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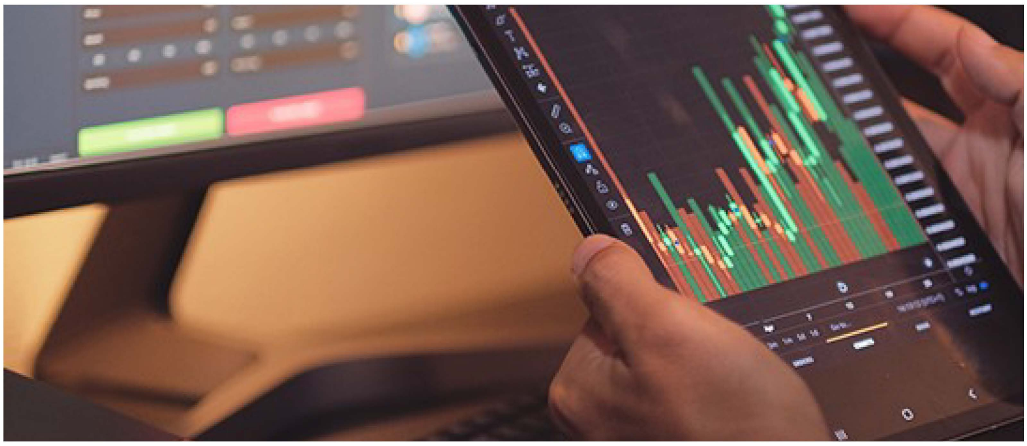
Home Market round-up



Article MARKET COMMENTARY

Market round-up: 14 – 18 October

Jason Day recaps the week and looks ahead to next week.

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This week just ended

US markets have continued to power on through the course of the year with the blue-chip index hitting its 46th consecutive high year to date on Monday posting a solid c. 23% in dollar terms and c. 20% in sterling terms. Given the backdrop of this performance and the fact that the overall index valuation is trading at premium compared to the long-term average, all eyes were focussed on company profitability and guidance from US executives to gauge the substance behind this American exceptionalism as US markets continue to demonstrate standout characteristics compared to bourses around the World.

By Friday, 67 out of the 500 companies in the index had provided their third quarter results with 76% posting upside surprises. Granted, the usual parlour trick was at play whereby the C-suite and industry sector analysts had already guided downwards prior to the results to dampen any disappointment but nonetheless, some of the actual results truly 'knocked the ball out the park' as they like to say across the pond.

The US banking behemoths led the earnings season with notable upward revisions to Earnings Per Share – this is important as US financials can provide a bellwether of sorts on the health of the overall economy and the all-important US consumer which drives a staggering 70% of economic output in the US, making it by far the largest component of the US economy and driving growth in areas such as retail, services and housing.

One prominent Chief Financial Officer poignantly noted on the earnings update call with analysts that overall, he saw 'quite a healthy consumer' despite signs of weakness in the lower-income segment and as consequence the bank had increased its provisions to absorb any future credit card delinquencies. He concluded that 'yes, the economy is slowing, but it seems to be on trend for very much of a soft landing.' On Wednesday we had the US retail sales reading which came in with an increase of 0.4% month on month which was ahead of analyst expectations of 0.3% equating to growth of 1.7% year on year. This strong reading points towards a trifecta of positive data in recent weeks with a decline in unemployment and moderating inflation heading towards target.

On the subject of inflation, on Wednesday we had confirmation that UK inflation fell sharply in September and was within the Bank of England target of 2% for the first time in three years, with the headline rate dropping from 2.2% year over year to 1.7%. This was also firmly below consensus expectation of 1.9%. A rate cut in November looks certain and there is even some speculation in the market that the bank might adopt a US style 'jumbo cut' of 0.50% rather than 0.25% which would point towards faster and deeper rate cuts in the UK than had previously been anticipated by market participants.

This is exactly the debate that is ongoing in Europe at the moment as economic growth has been lacklustre despite record low levels of unemployment and prominent wage inflation. Much of the drag has been in the manufacturing sector which has been a long-term area of global excellence in the past but has faced significant headwinds with key German auto manufacturers even closing factories and laying off workers recently as actively declines.

It was no surprise then that the European Central Bank cut rates on Thursday for the third time by 0.25%. Headline inflation was revised down from 1.8% to 1.7% year over year within the Eurozone during the week, which again is leading to some speculation that the next leg down as part of the ECB's easing cycle might be a 'supersized' 0.50% at the next meeting rather than a more progressive series of quarter point reductions.

This coming week

Data is pretty light next week but given the interest rate cuts that we saw from the ECB this week key things to look out for will be the readings for Euro Area Consumer Confidence survey and preliminary October manufacturing data from the Eurozone (PMI) on Thursday. We will also have Purchasing Manufacturing Indices for the UK and US and Japan. In the US we have MBA Mortgage Applications, Jobless Claims, Existing & New Home Sales which will all help provide a feel for the health of the all-important US consumer. In the UK we get a Consumer Confidence survey and the release of government spending/net borrowing figures on Tuesday which will be noteworthy given that we have the inaugural Budget of the new Labour government the week after.

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