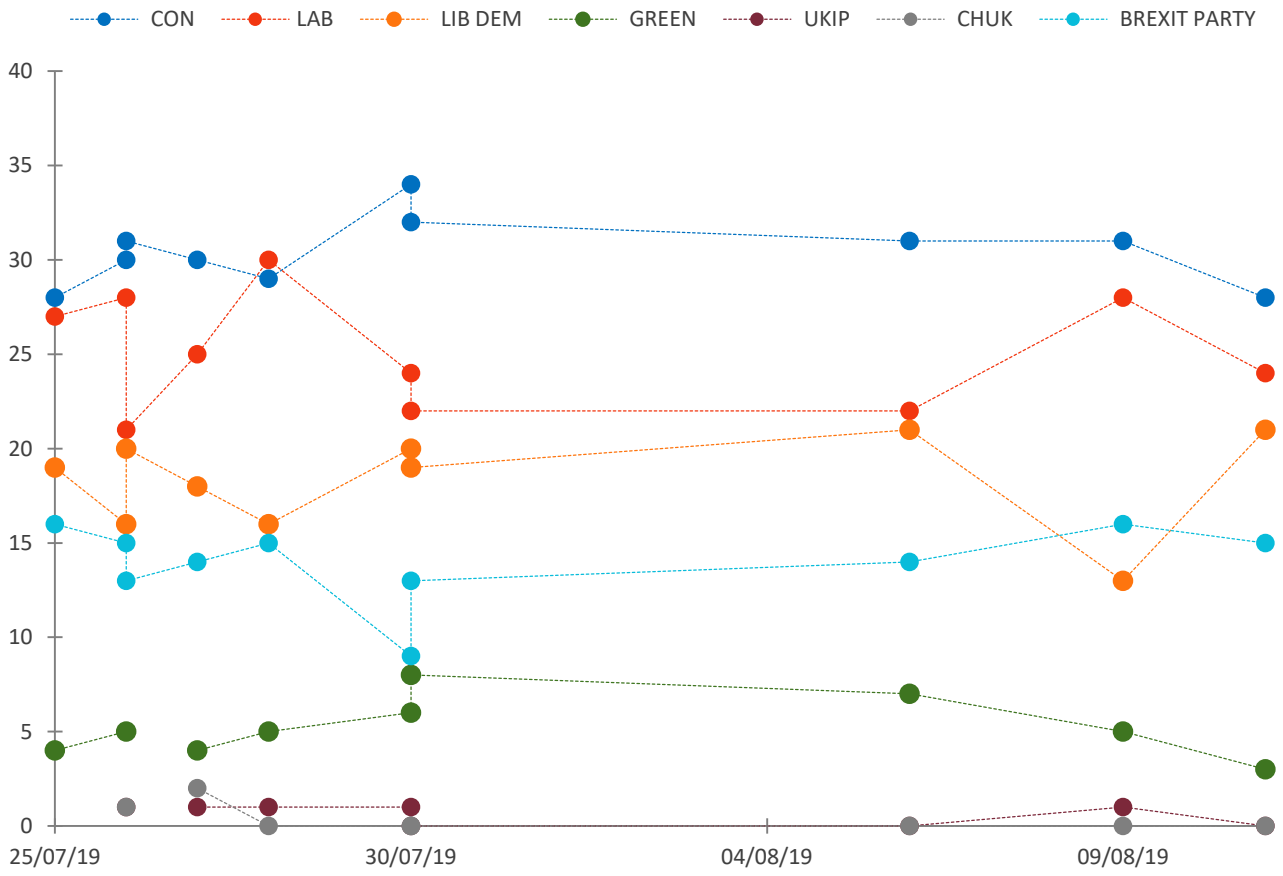
More and more negative

When the 10-year gilt yielded just 0.6 percent during August 2016, I thought we'd reached some kind of nadir and we might then be moving from a period characterised by 'ultra low interest rates' to one characterised by plain old 'low interest rates'. I was right for a while. The ten year rate climbed to 1.7 percent in February last year. More recently though, and really just in the last few weeks, it has plunged to less than 0.6 percent.

That reduction is not just a British phenomenon. Today, around a quarter of all of the world's listed fixed income securities yield less than zero – most notable are government bonds in Japan, Germany, France and Switzerland. I have to admit to being a little concerned about all of this. The consequences I fear are very far from immediate though. I'll write more on this subject in coming weeks.

Data source: OECD, ONS.

PARTY POLITICS



POLL OF POLLS (10)

- Conservatives 30 percent
- Labour 25 percent
- Liberal Democrats 18 percent
- Greens 5 percent
- UKIP 1 percent
- Change UK 0 percent
- Brexit Party 14 percent

NEXT GENERAL ELECTION

- No overall majority 4/6
- Conservative majority 7/4
- Labour majority 15/2
- Brexit Party majority 25/1
- Liberal Democrats majority 33/1

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

NOTES.

While a reasonable course of action regarding investments may be formulated from the application of our research, at no time will specific recommendations or customised advice be given, and at no time may a reader be justified in inferring that any such advice is intended. Although the information contained in this document is expressed in good faith, it is not guaranteed. Cormorant Capital Strategies Limited will not accept liability for any errors or loss arising from the use of this document. Readers are directed to our terms and conditions.

Cormorant Capital Strategies Limited, registered in England, number 05346579. Our registered address is 84 Bromefield, Stanmore, HA7 1AQ.

Crown copyright material is reproduced with the permission of the Controller Office of Public Sector Information (OPSI). Bank of England data reproduced with kind permission of the Bank of England.

(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