A world without much growth but not without hope

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- **Equities more at risk than bonds**
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- **Better news from China – good news for EM equities**
- **Oil prices live in hope of a deal at OPEC meeting**
- **Sterling weak but not likely to break the recent range**
- **Saudi Arabian equity market a potential winner from stability in oil prices**

We would take issue with commentators who continue to characterise the past few weeks' global bond and equity market sell-off as a reflection of a fear of US rate rises. In truth expectations for a Federal funds rate rise, this week have fallen from a 43% probability on August 25th to just 20% today. Expectations for a rate rise by year end have remained almost rock solid at around 50%. The greater fear is that global growth may be weakening again. Last week's market performances were telling, with equities and lower quality bond markets struggling and quality bonds rallying. Without a discernible more positive trend in global growth, we expect equities to struggle more than bonds.

US economic data is by-and-large back in the territory of disappointing the market. Last week's weaker than expected retail sales and industrial production data overwhelmed a slightly stronger than expected inflation data point and a rebound in the Philly Fed industrial confidence data. The Citigroup Economic Surprise Index for the US has now fallen back from a peak of positive surprise at an index level of 43.1 in late July to a current level of -3.

On the global scene, news that the Chinese economy is showing signs of improvement is encouraging even if it failed to ignite much interest in the local equity market. Economic data for August came in above expectations. Industrial production growth at 6.3% year-on-year, retail sales +10.6% and fixed asset investment at 8.1% all marginally beat expectations. Encouragingly money supply data also showed that there is still a good level of liquidity in the banking system.

We sense more investor interest in the Chinese equity market into the end of the year if the positive momentum in the economy can be maintained. Chinese equities failed to respond to the better economic data instead reflecting on the fears of a US rate rise later in the year. The government's efforts to boost infrastructure spend appear to be having a real impact which is helping growth to recover its poise. Better economic growth is prompting strategists to raise their expectations for Chinese corporate profits to be exhibiting positive year-on-year growth in the coming months- a remarkable turnaround from the constant disappointments of the past 12 months.

Oil prices fell through the week with WTI falling 6.2% to a one-month low. Brent oil fell 4.7% to $45.8. Part of the fall was a reaction to OPEC's downward revision to oil demand, suggesting that the oversupply of oil would continue for some time yet. In the very near term, there was also that tankers were lifting oil from a Libyan port for the first time in two years. According to Bloomberg, Libya's state oil company lifted curbs on crude oil sales from three ports potentially unlocking 300,000 barrels a day of supply. In Nigeria, the potential reopening of around 400,000 of supply this month also places the oil price under pressure.

All hope is not lost though for the oil price. There appears to be some effort by OPEC to get a collective agreement for some cap on production by the meeting on September 27th. However, a comment by OPEC Secretary- General on Saturday that the meeting is for consultation rather than decision making will have reduced expectations for immediate good news.

The GCC equity markets have remained largely indifferent to the volatility of the oil price. The DFM index, for example, has remained in its 3450 to 3590 range since mid-July. The Tadawul index still looks technically more vulnerable to the downside as the index has been tracking a downward path for the past two months. Should OPEC manage to deliver a more emphatic statement of intent to control the oversupply then we would expect a smarter rise in Saudi equities.

Market sentiment remains dominated by the market's perception of what central banks may or may not do. This week the great hope is that the Bank of Japan will pull something out of the bag, last week there was some disappointment that neither the European Central Bank (ECB) nor the Bank of England delivered any easing.

The Bank of Japan (BoJ) meets this week with the market hoping that they deliver some form of monetary easing. The Bank of Japan has been reviewing their monetary policy framework which suggests there is scope for a more radical policy shift – although this would not be in keeping with the recent character of the institution. The most likely outcome appears to be a cut in the deposit rate and efforts to steepen the yield curve by reducing the duration of their purchases of bonds. As suggested by some sources in the BoJ there is expected to be a switch of purchases to corporate bonds and local authority bonds; the latter could be seen as an effort to support an expansion of spending by local authorities on infrastructure projects.

There are some concerns in the market that the shift in Bank of Japan policy could lead Japanese institutions to buy fewer international bonds. With the possibility of higher yields on longer-dated Japanese government bonds, domestic investors may switch back to buying domestic-debt. Japanese buying of foreign debt has picked up markedly over the past six months at a time when yields on government bond markets in Europe and Asia have dropped sharply. Japanese investors may be tempted to lock in some gains – Australian 10-year yield is down 53bps over six months – and switch back into JGBs. A further reason for Japanese investors to switch-back is that the hedging cost of being in euros or dollars for a Japanese investor wipes away a considerable amount of the yield pick-up. In the US the rise in Libor due to money market fund reforms has significantly increased the cost of hedging. US 3month LIBOR has risen around 20bps since late June.

We see the recent weakness of the British pound as a move within the current trading range rather than presaging renewed weakness. The British pound came under pressure last week as the Bank of England signalled that further cuts in interest rates could not be ruled out. It was also a week when the political rhetoric around Brexit picked up again. The EU's choice of 'negotiators' appearing to favour arch-federalist who could potentially push the UK to accept a tough exit from the EU. Sterling has traded in 1.3440 to 1.2880 at the low over recent months we expect it to remain in this range.

Given expectations that the Fed will have raised rates by year end the dollar looks well supported at current levels. The traded weighted index is close to its six-week highs, which in the short term may limit the upside in the absence of marked improvement in US economic data. We continue to believe that the gold price will remain under some modest downward pressure with the dollar in the ascendency, however last week's jitters in the European banking sector give you reason for continuing with a good allocation to gold in your wealth planning.

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