All Set for September?

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- **A number of potentially market moving events in September**
- **Central bank meetings at ECB, BoJ and Fed**
- **G20 expected to argue for more support from government spending for global growth**
- **OPEC and Russia appear to be building a consensus for capping production**
- **Russia and Brazil to contribute to the recovery of emerging markets**

September is a busy month for potentially market-moving events around the global economy. The three central banks have policy meetings; the G20 annual meeting is about to get underway and OPEC meets on September 26th-28th. After such consistently solid performances from most asset classes through August, September could be more challenging. We expect more volatility and the potential for swift profit taking in risk assets if investors see trouble.

For the moment the feel-good feeling in markets continues. Global economic growth is better, or at least more consistent, and central banks are supportive without upping their intervention. Even late last week when US data was below expectations the market preferred to anticipate a positive that the Fed would be maybe more reluctant to raise rates at their meeting in September.

The feel-good feeling amongst investors has been reflected in the build-up in higher investor allocations to equities and, in particular, cyclical stocks and emerging markets. We continue to believe that investors are playing a game of trying to eek out returns from very short term rallies in asset classes, rather than any profound commitment to risk assets such as equities.

The latest Bank of America survey of institutional investors shows that the consensus has moved some money from bonds and into equities, but their caution is still evident with relatively high levels of cash in portfolios. The average allocation to equities is a modest overweight remaining significantly below where it has been over the last seven years. Also, 61% of investors say that the global economy is in late-cycle phase, which typically leads to more modest investment returns.

Investors are likely to maintain their modestly positive position in risk assets while awaiting three major central banks meetings this month. All three major central banks, the Federal Reserve, European Central Bank (ECB) and the Bank of Japan, remain very much in play. After good performances from many asset classes in August, much will depend on whether policy makers deliver on the ongoing easing of monetary policy.

In the very near term, there are doubts that the ECB will press ahead with a sizeable extension of rate cuts or quantitative easing. Brexit has not proven to be the Armageddon that many had feared. Hence there is limited near-term pressure on the ECB to ease policy still further at their meeting this coming week. However, as a positive, the ECB is likely to signal that it remains committed to maintaining quantitative easing through 2017. Latest inflation data shows that the ECB still has work to do to hit its medium-term inflation target.

Just as you were getting comfortable that global growth was looking better along comes a set of macroeconomic data releases that challenges your confidence; such was the case in the US last week. The US labour market report was a shade disappointing. Non-farm payrolls rose 151,000 against expectations of 180,000. Annual wage growth moderated from 2.7% to 2.4%. Perhaps most disappointing was the slip in manufacturing sector confidence where the ISM survey came in at 49.4, the lowest level since January. Many of the components of the survey dropped below the 50 level, which marks the difference between expansion and contraction. However, the manufacturing sector is only 33% of the U.S. economy and the survey for the service sector due out on Tuesday is expected to show that this sector continues to grow, although more moderately than in previous months.

Despite the slightly weaker data, **our Bank still takes the view that the Fed could and should raise interest rates maybe as early as the Fed meeting in September**. Although the Fed has told us that a rate rise is data dependent, many members of the FOMC have alluded to the ever-increasing risks of leaving rates far too low for too long. Persistently low rates are in many economists' eyes only adding to the imbalances in the global economy such as inflated asset prices and too much leverage. The market for the moment disagrees with our view with an implied probability of a September rate hike at 32%.

With markets remaining highly sensitive to economic data it is worth pointing out that the bankruptcy of South Korea's Hanjin Shipping has the potential to negatively affect trade data over the coming months. Hanjin is the world's ninth largest container shipping company. With some ports already refusing to handle its cargo, 45 ships are stranded at sea. Hanjin accounts for close to 8% of the trans-Pacific trade volume for the U.S market.

Not wishing to end on a negative note when discussing prospects for global growth, it is worth noting that **the G20 meeting has again focused on the need to accelerate the recovery in global growth**. There appears to be a growing consensus that countries need to consider increasing government spending. Whatever central banks may or may not do in the coming months, the efficacy of monetary policy to drive growth appears to be waning. We wait for governments to step up to the plate.

Oil prices, although unlikely to break the recent trading range, should find good support from a potential deal at the next OPEC meeting. In the build-up to G20 there appears to be more consensus in OPEC and with Russia for a cap on oil production. A deal should provide a prop for oil prices that had at one stage looked like they would test the key supports. WTI oil, for example, looked like it was at risk of falling back towards $40 from $45. At the last meeting, Saudi Arabia had not sanctioned a production cap given that they did not believe there was sufficient consensus amongst the major producing countries. However, ahead of this September's meeting there appears to be a greater consensus that Iran can be left to continue to rebuild its production back to pre-sanctions levels and for other countries to cap their production around recent (inflated) levels. While an agreement is unlikely to lead to the WTI oil price moving through $50, it should provide good support to maintain the price at the higher end of the recent trading range.

In our view emerging markets look set to continue their outperformance. Any outperformance would be more emphatic if there was an improvement in commodity prices, but that looks unlikely at the moment. However, even stable oil prices should give countries such as Russia and Brazil the opportunity to rebuild economic growth. The recent economic news-flow for both countries has been more positive. While asset prices have moved to discount a good measure of the better news, there may still be significant upside for their respective asset markets if that good news were to continue.

Russian assets have already performed well from their sanction-induced lows of earlier this year. To be fair to the policy makers, they have risen to the challenge of sanctions and a weak oil price. A fall in inflation from a peak of 16.9% in March 2015 has allowed the central bank to cut interest rates and for government bonds to rally sharply. As we look forward, ahead of presidential elections in 2018, the market expects that the government will start to reverse some of the significant cuts in government spending that weighed so heavily on the economy in the past eighteen months. A switch from interest rate cuts to a more relaxed fiscal policy should provide good support for the equity market, while modestly diminish the potential returns from bonds. But either way **Russia's asset markets look likely to remain a contributor to emerging asset market outperformance.**

Brazil is politically moving on. Last week's impeachment of President Rousseff finally allows the country to move on with a new President Michel Temer. His mandate will run until 2018. The new government is expected to come with a reform program incorporating spending caps and pension reforms. Meanwhile, the economic backdrop to the politics appears to be improving. While the country has had to deal with a six-quarter recession, economists increasingly feel that the worst may be behind the country, with consensus forecasts for 2017 GDP growth rising to around 1.5%. Although the central bank maintained interest rates at 14.25% for the ninth consecutive meeting, the guidance from the central bank about future policy appeared to soften. For sure the central bank wants to see inflation lower. However, if the government were able to get started on its reform program this could provide sufficient confidence to the central bank to enable them to cut interest rates during the fourth quarter.

We have stated on a number of occasions in recent months that the correlation between the oil price and the performance of the GCC equity markets has weakened. However, **with a possible deal to be done at the next OPEC meeting, there is scope for the Saudi equity market to recover after a period of marked underperformance.** The Tadawul Index, which trades close to 6100, is 23% short of the twelve-month peak of 7429 set in October last year. As investors return from the Eid break, we suspect they may be willing to add to their Saudi positions if for no other reason than that the market is a good way of investing in a possible deal at the upcoming OPEC meeting.

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