

PM seeks comfy ditch

Weekly Update

28 OCTOBER 2019

STEEPER, BETTER, FASTER, STRONGER

What is the yield curve telling us?

NOT FIS-CALLY-FRAGILISTICXPIALIDOCIOUS

The autumn budget has been cancelled

REASONS TO BE CHEERFUL

Why are US stocks at all time highs?

A SHOT IN THE ARM

China gets a liquidity injection

A GOOD WEEK FOR

- Equities in general; the global index rose 1.3% in local terms, with developed markets leading emerging.
- Oil, which rose 5% in USD terms.

A BAD WEEK FOR

- Sterling, which fell -1.2% versus USD.
- Government bonds outside the UK, as bond yields rose from low levels on greater optimism.

BREXIT

Did Prime Minister Johnson make progress on his Brexit deal this week? It may not feel like it. Parliament voted in favour of the current Withdrawal Agreement but, crucially, against the Government's proposed timetable for making it law. Johnson then began agitating for a December election, tabling a vote this week. Meanwhile EU leaders have agreed on a "flex-tension" to the Article 50 deadline as far as 31st January, but with the option to leave earlier. The question this week is can Johnson get his election? Parliament will vote on Tuesday and last-minute Labour support for an election suggests it will now pass. Polling suggests the Conservatives may be able to regain a parliamentary majority, making it easier to pass laws, including the Withdrawal Agreement Bill.

YIELD CURVES

Having troughed at the end of August, the US yield curve continues to steepen; meaning the distance between long and short dated bond yields is increasing. What does this mean? Given that an inverted yield curve can signal recession, a steepening curve may signal an improvement in expectations of economic data, and thus interest rates. However, at a time of tighter liquidity, technical effects may also be at play.

FISCAL SPENDING

On Friday Chancellor of the Exchequer, Sajid Javid, announced that his first autumn budget has been postponed, meaning that the Office for Budget Responsibility's analysis of the public finances will also be delayed. This comes at a time when many speculate the Executive will be forced to abandon its commitments to fiscal probity. Weaker UK growth is expected to result in a drop in tax income, a problem compounded by revisions to the treatment of student loans and new spending commitments. Diminished headroom for fiscal "boosterism" is unwelcome news ahead of an election.

TRADE

US stocks have reached a fresh all-time high, but why? One factor may be greater optimism on trade. The preliminary agreement being brokered with China is said to include much of the text of the deal drawn up last May regarding intellectual property. This suggests more progress has been made on a thorny issue than the market perhaps expected. As ever, the proof is in the pudding, but a better-than-expected resolution could be positive for both US business confidence and global trade activity- and thus should boost growth forecasts.

CHINA

On Tuesday last week the People's Bank of China injected the largest amount of cash into the banking system since May. The move comes in the wake of a tightening of liquidity conditions in recent months, and in anticipation of higher demand for liquidity at the end of the tax quarter. Is this stealth-stimulus? The short duration of the easing suggests not – the extra liquidity should last only a week. This suggests that, while Chinese monetary conditions have eased somewhat, policy makers are not flooding the economy with liquidity.

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