FRANKLIN TEMPLETON

BEYOND BULLS & BEARS

EQUITY

Notes from the Trading Desk - Europe

July 01, 2019

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.

Global equities were relatively flat last week as investors watched with bated breath ahead of the meeting between US and Chinese Presidents Donald Trump and Xi Jinping at the G20 summit. Trading volumes were lower, even into month- and quarter-end, as markets anticipated a stalemate between the two sides. Currency moves were also muted on the week.

The Digest

Markets Took Stock Ahead of Trump-Xi Meeting

Volumes in global equities were modest last week in the lead up to a much-anticipated meeting of Presidents Trump and Xi at the G20 summit in Osaka. Interest was less on the G20 summit in general and more on the meeting between the two leaders.

The failure of the two countries to agree a new trade deal (despite much posturing from both sides) has generated significant levels of uncertainty in the global economy for several months now.

Equities remained range-bound throughout the week. Late on Tuesday, one headline suggested Trump was willing to suspend the next round of additional US$300 billion of tariffs on Chinese imports, assuming trade negotiations were successful.

Later in the week, another headline stated that President Xi had set out conditions to President Trump for resolving the trade dispute, although at least one of the reported conditions was deemed to have crossed the US's line in the sand.

On Wednesday, markets reacted positively to US Treasury Secretary Steven Mnuchin's comments that, in terms of a deal, the United States and China "were 90% of the way there".

But the enthusiasm, and the rally, was short-lived.

As the week wore on, markets waited with anticipation as investors tried to predict whether there would be some kind of deal, truce or delay to the introduction of tariffs. There was some concern that none of these would emerge, and that an escalation in tariffs would prompt a cyclicals-led, sharp move lower in equities. The consensus prediction was for no further tariffs and a stalemate on negotiations.

Weekend update

Over the weekend, the US and Chinese authorities announced they had reached a form of truce.

The United States agreed to put on hold the introduction of new tariffs worth US$300 billion on Chinese products.

In return, China agreed to purchase significant amounts of US agricultural goods. However, the key upside surprise centred on Chinese telecommunications giant Huawei. Considered pre-meeting to be a non-starter for the United States in terms of any change to treatment, Trump appeared to perform a bit of a U-turn. The reported truce calls for an easing of restrictions on US companies selling to the Chinese firm.

We'd expect the markets to react positively to news Trump was willing to relax restrictions on Huawei. Despite this, a few market commentators this morning have noted that despite the positive developments, there remain some significant obstacles that have yet to be overcome.

All Eyes on Oil Prices as OPEC Gathers

The energy sector was also in focus last week ahead of this week's Organization of the Petroleum Exporting Countries (OPEC) meeting in Vienna.

At the last meeting, OPEC, along with 10 non-OPEC producers, agreed to reduce output by 1.2 million barrels a day (mbd) for six months effective from January 1, 2019. The focus now is on whether this reduction will be extended until year-end.

The consensus view was that it will. Based on recent commentary, OPEC seems to fully support an extension of the agreement.

Over the weekend, Russian President Vladimir Putin met with the Saudi Crown Prince Mohammed bin Salman at the G20 summit. Putin said on Saturday that Russia had agreed with its Saudi counterparts to extend their agreement for at least another six months.

We expect this to receive the stamp of approval from the larger OPEC group this week. Putin did also note that the extension could perhaps be up to nine months, so there will be some focus on the length of the extension once confirmed.

Europe

Although trading volumes were low and equity market moves were muted last week, a cyclical sector theme was clear. Real estate, utilities, consumer staples and media stocks were the notable underperformers in a week which saw the banks, basic resources, technology and travel & leisure outperform.

LOOK OUT FOR... (JULY 1 - 8):

Monday, July 1

- Holiday in Canada and Hong Kong
- Reserve Bank of Australia Interest Rate Decision Link
- German June Unemployment Report Link
- US Federal Reserve Vice Chair Richard Clarida

Greek and Turkish equities outperformed as the political situation continues to evolve in both countries.

Meanwhile, there was not much change in the race for the next UK Prime Minister with Boris Johnson remaining front-runner. Johnson and his rival Jeremy Hunt are on a tour of hustings events in the lead-up to the membership ballot. Inevitably, much of the campaigning has focused on Brexit, with Johnson leaning towards a harder separation from the European Union.

In terms of polling, Johnson is thought to have roughly 60% of support from party members. UK assets seem to be stuck in a holding pattern while the process of choosing a new prime minister continues.

In terms of data, eurozone consumer price index (CPI) was the focus for the week, and it came in ahead of expectations on Friday.

Speaks at the Bank of Finland Conference on Monetary Policy, Helsinki, Finland Link

Tuesday, July 2

- Spanish Employment Report Link

Wednesday, July 3

- Early Close in the United States
- Australia May Trade Balance Link
- US May Trade Balance Link

Thursday, July 4

- Holiday in the United States

Friday, July 5

- German May Factory Orders Link
- US June Employment Report Link

Monday, July 8

- German May Industrial Production Link

Americas

US stock markets were down slightly last week in anticipation of the meeting between Presidents Trump and Xi.

Despite the loss on the week, the Standard & Poor's 500 Index recorded its best June since 1955.[1] The cyclical rotation was evident here too, with materials, financials and industrials outperforming, while health care, utilities and real estate lagged on the week.

US Treasuries were stronger. On Tuesday, June 25, the 10-year US Treasury yield finished below 2% for the first time since November 2016.

With focus so heavily on the potential for a US Federal Reserve (Fed) interest rate cut, Federal Open Market Committee (FOMC) member James Bullard appeared to pour some cold water on expectations last week when he said a 0.5% cut would be overdone.

Also, Trump's disdain for Fed Chair Jerome Powell came to the fore again last week when US President Trump said Powell was "not doing a good job". Trump added he would prefer the European Central Bank (ECB) President Mario Draghi to be in charge of US monetary policy.

With the relationship between Trump and Powell somewhat fractious, we consider comments like these are potentially market-moving. Monetary policy has been a significant driver for markets year-to-date.

In terms of US data, the core personal consumption expenditure (PCE) figures beat expectations. Consumer confidence index fell in June, with the decline from May one of the largest monthly declines on record, raising questions over whether there has been a material drop in consumer attitudes.

Asia

Equities in the Asia-Pacific region finished higher for the fourth straight week. The cyclical rotation seen elsewhere was also evident across the region. Materials and consumer discretionary stocks outperformed, while real estate, consumer staples and utilities all lagged.

Most indexes in the region advanced on lower volumes. Chinese industrial profits grew in May, while Japanese retail sales grew in line with expectations. Meanwhile, the Reserve Bank of New Zealand kept rates on hold as expected.

Week Ahead

Politics

- In Italian politics, the European Commission may propose an excessive deficit procedure against Italy on Tuesday.

Economics

- Monday: OPEC meeting in Vienna, eurozone employment data, German retail sales, UK and US manufacturing (purchasing manager index) PMIs.
- Tuesday: Eurozone producer price index (PPI) data.
- Wednesday: Chinese services and composite PMIs, US trade balance and factory orders.
- Thursday: Eurozone retail sales.
- Friday: German manufacturing orders, US monthly employment report.

Monetary Policy

- The US Fed's John Williams speaks on Tuesday.
- The ECB's Ewald Nowotny and Bank of England's Ben Broadbent speak on Wednesday.
- The ECB's chief economist Philip Lane speaks on Thursday.

Holidays

- US markets closed on Thursday, July 4 for Independence Day.

Views You Can Use

Insight from Our Investment Professionals

Kuwait's Emerging Markets Arrival Signals New Era of Investment

Kuwait's upgrade to index provider MSCI's Emerging Markets Index puts the Middle East and North Africa (MENA) region firmly on the global investment map, according to Bassel Khatoun and Salah Shamma, Franklin Templeton Emerging Markets Equity. They consider the potential asset flows this move could bring, and weigh in on the opportunities they see for Kuwait and the wider MENA region. Read More.

An Investor's Perspective on the Proposed Taxonomy for Sustainable Finance

Can stakeholders (regulators, policymakers and market participants) deliver a sustainable finance framework that serves the end-client well? The European Union's technical expert group has just published its final recommendations on the taxonomy for sustainable finance, establishing common criteria to classify environmentally sustainable activities that support the transition to a low-carbon economy. Fresh from discussing the topic at the Responsible Investor Europe Conference in London, Julie Moret, Head of ESG at Franklin Templeton, offers some immediate feedback on the usability and implications for investors. Read More.

China's Sci-Tech Board: Hope or Hype?

China will be launching a Nasdaq-style stock market for technology and research-driven companies to list and raise capital. While it has some detractors, Franklin Templeton Emerging Markets Equity believes this upcoming board is of strategic importance to China. Jason Zhu, director of portfolio management—China Equities, says it could rev up China's emergence as a research powerhouse and help emerging companies grow into industry champions, but the team will be watching at least two key factors—the quality of companies listed and their valuations. Read More.

What's Really Driving Oil Market Volatility?

Recent attacks on oil tankers in the Middle East have grabbed headlines and revived geopolitical fears. However, Franklin Equity Group's Fred Fromm says other factors, namely global oil supply-demand dynamics, are more responsible for the bouts of oil market volatility we've seen this year. Read More.

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1. Standard and Poor's 500 Index is a capitalisation-weighted index of 500 stocks. Indices are unmanaged and one cannot directly invest in them. They do not include fees, expenses and sales charges. Past performance is not an indicator of future performance.