FINANCIAL PARTNERS

Weekly Digest

Week ending **07 May 2017**

Inflation: The return of The Great Eroder

Crude oil experienced some substantial moves last week, with an intraday swing on Friday of over 6% for West Texas Intermediate crude. Despite these sorts of moves, crude remains about 13% below its mid-April highs and appears to be stuck in a rut – the price of crude has not moved meaningfully away from $50 per barrel since the middle of 2016. Last year the Organisation of Petroleum Exporting Countries (OPEC) agreed a production cut to provide support for prices but today's oil price is only a few dollars above the level when the cut was announced. Oil was at its weakest at the start of last year and the price almost doubled through the course of the year. A move of that magnitude is inflationary because of the role oil plays as an input to production as well as being a commodity that is directly used by consumers in various energy forms. A reasonable component of the past twelve months' headline inflation has been a function of energy costs and there is also a feed through effect from the increases in these costs into core inflationary data. Much has been made of the rise in inflation over the past six months, but aside from a further jump in oil or other important input costs it is difficult to see where it will come from presently.

Indeed, oil's recent moves down in price are, if anything, modestly deflationary in the short term. The portfolio managers have repeatedly made the point that short term inflationary spikes or falls are of relatively low importance to long term savers and investors. Inflation will hit the headlines from time to time as it ebbs and flows but the reality for today's savers is that it rarely goes away. Even in periods of relatively weak economic activity it is extremely rare to see negative inflation (deflation) in economies such as the US and the UK and as a result investors must remain vigilant to the risks of inflation even when the current rate is low. This is because the compounding effect of even a lowly inflation level over a reasonable time horizon has a significant impact on the real value of savings if left unchecked. A recent story in the UK press brings this risk to life: a misplaced betting slip from 1974 with due winnings of £12 was adjusted by the bookmaker for inflation to a return of £130 in today's money. In just over 40 years the real value of the pound had dropped by 90% in real terms. While 40 years seems like a long time, today's life expectancy in the US is 79 years and in the UK it is 81 years, demonstrating that long time horizons for investors are no longer just the preserve of institutional investors – they are a valid consideration for all. Furthermore life expectancy is continuing to rise and as a result individuals still accumulating wealth today need to plan for greater longevity than current life expectancy rates would suggest.

So while inflation seems unlikely to be high for the rest of 2017, there are still indications that economic activity is solid. This is the case for a number of large global economies rather than simple isolated cases. For example, Bloomberg reports this morning that the Bundesbank has said that Germany's economy has likely gathered momentum in the first quarter on the back of strong consumer spending and a brightening outlook for manufacturers. Eurozone business confidence is at the highest level in almost six years, and data on Friday is forecast to show that growth accelerated in the three months through March. Furthermore US monthly non-farm payrolls growth remains robust; printing on Friday at 211k for April, compared to the 190k expected. Finally, China has seen exports rise by 8% from a year earlier in Dollar terms and China's export outlook has improved on recovering global demand and as the threat of a trade war with the US has fallen from the headlines. The International Monetary Fund boosted its estimate of global growth this year to 3.5%, brightening the outlook for external demand. Such measures and forecasts all point to sustained growth in the world economy, which likely brings with it sustained levels of inflation that, while perhaps lower than previously feared, is well worth keeping in mind when it comes to preserving and growing capital savings for future financial health.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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The **Marketplace**

- Macron becomes youngest ever elected French President
- Strong April jobs report points to robust US labour market
- Eurozone economy grows 0.5% in first quarter
- Greece agrees bailout terms with creditors
- Volatile week for commodity prices

Market **Focus**

France

- The result of Sunday's second round of voting in France's Presidential Election yielded no surprise as centrist, pro-EU candidate Emmanuel Macron won by a (projected) convincing majority of 65.5% to 34.5% over anti-EU, far-right candidate Marine Le Pen.
- The euro initially rose following the result, but is now slightly lower at USD 1.095; reflecting the extent to which Macron's victory was already priced into the currency.
- Whether Macron will be able to implement his proposed policies will now depend heavily on parliamentary elections on the 11th and 18th June, when he hopes to gain as many representatives as possible from his new party, En Marche!.

Europe

- Preliminary estimates showed GDP for the Euro Area growing by 0.5% over the first quarter of 2017 – an annualised rate of 1.8% – which outstrips the annualised 0.7% figure for US growth over the same period.
- Continental European equities appeared bolstered by the figure, as well as the prospect of a Macron victory, rising 2.7% last week, while the euro rose 0.8% against the US dollar.
- Greece and its international creditors announced on Tuesday that they had reached a preliminary deal to secure a further USD 7.6bn of emergency funding, before Greece is due to repay principal on the latest maturing tranche of its debt. Amongst other terms, the deal is contingent upon Greece raising the equivalent of 2% of GDP by cutting pensions and increasing taxes.
- Demand for Greek assets rose following the news, with Greek equities rising 5.8% over the week, while yields on 2 year government bonds fell 77 basis points to 5.4%.

US

- Friday's nonfarm payrolls number for April showed 211,000 new jobs added over the month, beating expectations of 190,000. On top of this the unemployment rate surprisingly dropped by 0.2% to 4.4%, its lowest level since May 2007. Finally average hourly earnings rose by 0.3% month-on-month, as expected.
- April's FOMC monetary policy meeting yielded no changes to interest rates and little development on forward guidance. Expectations remain for the next rate hike to occur in June's meeting, with market prices implying a near 100% probability.
- US equities rose 0.7% over the week, helped by a 0.4% gain on Friday after the strong jobs report.

Commodities

- Both oil and industrial metal prices fell significantly last week, despite a small recovery on Friday. Brent crude oil prices fell 5.1%, while silver, copper and iron ore prices fell 5.1%, 3.0%, and 8.2% respectively.
- Oil slumped amid data pointing to rising US stockpiles and a general supply glut. Although prices have recovered 1.4% to USD 49.08 per barrel since Friday, after Saudi Arabia's oil minister declared it likely that OPEC's production cut would be extended by a further six months.
- The decline in metals seems driven by China, the largest consumer of almost all base metals, amid their ongoing balance sheet tightening and concerns over the country's property market.

James Klempster (CFA) & Oliver Bickley

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Week ending **07 May 2017**

Asset Class/Region	Currency	Currency returns			
		Week ending 05 May 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.7%	0.7%	7.7%	18.7%
United Kingdom	GBP	1.3%	1.3%	3.7%	23.9%
Continental Europe	EUR	2.7%	2.7%	12.3%	25.0%
Japan	JPY	1.2%	1.2%	3.1%	21.8%
Asia Pacific (ex Japan)	USD	-0.4%	-0.4%	14.2%	22.5%
Australia	AUD	-1.5%	-1.5%	4.3%	15.4%
Global	USD	1.0%	1.0%	9.1%	17.9%
Emerging Market Equities					
Emerging Europe	USD	-1.1%	-1.1%	4.7%	17.0%
Emerging Asia	USD	0.2%	0.2%	16.0%	25.4%
Emerging Latin America	USD	0.8%	0.8%	13.0%	24.2%
BRICs	USD	-0.9%	-0.9%	12.6%	26.0%
MENA countries	USD	0.1%	0.1%	1.0%	8.6%
South Africa	USD	-1.2%	-1.2%	8.8%	18.2%
India	USD	-0.3%	-0.3%	20.2%	25.9%
Global emerging markets	USD	0.1%	0.1%	14.0%	23.7%
Bonds					
US Treasuries	USD	-0.3%	-0.3%	1.1%	-1.5%
US Treasuries (inflation protected)	USD	-1.1%	-1.1%	0.9%	0.8%
US Corporate (investment grade)	USD	-0.2%	-0.2%	2.1%	2.5%
US High Yield	USD	-0.1%	-0.1%	3.8%	13.9%
UK Gilts	GBP	-0.8%	-0.8%	1.1%	6.5%
UK Corporate (investment grade)	GBP	-0.1%	-0.1%	2.2%	8.6%
Euro Government Bonds	EUR	0.0%	0.0%	-1.0%	-0.6%
Euro Corporate (investment grade)	EUR	-0.2%	-0.2%	0.6%	2.2%
Euro High Yield	EUR	0.4%	0.4%	3.3%	8.7%
Japanese Government	JPY	-0.1%	-0.1%	0.0%	-2.4%
Australian Government	AUD	-0.4%	-0.4%	1.7%	0.9%
Global Government Bonds	USD	-0.2%	-0.2%	2.6%	-3.7%
Global Bonds	USD	0.0%	0.0%	2.6%	-2.2%
Global Convertible Bonds	USD	0.4%	0.4%	5.7%	6.0%
Emerging Market Bonds	USD	-0.4%	-0.4%	5.5%	7.9%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 05 May 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	-0.5%	-0.5%	0.3%	0.4%
Australian Property Securities	AUD	-0.3%	-0.3%	1.1%	-2.1%
Asia Property Securities	USD	-0.1%	-0.1%	11.6%	12.5%
Global Property Securities	USD	-0.1%	-0.1%	5.0%	3.9%
Currencies					
Euro	USD	0.8%	0.8%	4.5%	-3.6%
UK Pound Sterling	USD	0.1%	0.1%	4.9%	-10.5%
Japanese Yen	USD	-1.2%	-1.2%	3.8%	-4.9%
Australian Dollar	USD	-0.9%	-0.9%	3.0%	-0.7%
South African Rand	USD	-0.8%	-0.8%	1.5%	11.0%
Swiss Franc	USD	0.7%	0.7%	3.2%	-2.0%
Chinese Yuan	USD	0.0%	0.0%	0.8%	-5.5%
Commodities & Alternatives					
Commodities	USD	-2.3%	-2.3%	-6.2%	1.4%
Agricultural Commodities	USD	1.1%	1.1%	-0.3%	-0.8%
Oil	USD	-5.1%	-5.1%	-13.6%	9.1%
Gold	USD	-3.1%	-3.1%	6.6%	-3.9%
Hedge funds	USD	0.0%	0.0%	2.1%	6.8%

Source: Bloomberg

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Important notes