LGT Vestra Monthly Market Commentary in association with PIA Wealth Management

June/July 2019

So far this year, we have been reminded that economics in isolation can provide false signals for equity markets. Despite stronger nonfarm payroll numbers, in general, economic data has been weaker than expected. Soft data indicators, including the Purchasing Manager Indices (PMI), showed significant declines in new orders and production. On aggregate, global manufacturing indicators are now in contractionary territory and whilst services continue to expand, the extent of this has been coming down. In spite of this, markets have risen and the S&P 500 Index is at an all-time high. Markets have seemingly reacted favourably to the outcome of the G20 summit in Japan, which resulted in a temporary cessation of hostilities on trade, between the US and China.

Adding further support to markets, central banks have adopted a more dovish tone in response to the deteriorating economic data. The US Federal Reserve (Fed) appeared to confirm the market's expectations that they will cut rates at their next meeting taking place at the end of July. Members of the European Central Bank (ECB) also met at Sintra during the month at the ECB's annual symposium. Mario Draghi indicated that the ECB is prepared to cut rates further into negative territory, and even hinted at restarting its quantitative easing programme. As a result, European sovereign bonds rallied, with 10-year German bund yields reaching near all-time lows. At one stage, 10-year Greek government bonds yielded the same as 10-year US treasuries.

The eventual Brexit outcome remains unknown, with even the Bank of England forced to question its projections for a "smooth" Brexit. The leading candidate for the Conservative Party leadership contest, Boris Johnson, and his "do or die" attitude, suggests the chance of a no deal Brexit has increased. At the same time, he maintains that the odds of it happening are a "million to one". It remains unclear as to what Brexit proposition will get the support of Parliament. Members of Parliament have voted for a process that would make it more difficult for the future prime minister to prorogue Parliament and consequently make it harder for a no-deal Brexit to go through by default. On the other hand, the lower standing of the Labour Party in the opinion polls has reduced the fear of nationalisation, with investors potentially being unfairly treated in the process.

Central banks appear to be exercising a degree of caution in reacting to the deteriorating economic data. The reaction in equity markets seems to indicate a belief in central banks' ability to stave-off the threat of recession and its impact on earnings. Time will tell whether these actions will be seen as prescient, or eventually proven to be unjustified.