Time to Take a Holiday

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- **Economic data and policymaker actions remain bond friendly**
- **Weak US economic data reduces in the markets eyes the chances of a US rate rise**
- **Japan still waiting for the policymakers**
- **GCC equity markets have by-and-large already discounted the lower oil prices**

Markets continue to be enthused that the major central banks are still very engaged in providing very easy monetary conditions. However, equities, in particular, continue to ignore seemingly the fact that global growth is still woeful. **We continue to advise overweighting fixed income in a mix of asset classes, and we retain our caution on equities.**

So much can change in a week. A week ago the US economy looked like a real positive stand out. And while growth in the other major blocs of Europe and Japan remained unconvincing, it seemed that the Brexit vote had prompted the ECB and Bank of Japan (BoJ) to accelerate their monetary easing. By the end of last week, the financial markets were facing the fact that US growth had seemingly weakened to the slowest pace since 2010, and the BoJ was again disappointing the market.

So **we still find ourselves very much in a bond-friendly world**. The market is now pricing that the Federal Reserve has only a 36% chance of raising interest rates by the end of the year. Indeed, only by September of 2017 does the probability of a Fed funds rate rise move above 50%. Almost across the world bond yields have fallen. The US 10-year government bond yield, currently at 1.45%, was down 10bps for the week and sits just ten bps above the July low. The charts are pointing to new lows around 1.3%. Indeed, with a number of European 10-year government bond yields back in negative territory more of the global capital flows could be headed into US government bonds for the yield pick-up. Negative five-year government bond yields now exist in thirteen European countries including the likes of Slovenia, Latvia and the Czech Republic.

The Federal Reserve's Open Market Committee meeting, which decides on interest rates, got caught out again last week. The statement after the meeting talked a little more optimistically about the outlook for growth. However, the data releases later in the week undermined that confidence. The Citigroup economic surprise index, which measures the degree to which data is coming above or below expectations, was at a recent high of 43.1 on Tuesday but had fallen to 16.3 by the end of the week. There were two notably weak numbers; durable goods and second quarter GDP growth.

Durable goods orders at a headline level were down 4% against expectations of -1.4%. Excluding transport, orders were down 0.5% versus the +0.3% expected by the market. US second quarter GDP was also a big miss coming in at 1.2% quarter-on-quarter annualised versus estimates of 2.5%.

That investors continue to buy US equities flies in the face of history. As Jesse Felder at TheFelderReport.com points out, we have never seen a decline in corporate earnings of this magnitude without at least a 20% fall in stock prices. This is the fourth consecutive quarter of negative earnings growth. Although some commentators have characterised the second quarter corporate results season as a success, in reality companies have only 'beaten' earnings estimates that were heavily revised down in the month before results came through. Also, the guidance in the statements for the third quarter has led to a series of downgrades to earnings estimates. Hence today aggregate third quarter earnings are estimated to fall 3.3% down from a positive 0.1% a few weeks ago.

Japan remains very frustrating for investors. Another week has gone by with policy makers failing to deliver, but still tantalising the markets with a half-hearted effort. Prime Minister Abe announced that the government was preparing a budget of Yen 28 trillion (5.6% of GDP) to be spelt-out in more detail this coming week. However, there was no clear idea why the announcement had been made other than to encourage the Bank of Japan to upsize its efforts at their policy meeting on Friday. In the event, the Bank of Japan offered hope rather than proper delivery. They under-delivered at their meeting on Friday only a modest change in their current efforts to raise inflation to their target of 2%. However, they did say they would mount a comprehensive review of its policy framework. The BoJ would conduct a "comprehensive assessment" at the next meeting on September 20-21 of the effectiveness of the current policy tools they are using. Japanese equities were lifted by the commitment of the BoJ to expand their purchases of equity ETF but bonds sold off, and the currency rose against the dollar.

Of comfort was data that shows that the Eurozone economy is holding in despite the Brexit vote. Second quarter GDP at 1.7% quarter on quarter annualised was slight above expectations. Also a number of confidence surveys were at or above market expectations. The market expects the ECB to increase its efforts to drive growth and inflation higher, with possibly a cut in the deposit rate and further upsizing of quantitative easing at the September meeting.

In the end, the European Banking Authority bank stress test was a bit of a non-event with few surprises. Only the Italian bank Banca Monte dei Paschi failed the test. It seems that Monte dei Paschi will be able to raise sufficient capital through its efforts, thus taking some of the risks away from the markets.

The current level of oil prices does not necessarily put the local MENA equity markets at risk of downside, as they never really discounted prices above $45. A large overhang of inventory in the crude and product markets has kept the oil price under downward pressure in recent weeks. The Brent oil price is back to $43.5, the lowest price seen since April. Such levels do not present immediate problems for the local equity markets, as they never followed the oil price up to its peaks above $50.

India remains a bright spot in global markets. Certainly international themes of low oil prices and easy money conditions all help. However, domestically a number of factors continue to come together. The latest is the decision of the BJP party to agree to most of the demands of the Congress party in respect of the Goods and Services Tax legislation. The government will table the Bill in the Upper House of Parliament in India this week. Potential beneficiaries include consumer, logistics and cement companies.

Emerging market primary bond sales saw a strong appetite with the surge in bond deals notably by Indian corporates. Adani Transmission, EXIM Bank, Glenmark, and HDFC's "Masala" Bond to name a few. The recent capital flows towards emerging market bonds have picked up significantly as investors hunt for yield. India has benefitted from strong investor momentum and scarcity of Indian corporate debt, both in primary and secondary markets. The recent political turmoil in Turkey could also see the shift in capital flows towards India, which is providing a strong technical support for credit spreads. India's five-year year credit default swaps are close to historically low levels at 148bp, reflecting strong support from low yields.

Adani Transmission of India priced their maiden US $500 million, 10-Yr bond with a fixed coupon of 4% to yield 4.33%. The final order book was oversubscribed multiple folds to close at US$5.1 billion. Export-Import Bank of India also priced successfully US$1B of their 10-Year senior unsecured bond with a fixed coupon of 3.375%.

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