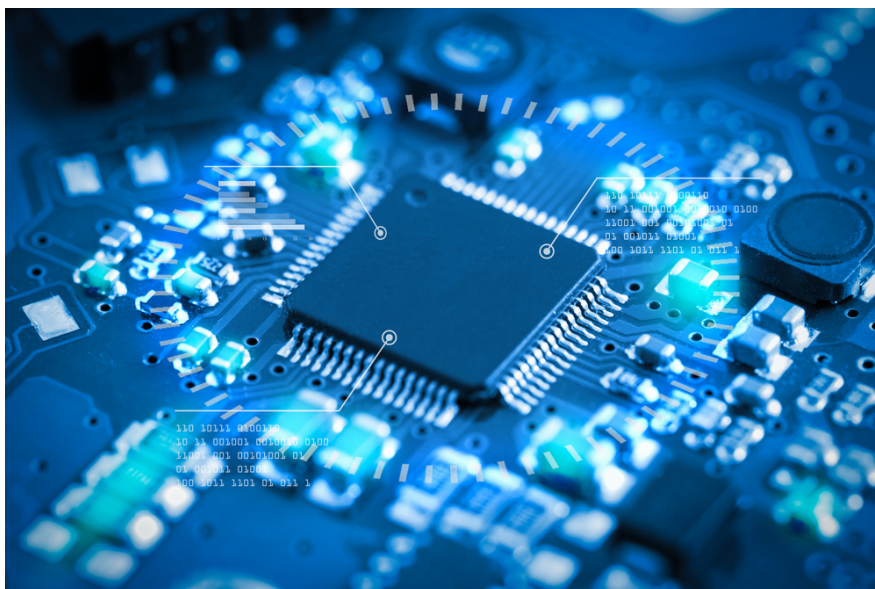


Turn your back and look what happens

Look away from markets for a few days, and when you turn back, the outlook has changed dramatically - USD lower, Fed expectations reeling, bond yields way down and stocks too. Nice for emerging markets while it lasts, but only whilst the US growth story still holds together too.



All change

I've been buried in a presentation for a few days and haven't really had my eye on markets as I've grappled with what I hope are some fancy new charts. And a bit like when you have been away from home and see your kids again, to think, "My how they've grown", my first take this morning was "My, they look weak". Now I don't need to tell you this - you're better plugged in than me in all probability. But it does affect the way I look at the world, and what I might expect to happen on a number of levels.

1. The Fed - markets have gone on a big downer with respect to the Fed. The current effective Fed funds rate is 2.20%, near the top of the 2.0-2.25% target range owing to issues with the interest on excess reserves. So to judge what the market is expecting from Fed policy decisions, I look at Fed funds futures, which are based on the average effective Fed funds rate over the relevant contract month, not any part of the policy target. And if I do this, it shows a December hike still firmly priced in. The weakness of stocks has not dented that.

But thereafter, they diverge sharply, with only one further hike fully priced in by the end of 2019, though the balance of risks still supports a second hike. As a house, we remain in line with the Fed for three 2019 hikes. Though this does raise questions about what the stock market will do if the Fed sticks to its guidance and our house view ends up being right. It makes you think...

2. Stocks look weak. This is backed up by some very ill-informed technicals (I read about a third of "Murphy" before I got bored...the easy bits). I'm concerned in particular by the tech sector. Oversupply in the semiconductor industry is an issue for Asia (prices as well as volumes under pressure), and made worse by an apparent lack of demand for some well-known producers of hi-tech products (you know the brand I mean), and a drop in demand for chips to run crypto-currency mining, now that the bottom seems to have fallen out of that market. That's not good for KRW or TWD, but in general, it is not a good backdrop for Asia, now that everyone has got in on the chip-game. For those not at the cutting edge of this technology, and operating as price takers in this increasingly saturated market, that is concerning.
3. The USD is weak. Even GBP has made some modest gains against the USD in recent days (which shows how weak it has been) and "proper" currencies have done much better still. So the love of all things USD is dipping sharply...though that does not extend to US Treasuries, where yields are now only 3.06% on the 10Y, which takes the 2s10s spread back to only 27bp, and indicates that market recession worries are mounting again.

Most of the preceding observations are in the short-term quite helpful to the backdrop of Asian FX, especially coupled with lower oil prices, and lower Treasury yields. But this benign market environment could be a deceptively enticing veil, masking some genuinely less encouraging times ahead. If we add a much weaker US growth picture to the story above, then I doubt that Asian markets would be looking quite so rosy.

UK PM May still holding on to power

My understanding is that the European Research Group (ERG), the Eurosceptic cabal within the Conservative Party, are well short of the 48 letters calling for a vote of no-confidence in Theresa May. This means the EU-UK draft deal, remains the central point for discussion between the UK and Europe, and subject to minor tweaks from either side, is what we should expect to be the subject voted on in parliament in December, though perhaps later.

But here, I am not sure that May has the numbers. The Labour leader yesterday suggested his party would vote against the bill. And the DUP, who Theresa May requires to lead parliament, abstained from two votes on a Finance bill on Monday. The Labour leader has also apparently decided a second referendum might be worth considering...if so, then maybe our house view that politicians will vote for this deal at the last minute as the alternative is so horrific (no deal and WTO trading) could be challenged.

Certainly, the bravado from arch-Brexiteers seems to suggest that the reality of a no-deal Brexit has not sunk in, and perhaps never will. So if May doesn't have the opposition, who may be looking for an election, and she doesn't have the DUP and she doesn't have a chunk of her own party, then the arithmetic looks like my youngest son's maths homework - it usually doesn't add up.

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