

# Bedrock Friday 03 November 2017 Newsletter

We are in November and another agitated week is behind us. As we anticipated last week, President Donald Trump nominated Jerome Powell to run the Federal Reserve once current Chair Janet Yellen's term expires in February. Powell has been part of the Fed's voting consensus since taking his seat, not once veering from the majority's position. We believe that the markets are correct in liking the new appointment, believing we are facing a new period with more the same market-supportive manner. Whilst we applaud the new Chair, we give homage to the departing Lady of the Money- Yellen's term has been marked by a mostly uninterrupted bull market that began in March 2009 and low interest rates even as the Fed has sought to unwind the stimulus initiated during the crisis.

The markets showed their appreciation of the New and Unchanged outlook with the Dow Jones industrial average closed 80 points higher after briefly falling 84 points. The index also hit a record intraday high. But it wasn't just the new Fed Chair- the details of the tax-reform plan proposed by Republicans are out and the key piece for investors is the permanently lowering of the corporate tax rate to 20%. Many details about deductibility of certain costs and retirement investing are still in negotiation, but overall, it "feels" like progress is in the making.

On this side of the pond, Bank of England policy makers raised interest rates for the first time in a decade, yet expressed concern for Britain's Brexit-dented economy by indicating that another increase isn't imminent. The Sterling now carries a 0.50% interest rate. Wow! Strangely, the Sterling fell and UK equities rose.

Another step towards global normalization? On Wednesday, Federal Reserve officials reinforced expectations for a December interest-rate increase by subtly upgrading their assessment of the U.S. economy, a day before President Donald Trump plans to unveil his choice to lead the U.S. central bank. The ECB is expected to join the rate raising party later in 2019. We view this change in central bank thinking/actions as supporting our own views that the global economy has clearly stepped out of the shackles of the 'Great Recession'. Normalization of economics and finance is on track, at last!

Away from the main headlines we see oil prices reaching \$55 per barrel of WTI and Brent crossing \$60. A rebalancing of the oil market seems to have been achieved- OPEC controlling supplies as the economies are improving and growing. According to Reuters data, it is the first time the calendar spread for the next six months moved has slipped from "contango" into "backwardation" since November 20, 2014. Backwardation is when the current price of oil is higher than a future cost of oil. It is seen as a sign of higher immediate demand. Conversely, contango is when the futures price of oil is higher than the spot delivery price. Interesting, possibly further confirmation of the continuation of the Bull Run?

As the stock market keeps moving higher, valuations have reached an ominous level that comes appropriately enough on Halloween (just passed). The Shiller CAPE ratio, which compares stock prices to their earnings over a 10-year period, is at 31.43, about where it was when then-Fed Chairman Alan Greenspan gave his widely cited "irrational exuberance" speech in December 1996, according to calculations by Nomura. The only time valuations were higher was around the time of the stock market crash and beginning of the Great Depression in 1929 and during the dot-com boom in the late 1990s, according to the model formulated by Nobel Prize-winning economist Robert Shiller.

Using a more conventional measure of valuation, comparing the S&P 500 price to forward 12-month earnings, the market is trading at a 17.9 multiple. That compares with the five-year average of 15.6 and the 10-year average of 14.1, according to FactSet. Shiller himself has been reluctant to push the CAPE level, recently telling CNBC that while he believes the U.S. market is expensive, he wouldn't encourage investors to sell aggressively. Instead, he believes they should diversify into global markets, particularly Russia.

What is different in this environment is the level of interest rates, way lower than they had been at the mentioned reference points in the past. As the term "expensive" is a relative measure, we concede that equities appear expensive when compared to their past, but they remain cheap when compared to their alternatives, i.e., bonds and the like fixed-income instruments. The bull run could soon hit turbulence once the record-breaking earnings season ends, according to Nuveen's Brian Nick. "We'll see in November and December as good news headlines go away – what, if anything – takes over and what kinds of bumps we get between now and the end of the year," the firm's chief investment strategist said recently on CNBC's "Futures Now." "If you're looking forward into the end of next year, the light is still green for the U.S. economy and for corporate profits," he added. "Between now and then, we see the markets anywhere between 8% and 10% higher, and that's basically in-line with our expectations for earnings growth," the investor said (Nuveen controls some \$900 billion in assets).

So the \$64'000 question remain- Where are we going from here? We remain stout believers that we will remain in a low inflation decade (or longer), low interest rate (if somewhat higher than today's), further continuing improvement in corporate results (therefore rising equity prices) and a strengthening of the US\$, which seems to be 'en-route' since some weeks. We are faced with two big, global issues- Global warming and pollution. These two, whilst scary in themselves, will require massive investments over the coming years. This will bring new business to certain sectors of the economy, further fuelling growth. We remain bullish ☺

There cannot be a crisis next week. Our schedule is already full. Henry Kissinger.

## Market Weekly Highlights:

- The dollar has marked a pause this week with DXY at 94.80. The EUR is trading unchanged against the USD after the market digested Draghi's dovish speech, currently at 1.1648, the same level as where it opened the week. USDCHF is at almost 1.00. The Pound started the week higher crossing 1.33 on Wednesday only to come off and trade unchanged for the week at 1.3080 after the first interest rate hike of BOE in a decade. The Japanese Yen stands at 114.13 against the USD almost at the same level where it was last Friday.  
The Russian Ruble and Brazilian Real have traded sideways against the USD for the week showing respectively about 58 and 3.26 as we write.  
Crude oil WTI is up trading at almost \$54, whilst Brent stands some \$7 higher at just \$61.
- 10Y U.S. Treasuries are trading up in price with yields going down some 12 pbs to 2.35% after last week's highs at 2.47%.  
The Japanese 10 year JGB yield has moved down this week at 0.055% continuing to offer POSITIVE yields.  
In Europe, the German Bund yield, which hit almost 0.50% last week, moved down and is trading at 0.36%, unchanged for the week. The French 10Y Yield followed a similar path reaching 0.75% early this week and remaining at that same level during the whole week.  
In Peripheral Europe Italian 10Y yields are now below 2.0% trading at 1.77%, almost where they started the year, whilst the Spanish 10Y yields trade some 20bps lower than Italy at 1.48% but slightly higher than where they started the year at 1.30%.
- Equity markets are higher this week in the USA with all three major indices trading higher and reaching new all time highs during the week. The DJIA is just at 23'516 up about 0.49% for the week, SP500 at just below 2'580, up for the week 0.76% and Nasdaq at about 6'714, adding a strong 2.41%.  
In Europe markets are showing positive returns as well for the week with Eurostoxx50 up 0.96%, the DAX and CAC40 at respectively +2.63% and +0.36% for the week while the peripheral Spanish IBEX 35 is up 1% and FTSE MIB at +1.60% as we watch. The Swiss SMI and FTSE 100 are also higher with almost 1% each for the week.  
The Nikkei trades higher by +3.68% for the week and shows strong positive returns for the year at a strong 18% on the back of the weakening of the Yen .



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