Market Recap 23-04-2017

United States

Amidst continued geopolitical uncertainty and mixed corporate earnings results, US equities experienced a week of sideways movement. Later in the week however, the major indices recovered some of their previous week´s losses as confidence in president Trump´s tax reforms strengthened again. US treasury secretary Steven Mnunich announced that a proposal for the tax reform may be expected "very soon". The S&P 500 ended the week up 0.85% at $2,348.69 from its $2,328.95 close the week before. This constitutes the first weekly gain after two weeks of losses. Similarly, the Dow Jones Industrial Average closed at $20,547.76, advancing by 0.46%. Fueled by first beneficial tech earnings reports the technology-driven NASDAQ index advanced 1.82% over the week up to $5,910.52.

Fixed income instruments faced much volatility, with US 10-year Treasury bond yields bouncing back to 2.25% after having traded as low as 2.17%. The volatility was subject to rapid changes in the market´s perceived likelihood of future FED rate hikes in June. This perceived probability fluctuated between 50% and 60%, strongly influencing treasury yields.

The VIX index, also labeled the "fear index", retraced after the previous week had brought large increases in implied volatility during a time of high geopolitical tensions. The index closed at 14.63 down on the week but still above its 50 days and 100 days moving averages.

Oil prices experienced the biggest weekly drop in one month. As data revealed increases in US inventories, the market´s confidence in OPEC´s production cuts dwindled. The two reference benchmarks West Texas Intermediate Crude Oil and Brent Crude oil closed at $49.62 and $51.96 respectively. Both benchmarks ended the week down more than 7%.

The US Dollar index, measuring the US Dollar against a basket of currencies, profited from the newly gained confidence in the tax reform. It closed at 99.98, however still down from its previous week´s close at 100.51.

Next week, the United States of America will be at the center of financial markets´ attention once more. With the government funding deadline approaching, the most urgent question is whether Congress will be able to agree on a budget and avoid a shutdown of the federal government. In 2013, government employees were put on unpaid leave for 16 days. This led to a strong deterioration of the confidence in the US government.

Eurozone

During the past two weeks French politics dominated the European Union's market. Extra-European developments such as the failure of Trump's policy proposals in the senate, affected the EU market indirectly. As many of Trump's campaign promises suddenly lost credibility and US equities markets declined, EU stocks did likewise. The Eurostoxx 600 decreased over the last two weeks and closed down by 0.1% on Friday. Similarly, the DAX and CAC fell during the week before Easter but rose slightly in the following one.

The Euro appreciated against the US Dollar, by 0.1% to 1.07$, whilst it depreciated against the Yen by 0.19% to 116.94Y. The realisation that Trump will not bring about all the promised policies drove up the Euro against US-Dollar. On the other hand, risks regarding the French presidential election looming this Sunday, drove many investors to seek the safe haven of the Japanese currency and to leave the Euro.

The French will vote for their new president from 8 am to 8 pm on Sunday and first turnaround estimates are expected at midday. Currently four parties have a chance at continuing to the run-off between the two final candidates. Volatility is primarily spread by Marine Le Pen's National Front party leading continuously in the polls and the surge of the left wing, communist party of Melenchon two weeks ago. This increased the cost of insuring against significant Euro swings with respect to the Dollar or Yen and thus Euro volatility to heights lastly seen during the Brexit vote. The higher risk of strong anti-trade and anti-Europe sentiment in France increased expected market risks. This affected domestically oriented small cap companies in particular, while large cap companies, with most revenues channeled internationally, remained largely unaffected.

However, overall investors seem to lean more towards a market friendly outcome of the election. The Euro appreciated against the US-Dollar and the premium paid on French 10-year government bonds versus German bunds declined slightly in the past week, after rallying upon the surge of the left-wing party.

The German 10-year bund yield is currently at 0.25%, whilst French 10 year bonds yield 0.93%, Italian bonds yield 2.24%, Greek bonds yield 6.64%. The spread between German and Greek bonds declined, since the primary budget surplus amounting to 3.9% of Greek GDP exceeded creditor's expectations and the negotiations about debt relief for Greece consequently proceeded more swiftly.

Eurozone inflation for March was estimated at 1.5% month-on-month, below February's figure of 2%. In France it remained stable, while Italy showed unchanged price levels for March. As core inflation remains sluggish, the ECB continues to signal diverging opinions on an eventual end to its quantitative easing activities. While political uncertainty is high, as at the moment, no clear indication of an end date is expected.

The most important event for next week will be the estimates and final results of the French presidential election on Sunday.

UK

On Tuesday, UK's Prime Minister Theresa May announced that an early general election will take place on June 8. In response to this event, Sterling surged from a low near \$1.25 at the start of the week to the height of \$1.29 before consolidating in the \$1.278 - 1.285 range (+2.23% from Tuesday to Friday). The movement is explained by the fact that the expected Conservative Party success in the surprise election should lead to a consolidation of Mrs. May's power and a consequent softer Brexit.

The UK's stock market was already under pressure before Theresa May's announcement, with miners falling on the back of sliding commodity prices; as the pound rallied, the FTSE 100 dropped from 7327.60 to 7147.50 on Tuesday (-2.63%) and then closed at 7114.55 on Friday (-2.91% over the week).

The government bond benchmark, the 10Y Gilt, closed at 1.04% on Friday (no changes from Monday) but it has been slightly volatile during the week reaching a peak of 1.09% on Thursday and a low of 1.00% on Tuesday.

The IMF upgraded, on Tuesday, its UK 2017 growth forecast to 2%, increasing it of 0.5 percentage points from the forecast made in January, and its UK forecast for next year from 1.4% to 1.5%.

On Friday, the Office for National Statistics published data about UK retail sales in March; shoppers bought 1.5 per cent less than during the previous month, excluding petrol. Analysts had expected a fall of 0.5 per cent.

Next week the data for Q1 GDP (YoY and MoM) will be published: previous quarter growth was 1.9% YoY and 0.7% MoM. Also the CBI Industrial Trends Orders will be published with an expected fall of 1 point from the previous value of 8.

Rest of the World

The IMF has raised its forecast for global growth for the first time in six years. The forecast is based on a stronger China, which this week reported that its economy grew at an annual rate of 6.9 per cent in the first quarter, and improving economies in Japan and Europe. The IMF predicts a 3.5 per cent global growth in gross domestic product this year.

In China, steel companies gave a mixed reaction when President Donald Trump launched a national security investigation that could lead to tariffs on steel imports this Friday. If implemented, it would be his first act of significant protectionism.

In emerging markets, Mr. Erdogan claimed victory in last Sunday's constitutional referendum to boost his powers as Turkey's president. He secured the victory with 51.3 per cent of people voting yes nationwide. Mr. Erdogan has long been opposed by Turkey's liberals and secularists and this has added to the political divide in the country.

In Canada, Consumer prices were up 1.6 per cent year-on-year in March, compared with a rise of 2 per cent in the previous month, and expectations of 1.8 per cent. The Canadian dollar was down by 0.17 per cent against the buck at C$1.3492 at the time of the news.

In other news, ratings agency S&P has downgraded El Salvador's sovereign credit rating to "selective default" after the government missed payments related to its pension debts. The government missed $28.8m worth of payments due between April 7 and April 10. In Pakistan, courts on Thursday gave a verdict that there was insufficient evidence to remove Nawaz Sharif from office, who was on trial for corruption charges.

Tokyo's Topix added 1.1 per cent to close at 1488.58 amidst news of the exports-sensitive benchmark boosted by the dollar moving back above ¥109. Gold, which hit a five-month high of $1,295 amidst political uncertainty in the Middle East and North Korea, was up $3 at $1,284.