Tatton Investment Management

Weekly Market Comment

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Confusing signals?

We are now over 90 days into this stock market correction and market action over the past week must have enforced the view of many lay investors that understanding what makes them rise and fall is beyond rational consideration. The ongoing Q1 corporate earnings results announcements are pointing to the strongest annual growth in corporate profits that most can remember – in excess of 20% - yet stocks fell on the good news.

How does that make sense?
The most widespread explanation was that company executives appeared to suggest it may be unreasonable to expect that profit growth could go any higher than this for the rest of the 2018. The term ‘highwater mark’ quarter made the round and thus fear of ‘cycle peak’ and ‘end of cycle’ was back. On the basis that further strong results announcements later in the week were greeted with rising stock prices, points to a different underlying reason: rising yields and a rising exchange rate for the US$ in their wake.

Yields of US 10 year government bonds (Treasuries) went through the closely watched 3% threshold. In the absence of renewed inflationary pressures it was initially positively interpreted as an indication that a growing number of investors are gaining confidence in further longevity of this economic cycle. Unfortunately, however, without further acceleration of growth, higher yields put pressure on equity valuations because they also serve as the discount rate for future earnings and the higher they are the lower is the present value of those future earnings in today’s valuations (more about this in the second article this week).

More attractive bond yields in the US could also increase the demand for the US$ and push the currency up against other global currencies (see the third article this week for more). This has in the past caused trade around the world to slow due to the greenback still acting as the global currency of trade. Furthermore, overseas revenue receipts of US multi-nationals (Apple, Amazon, Facebook et al.) would decline in USD terms.

So, maybe there is sense in the apparent market action madness after all. From our perspective, we welcome and are relieved that elevated earnings forecasts by research analysts are not being disappointed by corporate results announcements. That stock markets overall only slightly nudged upwards over the week is also welcome because it allows valuation levels to consolidate and indicates that January's exuberance may indeed have been shaken out by the return of normal levels of equity volatility since February. Unless we join the brigade of overinterpreting and doom saying investment strategist, the current consolidation phase in equity valuations should be welcomed because it helps to rebuild the earnings base of share prices, while preventing overheating market conditions.

The 10 year treasury yields fell back to 2.96% by the end of the week, which may tell us that the 3% is not as much a watershed as some had suggested and therefore the bond market normalisation remains a far more gradual affair than many believed and still fear.

Before getting complacent on the back of these insights, it is worth noting the work of our research partners at MRB, who point out that a key characteristic of non-recession stock market corrections like the one we are experiencing has been that they have tended to bottom only after 3-6 months, with the turning point usually marked by the stabilisation of the upward trend in bond yields. On this basis and the fact that global economic growth is currently going through a slowing phase, there is good reason to remain vigilant over the coming months and watch yield curve developments just as closely as the many macro and micro economic indicators.

In other news, the Q1 GDP reading for the UK has confirmed our view as we presented over the past two editions of the Weekly that the UK's economy has fallen back to much the same stagnation as its government's Brexit negotiation progress. This is not entirely the result of the unsatisfactory Brexit position, but has just as much to do with the sudden slowing of the rest of the EU, which had recently counter-balanced the lack of UK domestic demand. In any event, a second rate rise in May by the Bank of England should no longer be expected.

The growth baton passing back to the US has come as a surprise, but may yet prove temporary and a return to more sustainable rates of growth than the Continent experienced towards the end of last year.

Geopolitical risks continue to hinge on US politics, but the bullying diplomacy style of 'Trumplomacy' appears to have yielded the desired result of forcing Trump's geopolitical adversaries to the negotiation table. Progress in Korea and in trade negotiations with China appear to prove Trump's tactics. Unfortunately, from here onwards strategy, negotiating skills and detailed knowledge will determine success or failure. Looking at Trump's trade policy team of highly opinionated but politically inexperienced business people and pseudo-academics we are not convinced that he can repeat his tax reform success where he could rely on the Republican dominated Congress to chisel out and push through the detail.

For the time being we are relieved that the Middle East tensions have not led to hostilities between Iran and Israel or any other hostilities as we described as imminently possible in last week's edition.

Corporate earnings growth: As good as it gets?

We are pleased to report that the Q1/18 corporate earnings season is shaping up to be pretty spectacular so far, even exceeding the unusually high expectations from analysts we reported about a couple weeks ago. The gap between what analysts expected and what companies have reported is seems to be the result of improved profit margins and Trump's corporation tax cuts, which filter directly through to the bottom line.

In our last article on expectations for the current reporting period, we detailed how analysts had revised their forecasts significantly higher earlier over the quarter (from 11% to >20%), when traditionally it is the other way around. But even they will be surprised how strong earnings have been across the world, particularly in the US. Interestingly however, market reaction has been fairly lacklustre – the opposite of what you would expect. Perhaps markets are worrying that this may be as good as it gets?

Typically, investors reward consensus-beating numbers by pushing share prices higher and punish those that underperform by selling a company's stock. That historic pattern appears to have gone missing during this particular earnings results season.

Those that have beaten forecasts saw an average share price rise of just 0.1% over the 2 days before the earnings release and 2 days after reporting. This level is well below the 5-year average price increase of +1.1%.

This time around, companies who have failed to meet earnings expectations have seen an average share price fall of -0.9% 2 days before the earnings release and 2 days after reporting. But the 5-year average for companies in the same position is a much steeper fall of -2.4% over the same time frame.

The global breakdown of Q1 earnings makes for impressive reading.

In Japan, just 12% of firms on the Topix index have reported fiscal Q4 earnings, but 53% have beaten forecasts, resulting in EPS growing 7% YoY. 47% of Topix companies printed sales topping forecasts, delivering 4% top-line growth. So far, all sectors that have reported have posted positive growth. Although, revenue numbers for Utilities, Technology, Healthcare and Industrials are coming in a bit light of analyst expectations.

In Europe, 25% of Stoxx600 companies have reported. 60% of those firms beat estimates, with EPS growing +15% YoY, which is 4% above early consensus forecasts. Cyclicals and Financials are powering earnings growth, all the more remarkable given the lack of a tax boost in Europe. Sales are up +5% YoY, with 51% of the companies beating sales estimates.

The US has delivered the most spectacular numbers. Just 32% of firms listed on the S&P500 index have reported so far, but 77% have beaten expectations, which is above longer-term averages. Earnings-Per-Share (EPS) is up +23%(!) year-on-year (+22% excluding energy) beating the expectations – which were already unusually optimistic – by an average of +6%. There are strong performances across the board, with nearly all sectors posting double-digit growth, but driven primarily by financial and cyclical stocks.

In terms of sales revenues, 70% of firms have topped estimates, with growth running at +10% YoY. What's more, all sectors except utilities delivered sales growth. This leaves the blended Q1 EPS estimate around $36.5 a share, a growth rate of +18.2%. This is 6.5% above the rate of growth that analysts expected at the beginning of January.

Yet this positive news isn't translating into share prices. Aerospace firm Boeing, for example, smashed its quarterly numbers yet it's shares never really took off.

Revenues in Q1 printed at $23.38bn, beating not only the consensus forecast of $22.23bn but even the highest Wall Street forecast of $22.93bn. Q1 EPS was $3.64 a share. This was over 50% higher than the same period last year. Again, this didn't just beat the $2.58 consensus, but was almost a dollar above the highest analyst estimate, driven by Boeing's effective tax rate plunging from 26.4% to 12.8% in Q1.

Construction and earth moving equipment maker Caterpillar 'bulldozed' its way over estimates, but again, it's shares barely felt a rumble. Caterpillar is regarded as an important barometer for the health of the industrials sector, but also the global economy. As a result, the company has a high beta (correlation) to markets; where Caterpillar leads, stock indices tend to follow.

It's EPS of $2.74 a share printed way above the $2.02 estimate, on the back of tax cuts and a recovery in commodity prices. Caterpillar also upped its full year guidance from $9.75 to $10.75 a share, versus the previous range of $7.75 to $8.75 a share range given just 3 months ago.

Despite all the positives, Caterpillar executives appeared to say that Q1 earnings represented a "high watermark for the year". This appeared to result in the concern that earnings have now reached the top of the cycle, meaning investors might start fearing what comes next: the downward part of the cycle which follows the top.

Much has been said about this cycle, with investors questioning how much further profit margins and sales growth can go. While companies have mentioned higher wage and input costs, the blended margin for S&P500 firms in Q1 is 11.1%, marking the highest net profit margin since FactSet began tracking this data point in 2008.

Clearly Trump's tax cut is a factor, but we note that net profit margins have been sequentially improving throughout 2017, even before the launch of the lower tax rate. We believe that lower corporate taxes should help offset the impact of higher wage and other input costs, at least during Q1 and possibly over the next few quarters.

We find it interesting that equity analysts still expect net profit margins to gain further ground in 2018, with Q2 forecasts at 11.5%, 11.8% and 11.7%, for Q2, Q3 and Q4, respectively.

Concerns about rising yields could also be a factor behind sideways moving share prices. US 10-year bond yields crossed the "dreaded" 3% level for the first time since December 2013. Equities can be thought of as the sum of a stream of future cash flows measured in today's terms, known as the Time Value of Money. Those cash flows are typically discounted to a Net Present Value (NPV) using the risk-free rate (RFR) – in this case the US 10 year bond.

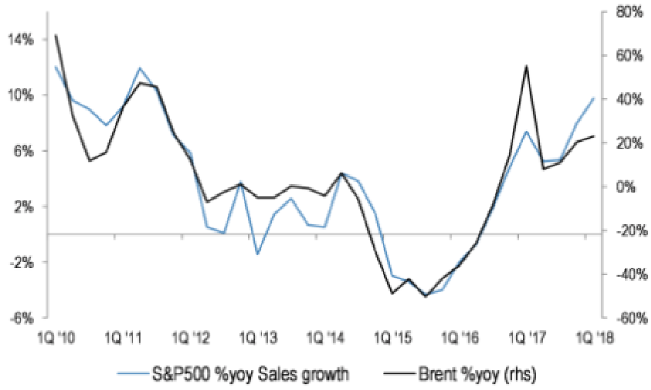
$$Net\ Present\ Value = \frac{Future\ Value}{1/(1+RFR)^{Number\ of\ Years}}$$

A higher RFR reduces the present value of future cash flows, which compresses valuation multiples. On the other hand, stronger or growing earnings can counteract the discounting effect, making valuations more attractive again (i.e. reducing the Price-to-Earnings ratio).

We think rising bond yields are broadly positive for investors. They shouldn't be feared, as they reflect increasing confidence in global growth and a return to more normal levels of inflation and bond yields. Volatility in interest-rate markets appears low at present and equity market swings have calmed down from levels seen in February, which suggests that investors believe rising borrowing costs may not be enough to cause too much pain for equities, for now at least.

Higher inflation might also be in play, but the recent move up in the oil price should not be taken as a bearish sign for corporate profitability. As the chart below shows, there is a clear positive correlation between oil price and S&P500 sales growth.

Figure 1: US quarterly sales growth and Brent



Source: J.P. Morgan, Bloomberg

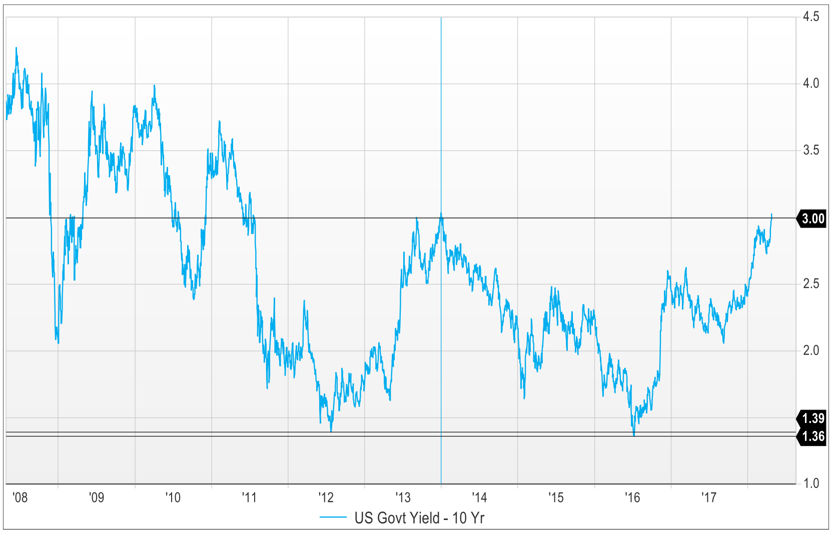
For the time being, we are pleased that company analysts have been proven correct with their exceptional earnings growth optimism over the course of the quarter. That stock markets have not immediately jumped back on January's upward trajectory is not a bad thing, even if there is much talk right now about 'high-watermark' and 'top of cycle' results. The fact is that an increase in earnings while share prices remain stationary lowers equity valuation levels – which had become a significant concern, particularly for the US market.

Managements' outlook statements did not suggest that they are seeing significantly more difficult trading conditions ahead. Altogether, this might mean that US stock market valuations may be becoming more attractive again. That is as long as we are not indeed witnessing peak-cycle conditions and declining earnings from here. To be clear, that is not our expectation at the moment. Rather, we expect that earnings growth may ease back to levels which are more aligned to the recent general slowing in the rate of economic growth. In summary, when combining both the macro (top-down) and the micro (company level) economic perspective, we see that we are neither witnessing an overheating of the economy (as the earnings growth rate would otherwise suggest), nor a turning over in the global economy's prospects (as the macro data flow has economists led to warn).

US 10 year treasury yields finally break through 3%

New Year's Eve 2013 was the last time the yield of US-10 year government bonds yield hit 3%, until this week. During these four and a quarter years we have seen the nadir of just 1.36%, below even the post crisis lows of 2012 (annotated on the chart below).

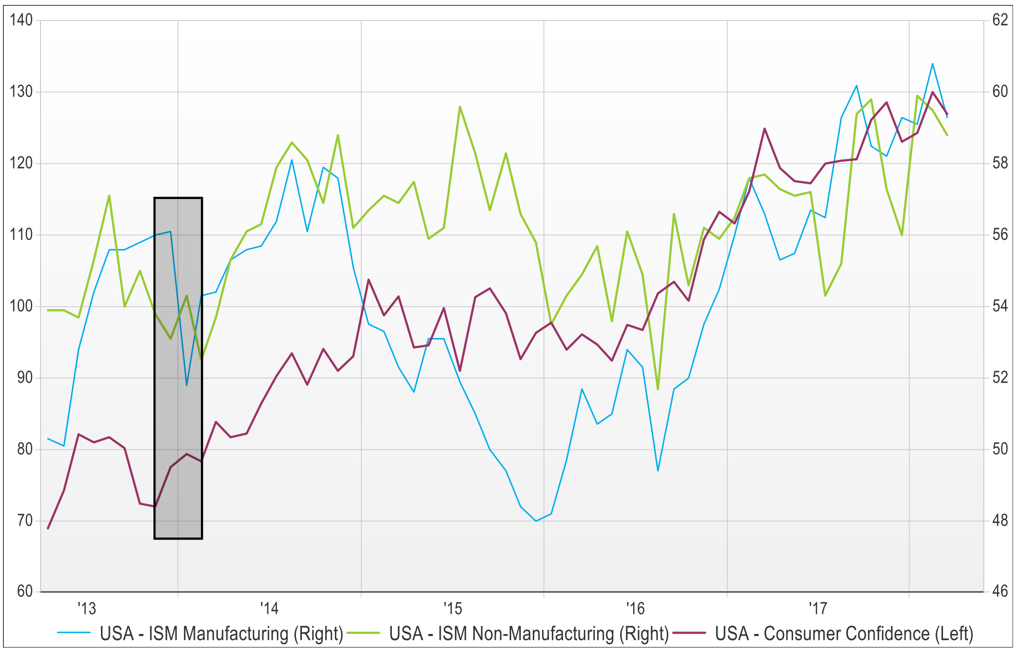
So why are yields now at their highest levels since 2011, and is this trend likely to continue?



Source: FactSet

Whilst central banks have targeted a 2% inflation rate as the equilibrium 'norm' for an economy, analysts interpret a 3% level for the ten-year treasury yield as an indicator of expected inflation and economic growth in the economy (See Jim Kean's insight article in the Weekly of 13 April). For many, reaching the 3% level indicates a gradual return to the 'old normal' conditions and a healthy economy. For others, it is an indicator that tightening monetary policy is likely to follow, with uncertain impacts.

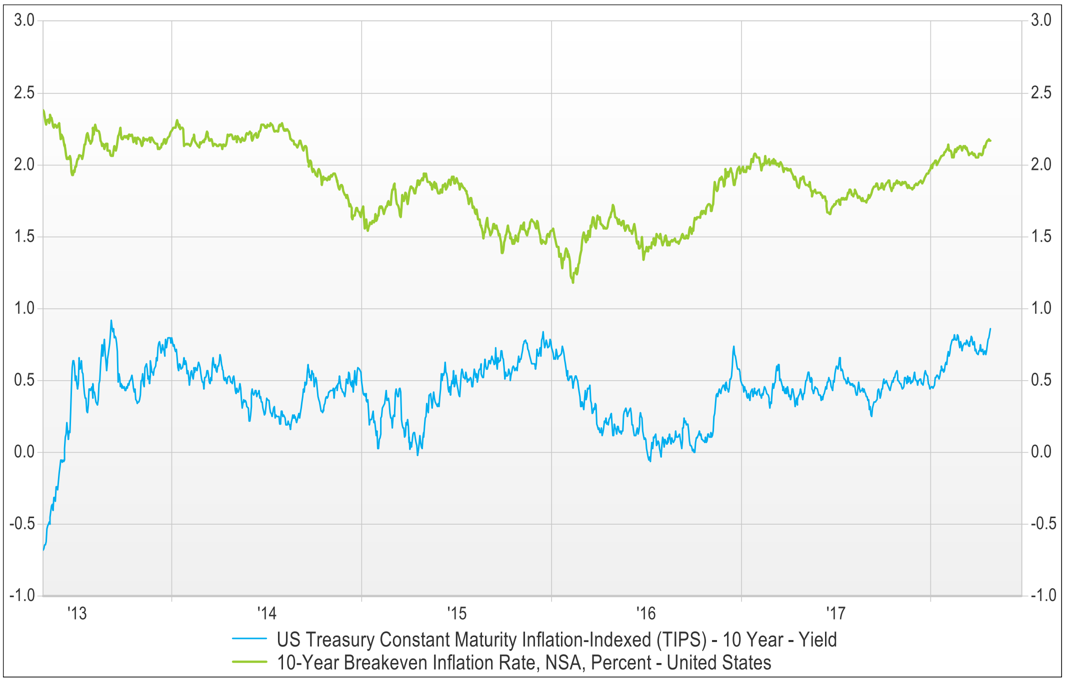
The economic environment now is quite different to 2013. Looking at survey data, we can see that businesses have had improving conditions since at least mid-2016, and have been on a more or less constant upwards trajectory when looking at consumer confidence (see below chart).



Source: FactSet (highlighted box shows the period of 3% yields for the ten-year treasury).

All this is perhaps obvious, given we are currently leaving the sub 3% region rather than entering it. As we wrote last week, these longer-term bond rates tend to be tied at least somewhat to nominal growth expectations, and so we would expect the US economy to be in an environment of higher real growth, higher inflation, or a combination of the two.

We can see expected real growth and inflation through looking at real yields, and we can measure expected inflation through breakeven levels (the two combined equalling nominal yields). As we can see below, there seems to have been a significant slowdown in growth expectations in early 2016. But since then, both real growth and inflation expectations have been stepping up in a consistent fashion.



Source: FactSet

Given this economic strength, and relative attractiveness of US yields in such a low interest environment globally, many may have expected US Dollar strength to prevail. However, since the end of 2016, we have seen an over 10% fall in the Fed's USD Broad Index, with similar falls in the Bank of England and FactSet's Dollar indices.

Two factors contributing to this have been the deteriorating current account and Government balances, as well as a worsening outlook for both. The prospect of fiscal stimulus from the Trump administration, and the negative trade balance, has led capital markets to believe that the US deficit is unsustainable. While the impact of these "twin deficits" on currency markets is debated amongst economists (downward pressure thanks to increased imports, upwards pressure due to foreign capital inflows funding the increased Govt debt levels), it is generally seen as negative for the country with regards to credit worthiness, which can also lead to downward pressure on the Dollar.

There have also been some more specific issues weighing on the Dollar. For example, the recent increase in commodity prices (such as oil and lumber in particular) has helped the Canadian Dollar, a major weight in indices like those mentioned above. The Chinese Yuan has also been stable since the start of the year, despite their economy slowing and liquidity being boosted by the cut in the reserve requirement ration. This isn't surprising though, given the Chinese Government's desire for a stable Yuan as it gains prominence in markets.

The last month has seen a potential start to the reversal of this trend. Since the start of the quarter, the USD has gained 3% vs the Swiss Franc and Japanese Yen. Perhaps the interest differential is now seen as sufficient for the increased risk and hedging costs for these ultra-low interest rate customers. On the other hand, economic data in the first quarter of 2018 pointed to slowing global expansion. This, combined with greater uncertainty in the Middle East, may have led investors to move money back to the world’s reserve currency.

Economists Mundell & Fleming would argue the strengthening of the dollar is well overdue; tightening monetary policy in the form of rate rises and offsetting expansionary fiscal policy should lead to a strengthening of the domestic currency in the short term.

Why is possible dollar strength a cause for concern?

A known impact of a strengthening dollar is a brake on global trade, as a majority of goods and services are traded and priced in dollars. This leads to higher costs for buyers (as their currency has depreciated relative to the dollar), which in turn slows demand. Traditionally, USD strength has had a negative impact on emerging markets (E.g. 1998 Asian financial crisis), due to their habit of borrowing outside their home countries in USD. But recently this effect has become less pronounced. Only countries whose currency is not considered as suitably hard/stable (E.g. Turkey) have continued to run significant USD debt balances, and are therefore even more exposed to a rising USD.

As we enter the second quarter, a dollar rally could put the cat amongst the pigeons. After all, even superb sales and earnings growth in the first quarter of 2018 have not been rewarded by investors (see our earnings season report for more information). Additionally, emerging markets could well look increasingly vulnerable if history is any guide. We discussed this view in March when we reduced our emerging market exposure, due to our analysis of dollar denominated debt held in these regions.

So where does this leave us in our outlook for both the future development of US yield levels and the possible impact this may have on the value of the USD?

As discussed, over the longer term, yields act as a barometer of expected rates of inflation and expected rates of economic growth. Meanwhile, central bank action, current account deficit trends and budget deficit changes drive levels over the shorter term. With current yield increases being driven by both rising inflation pressures (because of rising oil prices) and improving long term growth expectations (due to waning overheating fears), the question for the USD is which will be the stronger force going forward.

We actually expect both to reduce over the coming quarter. The current oil price is probably down to speculation rather than real demand increases, on the back of the Middle East/Syria tensions. With US shale oil production being increasingly profitable at $60-70/bbl levels, we can expect this pressure to subside. We look more in depth at the oil market in a separate article. The US growth outlook is also unlikely to dramatically improve, and therefore there is not much further yield pressure from the real yield side either.

Given how measured the wider bond markets have reacted to the 3% yield threshold breach (indeed on Friday it fell back to 2.96%), it is reasonable to expect that this was not a ‘breaking dam’ type event, but more a long-overdue range adjustment. This would mean that the yield may well enter a trading range around 3%, rather than storming towards 3.5%.

As such, following the recent bounce in the USD value, there is now less upside pressure for the US currency than there was at the beginning of the year. The USD recovery will likely put pressure on global trade for a little while longer. But it's unlikely that the dollar will appreciate enough to be a serious headwind for the global economy.

Diplomacy vs. 'Trumplomacy': Geopolitical risk update

Since the start of his Presidency, Trump has made it his mission to be the great disruptor, He despises the political establishment in Washington. He also despises trade deals that he believes have compromised US interests and influence through consensus negotiations. His response? Rip them up and bully his opponent to the table on his terms.

So, at the end of last year, the noise coming from Donald Trump's administration was outwardly worrying for investors. Trump and co had apparently lined up trade wars with the US' largest trading partners, China and the EU, and an actual war with North Korea's "rocket man". Skip forward to this week, and Trump has announced he's sending a delegation to China in search of a trade deal, given his blessing to an end to the war between the two Koreas and spent the week buddying up to French President Emmanuel Macron – the English speaking critic of virtually all of his foreign policies.

There is a pattern to all of this, and instead of being disruptive, it's predictable. Trump now notes that his team have "a very good chance of making a deal" with his "friend" Xi Jinping's government in Beijing. After weeks of tit-for-tat unilateral measures between the world's two largest trading nations – with hundreds of billions of dollars' worth of tariffs being threatened – the meeting will be the most substantial step forward we've seen since Trump took office. For all the China-focused ire we've seen from Trump during and since his presidential campaign, it looks more and more as though his 'stoking the fire' tactics are working.

And so to North Korea, where this week Trump went as far as to call leader Kim Jong-Un "honourable" and wax lyrical on the prospects for negotiations. A far cry from the button-measuring and "little rocket man" name calling we saw a few months ago. It comes after last week's announcement from Pyongyang that North Korea will stop all nuclear missile tests and scrap its previous test site. Instead, the regime's focus will now be on "the building of a socialist economy" and strengthening ties with the south. South Korean officials also confirmed last week talks with the North and the US to formally end the war between the Koreas – which has been in ceasefire since 1953.

Finally, we come to Macron's visit to Washington. Trump and Monsieur Macron's budding bromance made for great press photos early in the week. The apparent friendship between the 71-year-old nationalist President and the 40-year-old champion of centrist globalism belies their differences on the environment, global trade, the Iran deal, Syria, and just about everything else. But nonetheless, the young French President flew to the US with the intention of bridging the growing divide between the US administration and Europe. Among other things, he hoped to convince his newfound friend to re-join the Paris climate agreement, maintain a US troop presence in Syria and – especially – not pull out of the nuclear deal between the international community and Iran.

Macron didn't have much luck. Trump signalled he may reconsider his decision to pull out of Syria, but on the other points he appeared as stern as ever. On Iran in particular, Trump reiterated his belief that the international deal with Iran was "insane", and heavily implied that he wouldn't renew sanction relief (which the agreement mandates) by the May 12th deadline.

But Trump wasn't the only one to play both parts. Only hours after the public displays of affection with the US commander-in-chief, Macron delivered a rousing speech to US congress where he not-so-subtly criticised everything Trump stood for. One by one, he rebuked Trump's stances on the environment, on global trade, on Iran and on Nationalism, Despite the thunderous applause from the Democratic party, Trump won't be affected.

It's Macron who looks more likely to be coaxed – stressing the need for "flexibility" in international agreements. It's European leaders, not Trump, who are scrambling to make changes to the Iran deal or even writing a new one altogether. Once again, it looks as though all Trump's blustering tweetstorms, threats and indignant press conferences have actually lead to him getting his way. Rather than conventional closed-doors diplomacy, the President sticks to his own "art of the deal" tactics – bully your opponent as a way of forcing them to the table on your own terms – we have dubbed it 'Trumplomacy'.

Outwardly the downside to Trump's bully diplomacy is that it often leaves the other side unclear about what Trump actually wants, and therefore uncertainty. While he has repeatedly threatened to pull out of the Iran deal, none of his team have specified exactly what measures will make them stay in, much to the annoyance of European leaders.

Chinese officials have repeatedly complained that the Trump administration won't specify what measures would satisfy them, or even which US official is in charge of negotiations. But why should he? Trump wants a deal that works for him and his tactic is adversarial. He sets out to make his 'opponent' feel uncomfortable. His apparent rashness and willingness to act gives him leverage – we believe that he is mad enough to actually follow through on his threats. This is how he has acted in business and it's no surprise his political negotiations follow the same format.

The challenge for investors is: has political uncertainty translated into genuine market uncertainty? Is Trump the political disruptor affecting markets the way that the receding threat of nuclear war kept us awake at night? Stocks fell on the news of his steel and aluminium tariffs and the fears of a disastrous trade war, but virtually recovered in only three days, as analysts realised actual policy would be watered down.

Likewise in February when markets did become turbulent it wasn't because of Trump, it was because investors were worried the Fed might raise rates more than previously thought. Since then volatility has returned and we expect spikey but benign markets going forward, not because of Trump's Twitter account, but because economic indicators for the global economy look that way.

Do markets believe that Trump is simply noise over the larger global economic normalisation story that even his deliberate disruption has limited power to actually disrupt? So far it looks that way. His art of the deal tactic is now understood, and he has succeeded in forcing China and North Korea to the negotiating table. What we don't know is what kind of deal he can actually achieve with his inexperienced, somewhat disparate but individually very opinionated team. And therein lies the uncertainty and the potential for market shock. Not through what his disruption can achieve, but what it can't.

Markets bullish on oil

At the time of writing, Brent crude oil is sitting at just under $75 per barrel, and WTI crude at $68 per barrel. Both of these are levels not seen since the commodity price bubble started deflating in 2014, and the result of a sustained upward surge since mid-2017. This is despite the fact that, not long ago, many commentators made the case that the price of oil was range bound. Prices couldn't drop much below the $40pb mark, since most oil-producing nations (and especially those in OPEC) needed a higher oil price to sustain revenue stability, and so would agree production cuts to ensure that. But on the higher end, the thought was that upside was limited, because the new technology used by shale producers in the US meant oil supply could very quickly be expanded to capitalise on higher prices.

That doesn't seem to have happened. We've long since broken through what many thought was the upper bound of oil prices (around $60pb), and some are now suggesting that oil could move back up to the $100pb mark. Why?

The longer-term trend is down to supply cut agreements between OPEC and Russia, whose interests seem aligned at the moment, as well as a general pickup in demand (especially from China) on the back of synchronised global economic growth. But recent activity is being put down to a "re-pricing of geopolitical risk," according to research firm Tradition Energy. Donald Trump's staunch opposition to the Iran nuclear deal and production issues in Venezuela are dampening supply expectations, causing prices to rise. French President Emmanuel Macron's last-ditch attempt to bring Trump back into the Iran deal this week appears to have failed, with the US President strongly suggesting that he won't renew the sanction relief for Iran before the deadline next month. This will undoubtedly constrain Iranian oil exports.

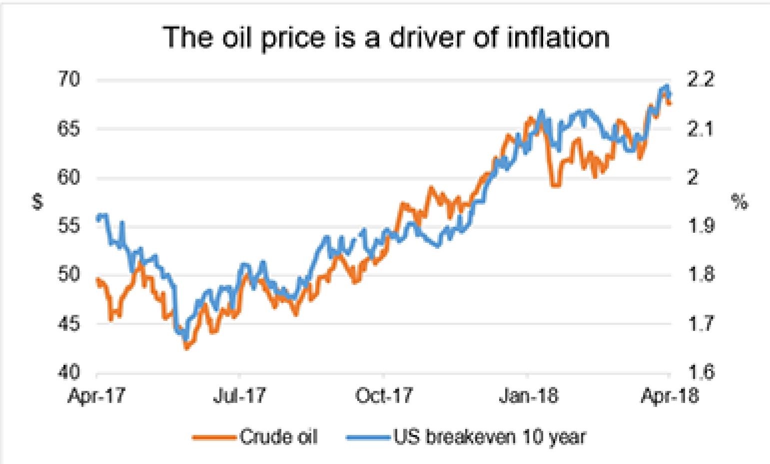
Even if European leaders were successful in convincing Trump to stay in the deal by slapping more non-nuclear-related sanctions on Iran (as is being suggested), Iranian officials have suggested they would not accept this and could pull out themselves.

Meanwhile, production in Venezuela has fallen from around 2.5mn barrels per day in 2016 to around 1.5mn barrels per day, due to the ongoing crisis there. To add to this, that very crisis is prompting European leaders to consider more sanctions on the country.

All of these recent developments come against record-breaking oil demand from the world's largest importer of crude, China. By the end of the month, it's likely that China's daily import volume will surpass 9mn barrels of oil – around 10% of global consumption.

So, while there is certainly a long-term trend towards higher prices which appears to be supported by supply and demand fundamentals, recent activity may well be more driven by speculation, with investors betting on a sustained bout of high oil prices. But we think this expectation may be overly bullish. While production has fallen in Algeria, Angola and Venezuela, the nature of the OPEC/Russia agreement means that any drop-off in those countries will likely mean more production from Russia and Saudi Arabia. What's more, the agreement between Saudi Arabia and Russia is based on interests which are aligned for now, but is shaky at best. The former's allegiance to the US – which is moving towards harsher sanctions on Russia – will likely test the partnership as we move forward, particularly as oil creeps towards $80pb.

However, that is not to say we are bearish on oil. Mohammed bin Salman, the de facto ruler of Saudi Arabia, is probably the most influential figure on the price of oil. He has a big modernisation plan for the Saudi economy (the ambitious Vision 2030), as well as large military ambitions in the region. Both of these factors require a higher oil price, and so supply cut agreements will likely ensure that in the short to medium term. That is, as long as global demand continues its steady path.



This matters, as oil is one of the primary drivers of inflation and as we know that drives interest rates and bond yields. At the moment, prices are enough to provide a boost for the energy industry (with Royal Dutch Shell and Total posting extremely positive earnings results for Q1 2018) without causing runaway inflation or dampening demand. That could change if prices increase much more though. If oil puts too much upward pressure on inflation, it could prompt the US Federal Reserve to raise rates more rapidly than currently planned. And if they are forced into raising rates faster than real wage growth can keep up, it could put quite a dampener on US and even global growth.

Still, despite having re-entered our list of potential economic headwinds to keep an eye on, we would be very surprised if the elevated oil price failed to - once again - rapidly increase shale based oil exploration volumes in the US. This should keep the speculative oil price forces wary to not suffer a repeat of their painful losses of 2014-2016.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7465.6	1.3	97.4	↗
FTSE 250	20252.9	0.2	32.1	↗
FTSE AS	4107.3	1.1	45.0	↗
FTSE Small	5861.4	0.7	41.2	↗
CAC	5458.7	0.8	45.8	↗
DAX	12546.1	0.0	5.6	↗
Dow	24223.1	-1.0	-239.9	↗
S&P 500	2663.3	-0.3	-6.8	↗
Nasdaq	6631.4	-0.5	-36.4	↗
Nikkei	22467.9	1.4	305.6	↗

Global Equity Market - Valuations

MARKET	DIV YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.0	13.3x	13.7x	17.1x
FTSE 250	2.7	15.0x	14.5x	17.0x
FTSE AS	3.7	13.5x	13.8x	16.6x
FTSE Small	3.2	10.9x	-	-
CAC	2.9	16.1x	14.4x	15.4x
DAX	2.5	12.4x	12.7x	16.9x
Dow	2.1	19.4x	15.7x	15.3x
S&P 500	1.9	20.2x	16.3x	17.5x
Nasdaq	1.1	25.2x	19.7x	20.2x
Nikkei	-	-	-	-

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
BRITISH AMERICAN TO	9.2	ANGLO AMERICAN	-4.9
IMPERIAL BRANDS	8.8	GLENCORE	-3.8
RENTOKIL INITIAL	6.7	BARCLAYS	-3.7
PEARSON	4.8	ROLLS-ROYCE	-3.5
CENTRICA	4.7	PADDY POWER BETF	-3.0

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	7465.6	1.3	OIL	74.8	1.0
USD/EUR	20252.9	0.2	GOLD	1322.7	-1.0
JPY/USD	4107.3	1.1	SILVER	16.5	-3.7
GBP/EUR	5861.4	0.7	COPPER	306.4	-2.9
CNY/USD	5458.7	0.8	ALUMIN	2275.0	-8.5

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W YIELD
UK 10-Yr	1.453	-1.8	-0.03
US 10-Yr	2.957	-0.1	0.00
French 10-Yr	0.794	-2.1	-0.02
German 10-Yr	0.571	-3.2	-0.02
Japanese 10-Yr	0.055	-8.3	-0.01

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.5
3-yr Fixed Rate	1.8
5-yr Fixed Rate	2.0
Standard Variable	4.23
Nationwide Base Rate	2.50
Halifax Standard Variable	3.99

* LTM = last 12 months' (trailing) earnings; **NTM = Next 12 months' estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, just send me an email.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel