

EQUITY

Notes from the Trading Desk - Europe

September 03, 2018

Franklin Templeton's Notes from the Trading Desk offers a weekly overview of what our professional traders and analysts are watching in the markets. The European desk is manned by eight professionals based in Edinburgh, Scotland, with an average of 15 years of experience whose job it is to monitor the markets around the world. Their views are theirs alone and are not intended to be construed as investment advice.

Last week, US equities made new highs thanks to reports of a trade deal between Mexico and the United States. In contrast, globally there were some concerns over emerging-market currencies and European equities drifted on familiar concerns over Italian government policy.

The Digest:

Holidays are Over, Back to Brexit



Last week saw a dramatic increase in Brexit noise as the UK Parliament prepares to return from its summer break this week.

Negotiations between the European Union's (EU's) chief Brexit negotiator Michel Barnier and Brexit secretary Dominic Raab last week struck a reasonably constructive tone and led to a rise in sterling against the US dollar, demonstrating some confidence that a deal could be possible.

However, a two-pronged attack on Prime Minister Theresa May's proposed plans shattered any illusion of progress. Firstly, Barnier stated in an interview that he was strongly opposed to May's Chequers plan. He described the proposal that had been put forward in July as "illegal" and said it would unpick the single market. Given his constructive tone over the prior week, these comments came as something of a surprise.

Leading Conservative Brexiteers Boris Johnson and David Davis also took to the press to launch withering attacks on May. With that, the pound slumped back to 1.288 against the US dollar early on Monday (September 3).

With Parliament back in session this week, we can expect the rhetoric to heat up considerably.

We expect Brexit talk to remain front and centre now for the foreseeable future.

Aside from the official EU-UK negotiations, the Conservative party conference in late September will be held against a back drop of unprecedented internal fighting. Even if May can reach agreement with the EU, she still has to push any deal through Parliament. Given the various factions May is trying to appease within her party and the Democratic Unionist Party (DUP), it is by no means guaranteed.

If the United Kingdom fails to reach a deal or pass it through Parliament, the prospect of a fresh general election is a very real likelihood, in our view, bringing with it much more uncertainty.

EM Currencies in Focus



Emerging-market currency moves remained in focus last week as Argentina continued to stave off a further fall in the Argentine peso.

The Central Bank of Argentina raised rates by 15% to 60% on Thursday (August 30), which helped the currency recover some of the fall from earlier on in the week.

Elsewhere, the Turkish lira also came under pressure. Some media reports say Germany is considering providing financial assistance to Turkey, to avert a full-blown economic crisis which could destabilize the region, but it remains to be seen whether Germany will follow through with this suggestion.

Last Week:

Europe

Last week, any European equity market gains were reversed on Friday (August 31) following US President Donald Trump's announcement that he wants to move ahead with a plan to impose tariffs of \$200 billion on Chinese imports.

Hopes of a deal between the EU and the US on import tariffs were raised on the back of comments from EU trade chief Cecilia Malmström, who said Europe would be willing to scrap tariffs if the United States vowed to reciprocate. Understandably this helped autos stocks outperform on the week despite Trump advising the proposal was "not good enough".

Italy was the notable laggard in Europe, due to increased tension with the EU and reports that the country may exceed the 3% gross domestic product (GDP) deficit ceiling.

LOOK OUT FOR... (SEPTEMBER 3 - 10):

Monday, September 3

- Holiday in the US and Canada

Tuesday, September 4

- Spanish Unemployment Rate [Link](#)

Wednesday, September 5

- Bank of Canada Interest Rate Decision [Link](#)
- Canada July Trade Balance [Link](#)
- US July Trade Balance [Link](#)
- Australia Second-Quarter Gross Domestic Product [Link](#)

Thursday, September 6

- Australia July Trade Balance [Link](#)

On Monday (August 27), Italian Deputy Prime Minister Luigi Di Maio said Italy would oppose the EU's next budget, claiming this was in retaliation to EU member states failing to follow through on a deal made in June on immigration issues. In this context, Italian government bond yields continued to creep higher, with the spread between Italian and German 10-year yield widening notably.

Macro data in Europe was varied. Provisional second-quarter French [GDP](#) matched estimates at 1.7%, while the Italian [GDP](#) was a little better. Eurozone inflation data was slightly softer on average, but it is unlikely to change the current thinking at the European Central Bank.

Americas

US equity markets were stronger for much of the week, making new all-time highs on Wednesday (August 29) before coming off somewhat after US President Trump announced he would go ahead with his \$200 billion Chinese tariff plan.

However, investors were also watching talks between the United States and Mexico on overhauling the North American Free Trade Agreement (NAFTA) closely. A proposed deal, announced on Tuesday (August 28), focused heavily on crafting new regulations for the automotive industry in the region. The changes would see an increase in the percentage of car parts sold in the US and Mexico which have been produced in both countries.

There were also hopes that Canada would join the United States and Mexico in agreeing to a deal by the end of the week. But the week ended without any agreements, despite Canadian Foreign Affairs Minister Chrystia Freeland saying on Friday (August 31) that she believed a deal was within reach.

US data was mixed last week with July [goods](#) trade deficit widening. However, second-quarter [GDP](#) was revised upwards, and [inflation](#) data points were also solid.

Asia

Asian equities were stronger last week. In Japan, signs that inflation was picking up coincided with Japanese Prime Minister Shinzo Abe's announcement he would run for another term. Elsewhere, the Japanese yen was also a touch stronger despite Bank of Japan Board Member Hitoshi Suzuki saying the country's monetary policy would likely be in place for some time.

In China, equities were weaker as further talk of tariffs from the United States weighed on sentiment, although the announcement was not overly surprising. Commodities were as a result softer overall.

Chinese macro data was mixed, with July [industrial growth](#) showing signs of slowing down. Purchasing manager's index was fairly solid.

Week Ahead:

Economic Data

- United States: The August unemployment report will be released on Friday.
- Australia: Second-quarter GDP will be published on Wednesday.

Politics

- United States: A consultation on additional US \$200 billion of Chinese imports subject to 25% US tariffs will

- Germany July Factory Orders [Link](#)
- US July Factory Orders [Link](#)

Friday, September 7

- Holiday in Brazil
- Japan July Household Spending [Link](#)
- Germany July Industrial Production [Link](#)
- Germany July Trade Balance [Link](#)
- Eurozone Second-Quarter Gross Domestic Product [Link](#)
- US August Unemployment Report [Link](#)
- Canada August Employment Report [Link](#)

Monday, September 10

- Japan Second-Quarter GDP [Link](#)

close on Wednesday. The timings on when this would be implemented remain unclear.

- UK Parliament reconvenes on Wednesday. We expect the Brexit debate to be all-consuming going forward.
- Sweden holds a general election on September 9 with the traditionally popular Centrist parties under pressure from anti-immigration populist parties.

Monetary Policy

- The Bank of England's (BOE's) Mark Carney, Andy Haldane, Silvana Tenreyro and Michael Saunders Speak in London on Tuesday. Focus will fall on BOE governor Mark Carney as it is expected he will step down next year.
- The Reserve Bank of Australia will meet on Tuesday for its monetary policy meeting. currently.
- The Central Bank of Sweden will publish its interest rate announcement on Thursday.

Views You Can Use

Insight from Our Investment Professionals

[Trade Turmoil Doesn't Derail Out Outlook for India](#)

Trade tensions have spooked investors in recent months, including those in India's stock market. Franklin Templeton Emerging Markets Equity's Sukumar Rajah weighs in on the positive economic fundamentals he and the team see, and why they think India's equity market should be able to weather recent challenges. [Read More](#).

[Three Developments in Europe You May Have Missed Over the Summer—and One You Didn't](#)

The months of July and August are traditionally a little quieter for markets in Europe as participants take a summer break. But things don't stop completely. As the wheels get back up to speed, David Zahn, Franklin Templeton's Head of European Fixed Income, considers a few developments in Europe over the summer months that might have slipped under the radar. [Read More](#).

[Of Currencies, Trade and Other Clouds](#)

Emerging markets have struggled in the first half of this year amid a storm of uncertainties. Franklin Templeton Emerging Markets Equity's Chetan Sehgal examines issues that have acted as clouds on the asset class—including a stronger US dollar and trade skirmishes—and highlights some positive longer-term fundamentals. He thinks some of the concerns are overblown. [Read More](#).

[Why We Think the US Equity Bull Market Could Keep Running into 2019](#)

Now that the US equity bull market has officially hit the history books as the longest on record, some observers are concerned it could soon stumble. Grant Bowers, vice president and portfolio manager, Franklin Equity Group, outlines why he thinks it could keep running into 2019. [Read More](#).

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