Smart[im]: Weekly Market Review

12 October 2018

Smart Investment Management

The week to date as at 12 p.m. Friday (GMT).

Markets and key events

Broad market sell-off continues

The sell-off in global markets over inflation and interest rate concerns extended into this week, not helped by a sharp fall in the Chinese equity market on Monday, having been closed for a 5-day public holiday last week, and the European Commission warning Italy that its budget plans may break Eurozone spending rules. By Friday, markets started to regain some composure, following the release of weaker than forecast US consumer price inflation on Thursday.
Technology focused Nasdaq just shy of correction territory

As of 12pm London time, the S&P 500 fell 5.5% over the week, having fallen 3.3% on Wednesday, its worst day since February. The technology focused Nasdaq index fell 5.9% over the week, falling 4% on Wednesday, its largest fall since 2016. This leaves the Nasdaq just shy of a correction, measured as a 10% fall from a cyclical peak. Emerging markets fell 4.6%, with the Chinese Shanghai Composite falling 7.6%, having been closed last week. This was despite the People's Bank of China injecting fresh capital into the banking system over the weekend to shore up economic growth. The Eurostoxx 600 fell 4%, Japanese Topix 5% and the Australian S&P/ASX 200 fell 4.7%. Having had a tough year so far, the Indian Sensex index rose 1.1% as the price of oil fell.

US 10-year Treasury yield hits 3.26% before rallying

Government bonds started the week selling off, with the yield on the 10-year US Treasury hitting a 7-year high of 3.26% on Tuesday (yields move inversely to price). However, as the equity sell-off continued, the government bond market regained an element of safe haven status once more, with the 10-year yield rattling back down just beneath 3.13%, now trading at 3.17%. Similarly, gold, which had been steadily falling against a backdrop of rising US interest rates, rallied by over 2.5% mid-way through the week as investors looked for safety, currently priced at $1,224 an ounce.

European Commission warns Italy over planned budget deficit

The European Commission warned Italy that its provisional budget, set at a 2.4% spending deficit, could break Eurozone spending rules, despite it being beneath the 3% level that is an outright breach of EU rules. As always, the devil is in the detail and it is the assumptions behind the plan that will be questioned. Giovanni Tria, Italy's technocratic economy minister has assumed that Italian economic growth would be 1.6% next year, which would help to fund the spending plan. However, Italy only grew at a rate of 1% in the first half of this year on an annualised basis, and the European Commission has forecast growth at only 1.1% for next year. Therefore, if Mr Tria's forecasts prove overly optimistic, the budget deficit could easily climb above 2.4%, and potentially breach the 3% limit. Italian government bonds sold off, with the yield on the 10-year rising above 3.7% for the first time since early 2014 on Tuesday, before rallying to yield 3.55% on Friday.

Australian gold miners one of the few places of sanctuary

The Australian S&P/ASX 200 followed the rest of the global markets, selling off late in the week to finish lower by 4.7%, its worst weekly decline since January 2016. As markets sold off on Thursday, Information Technology was one of worst performing sectors, tumbling 5.2% on the day. Gold miners on the other hand rallied on the same day, after investors sought the safe haven of the precious metal. Notable beneficiaries included miners Northern Star and Regis Resources who surged 5.3% and 8.0% respectively.
Elsewhere, Financials were also a drag on the index, falling 4.9% over the week. Besides the broad market sell off, the sector was under further scrutiny as the executives for Australia’s “big four banks”, were questioned by the Royal Banking Commission into financial misconduct. The head of Australia's largest bank, Commonwealth Bank, yesterday admitted to “failures of judgement, failures of process, and in some cases greed” in his description of the firm's conduct in recent years.

Issues under discussion

This week has felt like a repeat of the February selloff in markets. Investors have become spooked by a couple of leading indicators pointing towards accelerating US growth reading across into the US Federal Reserve becoming more hawkish, and ultimately bringing the curtains down on the current economic cycle. Whilst we do not contest the argument that inflation is rising, we do question the extent by which it is rising, especially whilst credit growth remains lacklustre in the US. We also believe it would take some very weak data to knock the US Federal Reserve off its path of 0.25% rate rises for the foreseeable future. Equity markets, and parts of the bond market, can continue to make progress with steady increases in interest rates. However, investors continue to be jittery after such an extended economic recovery, and these bouts of volatility we expect as a reoccurring feature of markets.